Cyprus Banking INSIGHT

ASSOCIATION OF CYPRUS COMMERCIAL BANKS

ISSUE Nº 1
March 2008

BULLETIN

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The "Cyprus Banking Insight" published by the Association of Cyprus Commercial Banks

It is with great pleasure that I hereby introduce the first "Cyprus Banking Insight" published by the Association of Cyprus Commercial Banks.

The primary role of the "Insight" is to inform interested parties on current issues and changes occurring in the financial system in Europe and in Cyprus.

During 2007, the Association has focused on implementing and expanding upon many initiatives, and through the "Insight" we aim to increase awareness on various issues of importance and provide a forum for dialogue and information exchange between the public, the business community, the media, the Consumers' Association, and others.

The "Insight" will also give you an overview of our work.

I hope that you will find this initiative interesting and helpful and we will welcome any suggestions or comments that you may have.

Dr Michael Kammas
Director General

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Director General

This publication coincides with the successful introduction of the Euro in Cyprus.

On 1st January 2008, the Euro became the currency of the Republic of Cyprus, replacing the Cyprus pound at the irrevocably fixed exchange rate €1=CYP 0.585274.

The introduction of the Euro as the national currency of the Republic of Cyprus and the withdrawal of the Cyprus pound has been a very important task rendered careful design and implementation.

For the last two years the banking community in close collaboration with the Central Bank of Cyprus and other organizations carried on a well-structured plan, dealing with every possible detail in order to ensure the smooth transition from the Cyprus pound to the Euro.

Member banks along with the Association of Cyprus Commercial Banks (ACCB), the government, the Central Bank and the business community, participated in information campaigns in an endeavor to familiarize the public with the Euro banknotes and coins. Furthermore, in collaboration with member banks we provided information and answered questions related to key changeover dates, characteristics of Euro banknotes and coins and the usage of Euro cheques and credit cards, especially during the period of the parallel circulation of the Cyprus pound and the Euro.

Banks began to pre-distribute Euro banknotes and coins to retailers by the end of October. Furthermore, the supply of eurocoin starter kits for the public and retailers began on 3rd December 2007 in order to familiarise them with the new Cypriot Euro coins, and to use them in their transactions as from 1st January 2008.

The excellent preparation by the banking sector ensured that the changeover was realized smoothly without any problems.

The banking community shares the view that the entry of Cyprus into the Euro area, despite any short-term costs, will in the long-term benefit the economy of the country. The Euro area provides macroeconomic stability and the single currency reduces exchange rate uncertainty, factors conducive to growth and development. ■

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Printing
R.P.M LITHOGRAPHICA LTD

Design
CHROMASYN - Alexia Nissiforou
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SEPA and its benefits to users

Following the successful application of the Euro, the European Commission and the European Central Bank expressed their ambition to also unify the domestic payment systems of the Member States, as it would be crucial for the integration of the European internal market. Bearing the above in mind, the European Payments Council, (which is the decision-making and coordinating body of the European Banking industry in relation to payments), undertook the creation of the SEPA project, (Single Euro Payments Area), whose main scope is to provide faster, safer, cheaper and fully unified electronic payments within the European Union (EU). SEPA will be implemented by the 27 Members States, as well as Switzerland, Norway, Iceland and Liechtenstein.

SEPA will be the area where citizens, companies and other economic stakeholders will be able to make and receive payments in Euro, whether domestically or cross border, under the same basic conditions, rights and obligations regardless of their location. SEPA will also enable citizens to make electronic payments to anyone within the EU, using a single Bank account and a single set of payment procedures. In addition, SEPA will aim to slowly diminish the issue of cheques and use of cash, since their usage is associated with several risks to the public, such as the issue of post-dated cheques (which could lead to the receipt of uncovered cheques), theft and the receipt of counterfeited cheques or money bills.

The three main SEPA instruments are Credit Transfers, Payment Cards and Direct Debits. Some aspects of the SEPA Cards Framework have already started to be applied through the issue of the "Chip & Pin" Cards, in many EU countries. SEPA Credit Transfers were launched on the 28th of January 2008 and SEPA Direct Debits are expected to be offered from the beginning of November 2009. It should be noted that from the 28th of January 2008 until the end of December 2010, Banks will be able to offer both their existing instruments as well as their SEPA-compliant ones, whereas from the 1st of January 2011, only the SEPA-compliant products will be available.

SEPA will provide a series of benefits to all involving stakeholders. A brief description is provided below:

A growing number of European Consumers live, work or study outside their home country. With SEPA they will no longer need to maintain one Bank account at home and another one abroad, since electronic payments within the EU will be as easy, quick and as cheap, as national payments. For example, SEPA could be applied for paying rent for children studying abroad, paying for holidays from home, or for paying for services provided by non-domestic companies (such as telephone, insurance and other utilities). By increasing the use of electronic payments (and subsequently reducing the use of cheques and cash), consumers will be able to save time since they will no longer have to wait in queues for their domestic transactions. Instead, they will be able to effect payments by electronic means, at the comfort of their own home or office.

Companies will be able to perform all Euro-denominated payments centrally from a single Bank account in one EU country. The handling of payments will be easier as all incoming and outgoing payments will be from the same account and will take the same form. This will enable companies to consolidate their payments and perform better liquidity management. At the same time cross-border payments will be quicker, more efficient and will cost the same as domestic payments (for transactions of less than EUR50.000).

Banks have so far incurred substantial costs for the implementation of SEPA in terms of infrastructure, new systems and training of employees. Nevertheless in the medium to long term, the new conditions are expected to improve the situation, since SEPA will simplify procedures and will provide equal and open access to the whole European market, thus improving reachability, transparency and interoperability. SEPA will also encourage competition and will enable Banks to negotiate better conditions with service providers. In addition, Banks will be able to further expand their business by offering customers value-added services such as e-invoicing and e-reconciliation.

Through SEPA, the **Public Authorities** will be able to receive Taxes, VAT and Social Insurances as well as pay salaries and pensions to government employees, by electronic means rather by cheques or cash. By effecting electronic payments, public authorities will be able to save costs, since they will no longer need to maintain many of their cash counters or other related departments. In addition they will be able to better administer the national inflow and outflow of funds, since payments will be effected quicker, with more efficiency and with less likelihood of error. ■

The rights of the European Consumer

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Consumers Affairs

One of European Union's strategic objectives is the improvement of the quality of life of all its citizens. The European market offers the chance to over 490 million consumers in the 27 Member States to access a wide range of products and services. The EU seeks to ensure that all citizens enjoy universal access to high quality goods and services at affordable prices. The Union perceives its citizens as the real players of market forces. Recognizing consumers as essential economic agents in the Internal Market, the EU concentrates in boosting consumer confidence as the key to a competitive and flourishing single market. In this sense, the European Commission's vision is to protect consumer rights and ensure that wherever you are in the EU and whatever you decide to buy, you will benefit from the same high level of consumer protection on the basis of a single set of rules.

Improvement of EU legislation and regulations are the means of achieving the above goal. A large number of measures have already been taken to safeguard consumer's wider interests in the areas of fair business practices, misleading advertising, price transparency, unfair contract terms, distance selling and e-commerce, holiday packages and travelers' rights.

In 2006, the EU adopted a new consumer protection programme (EU Consumer Policy Strategy) for the period of 2007 – 2013. The two main objectives are (a) to ensure a high level of consumer protection through better consultation and better representation of consumers' interests and (b) to ensure the effective application of consumer protection rules, through cooperation, information, education and redress schemes. In March 2007, the European Commission set out its strategy for implementing the new programme by improving current legislation and new proposed guidelines for good business practices to cover all aspects of consumer protection. The Commission's vision is to achieve by 2013 a single, simple set of rules for the benefit of consumers and retailers alike.

In the field of the financial services, the work is focused mainly on Consumer Credit, Mortgage Credit and the Distance Marketing of financial services.

Consumer Credit plays an important role in the EU economy. According to statistical data it levels to one tenth of the EU GDP. The consumer credit market in the EU is worth over €800 billion, with an average annual growth rate of over 8%. Aiming to create an environment where consumers were sufficiently protected throughout the EU, the first directive on Consumer Credit was adopted in 1987 and amended in 1990 and 1998. However, data showed that the internal market was still not functioning to a full extent as cross-border consumer credit represents less that 1% of the volume of credit transactions. This was due to lack of communication in other languages, lack of personal contact but more importantly due to lack of consumer confidence and quality of information. The Commission, therefore, in an attempt to tackle these barriers and open up cross-border trade, proposed a new directive on Consumer Credit which is focused on transparency, harmonization and comparable information.

On 16th January 2008, the European Parliament adopted the new Directive. The scope of the Directive excludes home loans and mortgage credit and covers credit agreements between €200-€75,000. The Directive foresees key rights for consumers, such as the 14-day right of withdrawal from the contract, the right of early repayment at any time, the Annual Percentage Rate of Change (APRC) indicating the cost of the loan which can be compared all over Europe, a list of pre-contractual information allowing consumers to compare offers before they conclude the contract and contractual information concerning the rights and obligations of consumers once they decide which loan to take out. Beginnning of 2010, all EU countries must apply the same provisions so that cross-border transactions function with the same, simple and transparent regulations throughout Europe.

Mortgage Credit is considered one of the greatest financial commitments consumers make in a lifetime, and therefore a number of guidelines have been endorsed to provide consumer protection in this area as well. These guidelines are set out in Voluntary Codes of Conduct where mortgage lenders commit themselves in giving borrowers general information as to the different types of products offered including all costs associated with mortgage credit as well as information on the specific product the consumer is interested in. In this way, consumers can make an informed choice by first comparing all possible products

offered by lenders in all Member States. In order to increase harmonization and consumer protection in this area, the Commission issued a White Paper for the integration of the mortgage credit market on December 2007.

Another area which has greatly evolved over the past years is internet transactions across borders, that is, when financial services are bought and sold over the internet/phone/fax in the fields of banking services, investment funds, insurance deals etc. The EU adopted in 2002, the Directive on Distance Marketing of Financial Services which lays down fundamental consumer rights. Similarly, the Electronic Commerce Directive (2000/31/EC) ensures legal certainty and consumer confidence by laying down a clear framework for electronic commerce in the internal market.

Nevertheless, the EU aims to strengthen consumer protection, not only by improving laws and regulations, but also by other means such as supporting EU Consumer Associations, Consumer Centers and education campaigns. The European Consumer Centers Network (ECC-Net) provides advice to EU citizens on their rights and assists with consumer complaints and the resolution of disputes concerning cross-border transactions throughout Europe. Additionally, each Member State has set up its own European Consumer Centre aiming to educate and inform European consumers so that they are aware of their rights when shopping or buying services within the European Union without putting in danger their health, safety and financial interests.

The Commission has been also active in promoting the development of Alternative Dispute Resolution (ADR) schemes, known as 'out-of-court mechanisms'. The Commission initiated a set of principles in order to ensure minimum standards for the settlement of consumer disputes across Europe. These standards were published in the form of Recommendations (1998 and 2001) and give consumers and businesses confidence that their disputes will be handled fairly and effectively. Following this, most Member States have developed their own Alternative Dispute Resolution Schemes in the form of consumer complaints boards, arbitration mechanisms or Ombudsmen schemes. Compared to court procedures, ADR schemes are considered quicker, easier and cheaper. In 2001, the Commission launched a Europe wide network for out-of court settlement of cross border financial disputes, called FIN-NET. This network aims to facilitate out of court resolution of disputes when the consumer and the financial services provider come from different countries.

Undoubtedly, consumer policy has progressed substantially since the first programme for consumer information and protection was adopted in 1975. Still, progress needs to be made. The European Commission continues its efforts to boost further consumer protection and safety in cross border transactions, so that all European citizens will make more informed decisions and will be able to take full advantage of the opportunities of the Single Market. ■

Credit expansion and real estate prices prior to Euro adoption

Michael Kronides
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During the last year two issues have received considerable attention from both policy makers and the media, namely credit growth and rapidly rising house prices. In order to analyse the cause and the effects of these issues it is important to observe similar phenomena that appeared in a number of countries prior to adopting the euro.

Rapid expansion in bank credit begun in several euro area countries about five years before euro adoption, and in fact peaked during the accession year. The main reasons for the lending boom were the decline in interest rates, the improved growth prospects and the liberalisation of financial markets. Bank credit to the private sector rose dramatically, especially in countries like Portugal, Spain and Greece. In Portugal the expansion started in 1995-6, reached its maximum in Q3 1999 at 28% and then returned within two years time to the 0-5% range. It was accompanied by a relatively gradual reduction in real interest rates, falling from 7.2% in Q1 1995 to zero in Q1 1999 and remained around this value for the next few years. Despite the high growth rates of housing loans, real estate prices remained modest over the years. The lending boom in the Irish banking sector started around 1995 and real total loans to the non-financial sector increased by 32% at the peak in 1998. By 2002 the boom seemed to be over, however, in 2004 another period of strong loan expansion begun. In the first expansion phase corporate loans were the major source of expansion, whereas after 2002 this was taken over by housing loans. The drop of real interest rates from above 10% in 1993 to negative regions in 1998, remaining there with minor exceptions until 2004, influenced the magnitude and the time of occurrence of the lending boom. The surge of mortgage loans brought about a boom of house prices, growing at an annual rate of almost 20%. In Greece the lending boom begun around

1995, but it is not obvious whether this was related to monetary integration as there was no significant decrease in real rates. A more likely explanation of the expansion is the removal of foreign exchange controls. The last phase of the expansion started in 2000 and credit peaked in Q2 2001 at 22%, remaining above 10% throughout the period. During this time real rates dropped from 5-6% in 1999 to about 1% in 2000 and further into negative regions in the following years. Housing loans had the highest growth rate over the whole period. In general, no unwelcome developments were noticed except the steady increase of property prices at about 10% p.a.

An important issue that needs to be addressed is whether credit expansion has any impact on financial stability. From an economic point of view, periods of strong credit growth are associated with an overheating of the economy, creation of asset price bubbles and a possibility of a banking crisis. These effects are caused by a surge in domestic demand, inflationary pressures, underestimation of risks by banks during expansionary phases of the business cycle, loosening credit standards and finally high competition among banks trying to win market share. From an empirical point of view it is important to mention that rapid credit expansion may not necessarily be harmful for the financial sector, as evidence indicates that such periods are not necessarily followed by a banking crisis. In fact, during the years of credit expansion in Portugal, Ireland and Greece no substantial deterioration of the banking sector was noted. The strength of the banking sector was not undermined and no banking crisis was experienced. Capital adequacy ratios remained broadly stable over the period, non-performing loans remained low and profitability was stable but above the euro area average.

Nevertheless, authorities must be vigilant and take measures to increase the resilience of the financial system and reduce the likelihood of risks materializing. Giving up monetary policy independence deprives accession countries of an essential tool for putting the breaks on rapid credit growth. As a result the line of defense against possible disruptive effects must come from strong supervisory and prudential oversight. Supervisory authorities must tighten prudential regulations and implement other policy measures to contain credit growth, especially in the case of mortgage lending and other real estate activities.

The most commonly applied measures are: enhancing regulations for banks to strengthen risk management and internal controls, tightening of provisioning rules for non-performing loans, increasing capital adequacy requirements, decreasing the maximum loan-to-value ratio for housing loans and imposing credit ceilings by restricting the volume of mortgage loans relative to other lending activities.

The rapid growth of credit to the private sector experienced during the years of pre eurozone accession may be beneficial for growth, but also pose risks to financial stability. Excessive credit growth requires continuous and close monitoring by supervisory authorities, and at the same time application of meaningful and appropriate prudential regulations and policy measures in order to minimize potential risks, improve the shock absorbing capacity of the financial system and allow bank lending to contribute to higher growth and efficiency. ■

Elena Frixou
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Legal Affairs

ANTI MONEY LAUNDERING DIRECTIVE 'NUMBER THREE':

Main changes to the EU anti money laundering framework and the Cyprus implementation

The Third Directive on the prevention of the use of the financial system for the purpose of money laundering (the 3rd AML Directive) was formally adopted by the EU in September 2005.

The principal aim of the 3rd AML Directive is to update European Legislation in line with the revised internationally agreed Financial Action Task Force (FATF) 40 recommendations on anti money laundering. Implementation of the 3rd AML Directive will help establish an EU-wide harmonized approach to dealing with the global problem of money laundering and terrorist financing.

The 3rd AML Directive reproduces much of the Second Anti money Laundering Directive (2nd AML Directive) but it is considerably more exhaustive and increases the range of the regulated sector. The main changes in the 3rd AML Directive are the following:

Scope

The scope of the 3rd AML Directive is wider than the 2nd AML Directive as:

(i) it specifically includes the category of trust and company service providers;

(ii) it covers all dealers trading in goods who trade in cash over 15000 Euros; and

(iii) the definition of financial institution includes life insurance intermediaries

New Risks

The Directive takes account of modern risks and explicitly covers terrorist financing and vulnerable sectors (ie banning credit institutions from entering into a correspondent relationship with shell banks).

Risk Based Approach

It introduces the requirement of a 'risk based approach' when applying the due diligence requirements. The use of the risk based approach demands from the regulated parties to apply their preventative measures and due diligence requirements according to the associated risks of each situation ie type of customer, business relationship, product or transaction.

Customer Due Diligence

It provides more detailed customer due diligence requirements, in particular by providing examples of when enhanced and simplified due diligence should be taken.

Beneficial Ownership

The customer due diligence is expressly extended to the obligation to identify the beneficial owner(s) of any company, trust or similar arrangement.
The 3rd AML Directive defines the beneficial owner as the natural person who ultimately, directly or indirectly, owns or controls 25 percent or more of the shares or of the voting rights of a legal person.

Politically Exposed Persons

Enhanced customer due diligence is required for Politically Exposed Persons (PEPs) in other Member States and in third countries. PEPs include all persons "who have been entrusted with prominent public functions and close family members or close associates of such persons".

Reliance on Third Parties

It specifically covers the reliance of institutions on third parties and the mutual recognition of customer due diligence procedures between member states. Reliance is defined as permitting one regulated institution to rely on another to undertake the customer identification and verification responsibilities under the Directive.

Cyprus Implementation

The 3rd AML Directive was implemented in the Cyprus Anti Money Laundering Framework on 13th December 2007 by the enactment of a revised Consolidated Legislation for the Prevention and Suppression of Money Laundering Activities (Consolidated AML Legislation).

Issues left on the discretion of each Member State have been accordingly inserted in the Consolidated AML Legislation. Hence the definition of the beneficial owner has been formulated in the Consolidated AML

Legislation as the natural person who ultimately, directly or indirectly, owns or controls 10 percent or more of the shares or of the voting rights of a legal person. Additionally a new article for the Exchange of Information has been inserted. Furthermore Trusts and Company Services providers are now caught under the scope of the Consolidated AML Legislation.

Articles which recital the risk based approach as dealt with in the 3rd AML Directive have also been incorporated in the Consolidated AML Legislation. The 'risk based' approach however is not a new perception for the Cyprus Banks as the concept and methods for its application have been included in a legally binding Guidance Note issued by the Central Bank of Cyprus, in November 2004.

Undoubtedly the introduction of further regulation for the suppression of money laundering and the fight against terrorist financing shall benefit indirectly the regulated sector as it shall increase the integrity of the sector. Furthermore the establishment of a pan EU standard for money laundering preventative measures shall enhance the competitiveness between the different member states' regulated sectors and improve their productivity.

It is however of outmost importance for Member States to support the regulated sectors in their task of applying the provisions of the 3rd AML Directive. More specifically the regulated sectors should be allowed enough leeway to implement the risk-based approach in a flexible manner, without of course any substantial derogation from the basic principles that underline the core aims of the approach.

Additionally the EU and the Member States should take measures to help the regulated sectors to combat problems which hinder the application of the Directive such as the difficulty of the regulated sector to gain access to reliable information through gazettes and registers throughout the EU and internationally, to enable them to carry out identification in relation to 'beneficial owners' and 'political exposed persons'. ■

Operational Risk under Basel II

Need for Two-Step Approach

Dr. Demetra Valianti
Senior Officer
Legal Affairs

Historically organisations have accepted operational risk as an unavoidable cost of doing business. Although the risk applies to any organisation, it is of particular relevance to the financial industry, given its size and complexity, globalisation and the new threats to financial stability from rising geopolitical risk, poor corporate governance and systemic risk. Events such as the September 11 terrorist attacks, trading losses at Barings, AIB and National Australia Bank, and the Y2K scare serve to highlight the fact that the scope of risk management extends beyond merely market and credit risk. Now, operational risk is becoming a salient feature of risk management in financial institutions, especially after its inclusion in the New Basel Capital Accord (Basel II). Below, follows a description of operational risk and methods of its measurement.

Definition and Description

Operational Risk is commonly defined as the risk of some adverse outcome resulting from acts undertaken (or omitted) in carrying out business activities, inadequate or failed internal processes and information systems, misconduct by people or from external events[1]. It should also be noted that the Basel Committee recognises that operational risk is a term that has a variety of meanings and therefore, for internal purposes, banks are permitted to adopt their own definitions of operational risk, provided the minimum elements in the Committee's definition are included.

These minimum elements may be devided in the following internal (i-iii) and external (iv) categories of risk:

(i) process risk associated with operational failures stemming from the breakdown in established processes, failure to follow processes or inadequate process mapping within business lines (data entry errors, accounting errors, failed mandatory reporting, negligent loss of client assets);

(ii) people risk from management failure, organisational structure or other human failures, which may be exacerbated by poor training, inadequate controls, poor staffing resources; internal fraud (misappropriation of assets, tax evasion, intentional mismarking of positions, bribery); improper business practices (market manipulation, antitrust, improper trade, fiduciary breaches, account churning);

(iii) system risk, which reflects the operational exposure to disruptions and outright system, utilities, software and hardware failure in both internal and outsourced operations[2];

(iv) External operational risk (or external dependency risk) arising from environmental factors, such as a new competitor that changes the business paradigm, a major political and regulatory regime change, unforeseen (natural) disasters, terrorism, vandalism, External Fraud (theft of information, hacking damage, third-party theft and forgery), and other such factors that are outside the control of the firm[3].

Finally, it should be noted that the Basel II definition includes legal risk. This may be failure to comply with laws as well as prudent ethical standards and contractual obligations. The definition however excludes strategic risk: i.e. the risk of a loss arising from a poor strategic business decision. Reputational risk is also excluded (i.e. damage to an organisation through loss of its reputation or standing) although it is understood that a significant but non-catastrophic operational loss could still affect its reputation possibly leading to a further collapse of its business and organisational failure.

Measurement of Operational Risk

The measurement and regulation of operational risk is quite distinct from and relatively more difficult than market risk and credit risk. This is due to its elusive and diverse nature from internal or external disruptions of business activities and the unpredictability of their financial impact[4].

These are three major methods to quantify operational risk[5]:

(i) Basic Indicator Approach - relating operational risk to business volume;

(ii) Standardised Approach – including various types of self-assessment;

(iii) Advanced Measurement Approach – relating to loss distributions.

Cyprus

In Cyprus, banks will first use the Basic Indicator Approach. Only very few of them will use the standardized approach. However, their intention is to slowly move into the more complex approaches.

Closing Remark

In relation to the methods described above, it has been argued[6] that while qualitative self-assessments are prone to bias and rely on broad assumptions in support of general yet unconditional estimates, quantitative models predict future losses conditional on the historical loss experience and often fail to account for the dynamic process of extreme outcomes. Thus, the complexity of operational risk will continue to require close collaboration between supervisors and banks as regards the implementation of regulatory guidelines that better reflect the incidence and impact of operational risk events. This is essential, so as to achieve a more risk-sensitive regulatory framework that aligns minimum capital requirements closer to the actual risks of bank assets. ■

1. Basel Committee on Banking Supervision, Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework--Comprehensive Version (June 2006b, BCBS Publications No. 128, Bank for International Settlements, www.bis.org/publ/bcbs128.htm).
2. M. J. Zamorski, "Joint Supervisory Guidance on Operational Risk Advanced Measurement Approaches for Regulatory Capital--Board Memorandum", FDIC, Division of Supervision and Consumer Protection, July 2003, www.fdic.gov/regulations/laws/publiccomments/basel/boardmem-oprisk.pdf.
3. R. M. Mark, "Operational and Infrastructure Risk", Presentation at a symposium in preparation for the conference The Information Technology Revolution--Implications for Financial Services and Public Policy (March 6-8 2002), Black Diamond Risk Enterprises, Toronto.
4. Empirical evidence suggests that contingencies from operational risk fall broadly into two categories: high impact events at low frequency, which entail substantial losses, and events of high frequency but low impact, Andreas A. Jobst, “The Regulation of Operational Risk under the New Basel Capital Accord-Critical Issues”, J.I.B.L.R. 2007, 22(5), 249-273.
5. Basel Committee on Banking Supervision, Observed Range of Practice in Key Elements of Advanced Measurement Approaches (AMA) (October 2006a, BCBS Publications No. 131, Bank for International Settlements, www.bis.org/publ/bcbs131.htm).
6. See note 4 above.

"Contactless" card payments let buyers...

"Tap and go"

Loucas Christofides
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Marfin Popular Bank

Contactless (branded by Visa as "Visa Paywave" and by MasterCard as "Paypass") is set to be the next big thing in the card industry since European card issuers generally agree that the payment card market has reached a high level of maturity and the current levels of growth can only be maintained through expansion into new market segments.

There is a common interest amongst banks that all players would benefit from increasing the size of the consumer payments playing field by driving down average transaction values through a true "cash displacement" product.

Cash may be inconvenient and inherently insecure but until today, cash has been the only realistic option for our low value payments. The alternative is "Contactless" payments.

Contactless payment is a change to the way debit or credit card payment is handled when making a purchase. Contactless payment transactions require no physical connection between the card (EMV chip card) and the checkout POS device. Instead of "swiping" or "inserting" a card, the contactless card is tapped on or held within 3 cm of a POS machine that reads the card.

Payments are securely exchanged between a chip card and a specially adapted POS terminal without the card having to be inserted or swiped at the terminal. In fact, consumers don't even need to hand over their card to the merchant. They just wave or tap the card in front of the POS and can authorize payments up to an amount (set around $25 max. in the US) without the need for entering their PIN or signing the merchant receipt.

In Europe, the maximum authorization amount is again up to the card issuer but for security purposes, the amount is usually limited for low value transactions of up to 15 euro per transaction and an off-line limit of 50 euro. The contactless cardholders can authorize up to 10 contactless transactions in a row. If they make ten contactless transactions in a row, on the 11th transaction they will be asked for their PIN at the POS terminal for security purposes. Thus, the maximum pin-less risk exposure for a contactless chip cardholder is 150 euro (10 transactions X 15 euro).

Contactless payments are ideal for high volume retail environments such as newsstands, convenience and express stores, fast food restaurants, sandwich shops, coffee shops and pubs, vending machines, parking places, ticketing, express lanes, road tolls, taxis and definitely, metro transport systems.

As with every payment method, there are certain pros and cons that need to be considered before an issuer switches to contactless card technology:

- Benefits for consumers: fast, convenient, and secure, reduced queues, less cash in hand

- Benefits for retailers: quicker service, reduced queuing, easy to implement, less staff errors in payment collection, higher volumes, protection from losses and fraud, less cash collection, competitive advantages

- Disadvantages: acquirer's high infrastructure cost, need for new POS terminals, existing cards not accepted since contactless cards have an internal antenna affixed

A recent report by market analyst Datamonitor estimates the market for contactless payments to be around $226 billion a year. Cash payments of $25 or €15 and under in six key sectors (gas purchases, convenience stores, fast food, bars, nightclubs, and vending machines) totalled $724 billion in the United States in 2006, the most recent figure available.

At the end of the first quarter of 2007, more than 11 million contactless cards were in circulation under the Visa, MasterCard, and Amex brands. A growing number of merchants in the US, including selected 7-Elevens, CVS pharmacies and McDonalds, have recently started to accept contactless cards.

Card issuers are also beginning to extend the technology past the corner grocery store. Citibank and MasterCard recently began testing the use of contactless cards at some New York subway stations, allowing trial participants to pay for subway fares by using their contactless cards.

And consumers may, in the future, forego plastic cards altogether. Chase recently tested its "blink technology" on mobile phones. "The more convenient it is to make a payment, the more apt you are to use that form of payment," says Curtis Arnold, publisher of Card Rating magazine.

But consumer advocates worry that the technology raises new security and safety concerns, particularly since cardholders often do not have to sign for purchases. Issuers say that the same liability and fraud protection applies to contactless cards as to regular credit cards. "Our base promise to our cardholders is that they are always protected, no matter what," says Scott Rau, a senior vice president with Chase.

In the UK, further to the extremely successful "Oyster" contactless card at the London Metro transport system, contactless is being introduced on many payment cards from Autumn 2007 in London and in London based retailers, followed by a gradual rollout across the UK. This feature is to be used for transactions of £10 or under. Industry estimates suggest that in the UK, over 5 million contactless cards will be issued by the end of 2008, and that they will be accepted by at least 100.000 merchants.

In Cyprus, Banks are still some time behind from introducing contactless payments. A necessary step, however, to this end was the introduction, in 2007, of the EMV Chip cards and the gradual replacement of the POS readers with EMV-enabled ones. This process is expected to be completed by the end of 2008, early 2009, at which time, JCC, the national acquirer and the Banks, may start considering a move towards contactless payments.

In the meantime and bearing in mind that Cyprus does not have high usage mass transit systems (busses, trams or undergrounds), that are the usual targets for contactless payments due to the high importance of transaction speed, JCC made its tactical move on the "war against cash" by introducing the JCC Express payment system. Through this, for card payments of up to £10 (€17) at participating merchants, there is no need for the customer to sign the receipt. "JCC Express" is Cyprus' method to promote low-value card payments and participating merchant categories include kiosks, newsstands, movie theatres, bakeries, dry cleaners, DVD rental stores etc.

At present, the slightly "slower" JCC Express payment system is quite effective for low value transactions, especially in fast food and other similar outlets around the country. ■

There is an internationally recognised logo for contactless payments known as "the ripple", which cardholders should look for on their cards.

The internationally agreed acceptance mark is located at the most effective part of the contactless POS reader, indicating where the cardholders should hold their card.

What is 360 degree Assessment

360 Degree Assessment is a process by which a company collects detailed, confidential, anonymous feedback covering a broad range of competencies for its managers by using a variety of rating sources.

The 360 degree term refers to the fact that evaluation on each participant is sought from all angles – boss, peers and subordinates in addition to self. The process involves a participant evaluating himself against a set of criteria with the participants supervisor, peers and subordinates conducting the same evaluation about the participant.
Bank of Cyprus Plc uses 360_degree assessment for development purposes for its managers at all levels. In essence, the feedback offers a unique opportunity to managers to discover how their colleagues perceive and are impacted by their behavior.

During the feedback session the facilitator from the HR Division and the participant discuss strengths and areas of improvement and draw up a personal development plan based on the areas of improvement.

Benefits of 360 Degree Assessment:

Benefits to the participant include an identification of personal development needs and the mechanisms to change their managerial and personal behavioral styles. To the company, benefits include a picture of organizational development needs, improved communication between managers and their colleagues and encouragement of a culture of open feedback. It also raises consciousness on issues which relate to managers' effect on people and to their personal effectiveness and attitudes.

Procedure:
A mixture of about twelve to twenty people fill out an anonymous online feedback questionnaire that asks questions covering a broad range of workplace competencies like knowledge, abilities, behavior, etc These questions are measured on a rating scale. The person receiving feedback also fills out a self-rating survey that includes the same survey questions that others receive in their forms.

The questionnaire that is used contains questions that are rated on a 5 point scale. These items measure different dimensions of job performance like leadership, organization & planning, problem solving & analysis, teamwork, persuasion, customer service, self-development and business development. The Questionnaire includes 54 questions and the amount of time to be completed is estimated to 20 minutes. The whole procedure is computer based and all the information is collected and analyzed from the software and therefore anonymity of participants is ensured.

There are four steps for the procedure as follows:

1. Raters Selection: The participant has to choose a number of co-workers that will asses him from the three categories of raters (manager, peers, and direct reports). More specific, from each of the categories 'peers' and 'direct reports' he must choose at least three raters and from the category of 'managers' at least one. Then the HR department randomly chooses the remaining raters in each category in order to have minimum twelve and maximum twenty raters.
2. Complete the questionnaire: Raters receive an email with all the instructions and information they need, in order to visit the homepage of the appraisal system and complete the questionnaire.
3. Develop and Distribute Results / Development Plan: When all the raters submit their questionnaire, the system automatically tabulates the results and presents them in a format that helps the feedback recipient create a development plan. Individual responses are always combined with responses from other people in the same rater category (e.g. peer, direct report) in order to preserve anonymity and to give the employee a clear picture of his/her greatest overall strengths and weaknesses.
4. Follow Up: The feedback report and the development plan are also shared with the employee's supervisor who is responsible for its implementation and the performance review which follows.

The 360 Degree Appraisal is used every 2-3 years in order to assess the participant's performance improvement. ■

Solvency II: EU leads the way in insurance regulation

Towards a comprehensive strategy of risk management

Stephie Dracos
Director General
Insurance
Association of
Cyprus

TThe European directive proposal known as Solvency II was finally launched in July 2007. In its official announcement the proposals are described "as a ground breaking revision of EU insurance law designed to improve consumer protection, modernise supervision, deepen market integration and increase the international competitiveness of European insurers. Solvency II constitutes a long-awaited measure expected to overhaul and modernise insurance law across the European Union".

The initiative was welcomed by CEA the european insurers federation who acknowledged the need to modernise and expand Solvency requirements, noting that a true risk-based economic approach and supervisory harmonisation will be central to the success of the proposal. It is a fact that in developing the directive proposal the European Commission and CEIOPS have been transparent allowing for an open consultation with all stakeholders. It therefore comes as no surprise that the proposals were well received as a step forward in european insurance regulation that may set the regulatory benchmark for the rest of the world. That said, it must also be noted that there are areas the industry believes that the framework directive needs further work.

The Commission's proposals, which if endorsed by the European Parliament and the European Council will take effect in 2012, seek to harmonise insurance practice with the changing economic environment, by obligating insurers to take account of all types of risk to which they are exposed. They are also expected to manage this diversified range of risks more effectively.

At present solvency requirements only cover insurance risks whereas upon implementation of the Solvency II proposals, Insurers would be required to have sufficient capital to meet a wide variety of risks which, insurers face as a result of their operations. These include market risks, e.g. a fall in the value of the insurer's investment, credit risk e.g. when debt obligations are not met, operational risks e.g. malpractice or systems failure. Even though these types of risks pose threats to insurers they are not covered by current solvency rules.

Under Solvency II insurers must allocate resources to identify and measure risks while providing the appropriate systems for good risk management. For the first time insurers must have regard and rely not only on historical data but also on trends and future developments such as new business plans or the possibility of catastrophic events that might affect their financial standing. Insurers would then have to assess their capital needs of all potential risks by means of the "Own Risk and Solvency Assessment".

Through the proposals, Brussels is confident that the sophisticated solvency requirements would greatly help to ensure insurance undertakings can absorb and survive otherwise ruinous shock losses.

The proposal, which effectively abolishes 14 existing directives replacing them with a single one, paves also the way for consolidating the european insurance market by promoting supervisory harmonisation. The supervisory process changes so that problems can be detected at an early stage and before companies find themselves in serious trouble.

The focus of supervisory work is shifted from mere compliance monitoring and capital adequacy to evaluating company risk exposure and their risk management and governance systems.

Through Solvency II, it is expected that the different regulatory requirements across EU, which ultimately undermine the Single Market, will be replaced ensuring a level playing field and a uniform level of consumer protection while fostering and imposing greater co-operation among national supervisory authorities.

The new system introduces a new and more appropriate way of supervising insurance groups with cross-border operations. Through the concept of the Group Supervisor in the home country, in close co-operation with competent national authorities, a more streamlined approach that would recognise the economic realities of such group is adopted.

There are also proposals that allow groups under certain conditions to use group capital to support part of a subsidiary's Solvency Capital Requirements. This would enable such groups to operate a more efficient capital allocation strategy for the benefit of both the enterprise and the policyholders.

The Insurance Association of Cyprus works with CEA, who has been involved in the Solvency II debate as an active participant from the beginning, to ensure that the new regime provides incentives for good risk management and delivers an economic risk based framework that fosters transparency and enhanced supervision. It will monitor developments and work for the successful implementation of the Solvency II in the Cypriot market ensuring, in every sense the readiness of the industry to work under the new regulatory framework and respond effectively to this new challenge. ■

Note: CEIOPS= Committee of European Insurance and Occupational Pensions Supervisor

Latest developments of the CSE

George Koufaris
Chairman of Council CSE

Stock exchanges, which traditionally were slow to changes, are now responding with great alacrity. The catalysts for change are the increasing demands from the users of the exchanges and the enforcement of new legislation and regulations. The users, some of which are very large and powerful financial institutions, are now demanding better liquidity and transparency of trade execution at lower cost.

As barriers to entry have fallen the exchanges have to become more competitive. Increasing competition, which is extended beyond national borders, has spawned a flurry of consolidations. In addition, Exchanges are implementing wide programmes for regional co-operation. Furthermore, the European Exchanges are facing with the additional task to harmonise their national legislation with the EU Directives in achieving the aim to create a true pan- European financial market, subject to the same rules and regulations.

The Cyprus Stock Exchange (CSE) is obliged to continue to operate successfully in the new financial environment, even on a non for-profit basis, as CSE is still a Corporate Body established by law. Towards this direction, the CSE has successfully fulfilled the implementation of its previous strategic plan. The Exchange aimed primarily for the further development of listed companies and of the economy of Cyprus in general, and also at accomplishing the effort to play an important role in the region, through enhanced competitiveness, alliances, synergies and economies of scale.

Within this framework, the CSE proceeded to the necessary regulatory adaptation and compatibility, for implementing all relevant EU Directives and for its harmonisation to international new developments. The CSE has introduced a robust IT and communications infrastructure and also introduced the code of Corporate Governance in the market. The Exchange proceeded to a market segmentation in accordance with new criteria based on quality and quantity, it adopted FTSE's sectoral classification system and it has completed a business process re-engineering, in accordance with the market needs.

The most important and innovative project was the accomplishment of the common platform between the CSE and the Athens Exchange (Athex), which was launched on the 30 October 2006. The CSE has implemented, within a relatively short period, a common technological infrastructure to that which is used by the Athens Exchange, in a cost – effective mode. The CSE, through this co-operation retained its autonomy, managed to attract international investors' visibility and also part of liquidity, which is directed to emerging markets, by providing low - cost investment and operation. An increased choice of products was offered to CSE and ATHEX members, investors and also an improved market value is also offered for listed companies that eliminates the need for secondary listing in larger markets.

Through the common trading platform, the CSE accomplished the following legal, regulatory and procedural adaptations/ innovations, in the market:

- Creation of a Counterparty Risk Management Fund.

- Establishment of the framework for the operation of custodians, in the Cypriot capital market.

- Establishment of a regulatory framework for remote members (removal of barriers to entry).

- Adoption of Euro for stocks trading, clearing and settlement, 15 months before Cyprus' acceptance into Eurozone.

- Extension of market trading hours, closer to these of major European markets.

- Fine tuning to international settlement standards.

Among the positive results which are derived from the operation of the platform, is the fact that this, had a positive impact on international investment community and that the visibility of the Cyprus market was enhanced significantly. It should be noted that at present, ten members operate remotely from Athens and twelve custodians are providing their services, also remotely. It should also be emphasised that the foreign investors shares ownership, has increased from 4% to about 10%, at the end of 2007.

The Council of the Exchange places great emphasis on the further development of regional co-operation, with the purpose of exchanging useful information, know-how and experiences with other Exchanges, to attract international liquidity, to provide access to market participants and also to exploit opportunities and benefits from economies of scale and synergies. The CSE has already developed co-operation with a number of regional Exchanges.

Cyprus, as an E.U member – state, can act as a bridge between the Exchanges of the Middle East area and E.U. There is potential scope for development of business among the regional capital markets, regarding issues such as cross-border activity, dual listings and through exploiting the benefits which are offered through the Common Platform. More specifically, regarding double listings, listed companies can benefit through:

- Access to international institutional funds through the Common Platform
- Access to Eurozone

The CSE can provide expertise, know – how and support to other Exchanges in the region, that would have a desire to harmonize their practices, to those of the E.U. directives and principles. It should also be mentioned that Cyprus offers a very favorable tax treatment, for companies and investors. Since 1st May, 2004, all capital restrictions have been lifted. Any foreign citizens and entities (EU as well as non –EU) are allowed to acquire up to 100% of companies listed on the Cyprus Stock Exchange, with no restrictions.

The CSE is at present, in a state of constant vigilance in order, on the one hand to make full use of opportunities in our region and on the other, to tackle the enormous challenges of competition. The CSE vision is to become the top exchange in the region and a leading specialist exchange. We are working in a systematic, organized and strategic way, to accomplish it. The CSE has already decided about the strategic initiatives that should be followed. The focus is on niche markets regarding new listings. The CSE is also at the final stages of introducing derivatives products and a semi – regulated market. With the purpose of sustaining its competitiveness, the CSE has recently introduced a new pricing policy, is focusing on a continuous simplification of procedures and its associated legislation, and is placing new important tools in the market, such as the omnibus accounts, the securities lending, the market makers. Furthermore, for the next couple of years, the CSE will significantly increase its efforts regarding regional exchanges' alliances and for its adequate visibility, through promotion to international investors and market participants.

In general, the CSE is undertaking many initiatives with a view to enhancing the standing, credibility and visibility of the CSE. We are convinced that the CSE has a promising future and good prospects. We are optimistic, that we will manage to make full use of these prospects. We intent to prove that there is room for small regional exchanges to operate efficiently and effectively. ■

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