

ANNUAL REPORT2007/2008



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Message from the Director General

The past year has been a landmark for Cyprus' banking industry as it marked the transition from the Cyprus pound to the euro, which became the national currency on January 2008. Our member banks have been pivotal to the changeover and the successful euro launch bears witness to the many months of preparation that went into this.

While the adoption of the euro has eliminated the risk of a currency crisis and has further consolidated the credit strength of Cyprus, our country could not have remained

unaffected by the recent turmoil in global financial markets. On the positive side, several years of strengthening profitability has by mid-2008 left the Cyprus banking sector in a strong financial position to face the possibility of a credit cycle downturn. The strong results and favorable prospects of Cyprus banks have been providing ample opportunities for growth, which our members have been quick to seize, most notably through expansion in Eastern European countries with underpenetrated banking sectors.

During the past twelve months the process of European financial integration has further progressed, generating a wide range of topics that our members had to deal with and consequently that the Association has been active on. We have been heavily involved in the introduction of SEPA in January 2008 and carried out a briefing campaign to inform the public. We have supported our members in complying with the new Markets in Financial Instruments Directive, which came into force in November 2007. Also during 2007 we supported member banks in their efforts to address existing and upcoming regulations relating to Basel II framework. Following our initiative, the Account Switching Code was approved by the Board of Directors of the Accossiation of Cyprus Commercial Banks (ACCB) and will be implemented in the second half of 2008. In the area of suppression of money laundering activities, we have promoted the successful implementation in Cyprus of the Third EU Directive on the prevention of the use of the financial system for the purpose of money laundering. Additionally, the Association has taken an active role in promoting the Electronic Cheque Clearing System which is in the process of being finalized.

As part of our on-going efforts to better inform our members and the public, we introduced in 2007 a monthly newsletter that covers the activities of our Association and in March 2008 we launched the

semi-annual "Cyprus Banking Insight" brochure that outlines current issues and developments in the financial system in Europe and in Cyprus. We also organised a number of popular seminars tailored to the needs of our members and in March 2008, jointly with the Cyprus Management Development Association, we introduced the first Banking Forum.

The challenge for the year ahead is to continue striving for our members' views to be properly represented, in an environment where both competition as well as regulation is becoming more and more globalized. We recognize that our success in this relies on the expertise and knowledge of our staff members but foremost, it relies on fostering effective teamwork through our committees and leveraging on the important skills that our members contribute.

I would like to thank the Board of Directors for their continuing support in all the projects the Association of Cyprus Commercial Banks has undertaken and assure our members that we look forward to facing together the new challenges in the year ahead.

Dr. Michael Kammas Director General

Economic Environment

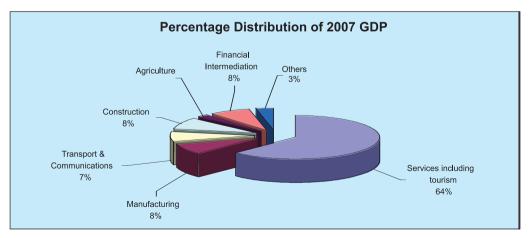
The Cyprus Economy

Cyprus is an independent republic with a presidential system of government and, as at 1 May 2004, a member of the European Union. The euro has been used as legal tender since 1 January 2008.

The island's increasing attractiveness as an International Financial Centre is supported by the following:

- Cyprus offers the lowest tax rate in the EU and has a number of advantageous double tax treaties.
- Cyprus' legal system is based on its British counterpart and UK court decisions are often used as precedent.
- The labor force is highly skilled and multilingual.
- The island is strategically located and has excellent climate and high standard of living.
- International Financial Reporting Standards have been used for over three decades.
- There is a strong banking infrastructure.

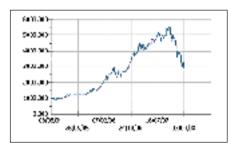
Cyprus has an open market economy dominated by the service sector which accounts for more than 78% of GDP, while the importance of agriculture and manufacturing is declining steadily. Services include tourism, banking, accounting, consultancy, telecommunications, education and medical. The private sector dominates economic activity while the Government is limited to monitoring the economy and providing public utilities.



Source: Statistical Service of Cyprus (provisional data for 2007)

The Cyprus Stock Exchange (CSE) is an EU-regulated market and has 140 listed companies. The competent authority for overseeing the operation of CSE and for approving prospectuses in Cyprus is the Cyprus Securities and Exchange Commission (CySEC). CySEC is a member of the Committee of European Securities Regulators (CESR).

CSE General Index



Source: Stockwatch

As at the end of 2007 the CSE had total market capitalization of €20.6 billion and the CSE General Index had annual returns of 21.4%. However, over the first four months of 2008, the CSE was strongly affected by the international uncertainty relating to the subprime loans crisis, as well as by the persistent increases in oil prices and the strong euro.

The banking sector accounts for around 70% of total market capitalization. The shares with the largest market capitalization as at the end of April 2008 were as follows:

Company	Market	Market Capitalisation (€)	Weight (1) %
1 Bank of Cyprus Public Company LTD	Main	5,118,656,670	33.8%
Marfin Popular Bank Public Co LTD	Main	4,668,610,133	30.8%
3 Hellenic Bank Public Company LTD	Main	843,734,671	5.6%
4 Pandora Investments Public LTD	Alternative	365,014,281	2.4%
5 Aristo Developers PLC	Alternative	269,704,260	1.8%
6 Louis PLC	Main	228,265,540	1.5%
7 Cyprus Trading Corporation PLC	Main	186,496,822	1.2%
8 Sea Star Capital PLC	Alternative	160,695,767	1.1%
9 Vassilico Cement Works Public Company LTD	Main	147,237,059	1.0%
10 Woolworth (Cyprus) Properties PLC	Parallel	137,823,702	0.9%
Total		12,126,238,905	80.0%

(1) The weight is calculated to the market capitalisation (shares only, including Investment Companies Market)

Source: Cyprus Stock Exchange





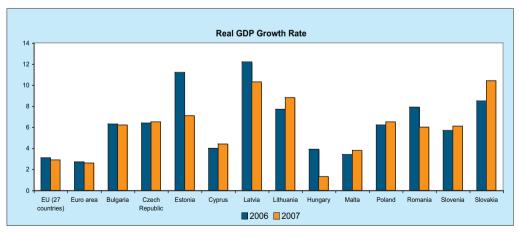
GDP Real, % Change						
	2003	2004	2005	2006	2007	2008F
Cyprus	1.9	4.2	3.9	4.0	4.4	3.7
EUR 27	1.3	2.5	1.9	3.1	2.9	2.0
Euro Area	8.0	2.1	1.6	2.7	2.6	1.7
USA	2.5	3.6	3.1	2.9	2.2	0.9
Japan	1.4	2.7	1.9	2.4	2.1	1.2

Source: Eurostat

In 2007 economic growth remained robust at 4.4% and exceeded the EU27 average (see table above).

Consumer demand was up, with a growth of 8.9% in the Turnover Volume Index of Retail Trade for 2007. Furthermore, the reduction of excise taxes in November 2006 led to car registrations exhibiting an increase of 33% during 2007.

Tourist arrivals for 2007 reached 3.8 million, recording an increase of 3.8% compared to 2006. For the first two months of 2008, tourist arrivals had an increase of 5.1% compared to the first two months of 2007. The construction sector has exhibited strong growth as evidenced by the 10% increase in sales of cement as well as by the rise in building permits (the area covered by the building permits has increased by 3.0% in 2007). Additionally, the manufacturing output grew by 3.1%.



Source: Eurostat

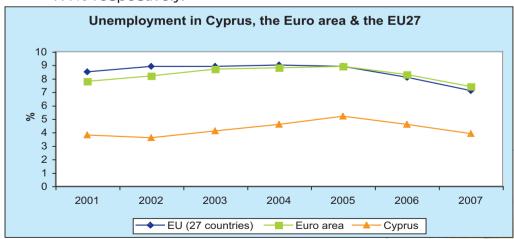
Cyprus has adopted the euro on 1 January 2008 following a decision by the Council of Finance Ministers of the EU. The conversion rate between the euro and the Cyprus pound was set at 1 euro = 0.585274 Cyprus pounds by the ECOFIN Council, which was the same rate at which the Cyprus pound had entered the Exchange Rate Mechanism II.

At 2.2%, inflation in 2007 remained at the same levels of 2006. However, inflation has picked up in 2008 with the latest data showing the harmonized index of consumer prices had an increase of 4.4% in March 2008 compared to March 2007. This increase was due to rising fuel and food prices internationally.



Source: Eurostat

Reflecting the strong economic activity, unemployment has further declined in 2007 to 3.9% (2006: 4.6%). By comparison, unemployment in the EU27 and the euro area was 7.1% and 7.4% respectively.



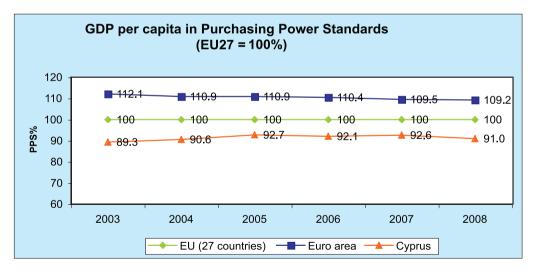
Source: Eurostat



Major Economic Indicators

CYPRUS MAJOR ECONOMIC INDICATORS						
		2004	2005	2006	2007	2008 f
Inflation Rate Unemployment	% Change ⁽¹⁾ %	1.9 4.6	2.0 5.2	2.2 4.6	2.2 3.9	2.5
GDP (At Current Prices) GDP (Real Growth)	EUR mil. % Change ⁽¹⁾	12,654 4.2	13,462 3.9	14,318 4.0	15,313 4.4	16,390 3.7
GDP Per Capita (EURO)		16,890	17,566	18,387	19,432	20,552
GDP Per Capita (PPS)	EU - 27 = 100	90.6	92.7	92.1	92.6	91.0
Fiscal Deficit	% of GDP	-4.1	-2.4	-1.2	1.5	0.5
Total Public Debt ⁽²⁾ Total Public Debt ⁽²⁾	EUR mil. % of GDP	8,891 70.3	9,300 69.1	9,331 65.2	9,187 60.0	7,946 48.5
Source: Eurostat, Ministry of Finance	·					

In 2007, Cyprus together with Slovenia, had the highest standard of living between the 12 new country members, as measured by GDP per capita in Purchasing Power Standards.

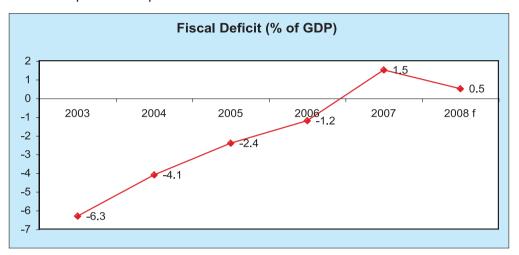


Source: Eurostat

⁽¹⁾ Percentage change compared with the corresponding period of the previous year

⁽²⁾ Excluding intergovernmental & short-term liabilities of the Central Bank to the IMF

Significant progress has been made in turning fiscal deficit into a surplus (see chart below). This has mainly been achieved through the strong performance of the construction and property sector which provided higher tax receipts than originally anticipated. According to the Finance Minister, fiscal surplus is expected to reach 0.5% of GDP in 2008.



Source: Ministry of Finance

All the above major economic indicators comprise an environment of economic macro stability that Cyprus currently enjoys, exhibiting robust real GDP growth while having relatively low inflation and virtually full employment. This is also reflected in the international credit ratings assigned to Cyprus' government debt, as follows:

- Fitch: Long term Issuer Default Rating AA- with Stable outlook (upgraded from A+ in May 2007).
- Moody's: Cyprus government debt is rated Aa3 (upgraded from A1 following Cyprus' entry to the Eurozone).
- Standard & Poor's: Rating of A/Positive/A-1.



The Banking Sector

General Overview & Key Figures.

The Cyprus Banking Sector is composed of the domestic banks, the co-operative credit institutions (CCIs) and the former international banking units (IBUs). Following the complete liberalisation of capital movements that took place in 2004, the former IBUs are free to provide credit to Cypriots.

The five regulatory authorities that are involved in the monitoring of all financial institutions are:

- The Central Bank of Cyprus.
- The Cyprus Securities and Exchange Commission.
- The Co-operative Credit Societies' Supervision and Development Authority.
- The Commissioner of Insurance Companies (Ministry of Finance).
- Authority for the Supervision of Pension Funds (Ministry of Labour and Social Insurance).

Banking Sector – Statistics (end of 2007) Amounts are in EURO (milion)						
	Commercial Banks	Coops	IBUs	TOTAL		
Deposits	39,870	10,305	5,374	55,549		
Loans	27,324	7,822	5,574	40,720		
Branches (1)	444	442	N/A	886		
Personnel (1)	8,696	2,371	N/A	11,067		
Branches per 100.000						
inhabitants	56	56	N/A			

⁽¹⁾ Totals do not include figures for IBUs

Source: Central Bank of Cyprus, Co-operative Credit Societies' Supervision and Development Authority

As can be seen from the table above, Commercial Banks dominate deposits (72% market share). Cooperative Credit Institutions hold a 18% share of deposits and International Banking Units (IBUs) hold approximately 10%. On the loans side, Commercial Banks hold a 67% market share of total loans, followed by the Cooperative Credit Institutions with a 19% share and IBUs with a 14% share.

Commercial Banking

The Central Bank of Cyprus has been integrated into the Eurosystem in January 2008 and as a result, the setting of interest rates is now the responsibility of the European Central Bank whose monetary policy decisions are implemented by the Central Bank of Cyprus. One of the primary aims of the Central Bank of Cyprus is to exercise supervision of Commercial Banks, with a view to minimise systemic risk and preserve the stability of the banking system. The Central Bank of Cyprus applies strict rules and regulations based on the recommendations of the Basle Committee and the EU Directives.

Cypriot banks have intensified their efforts to expand their foreign operations, a strategy that presents a number of benefits such as diversification of assets, revenues and risk as well as higher growth potential. The banks have mainly targeted developing high growth economies with lower levels of financial sector penetration and have expanded by opening branches or acquiring banks in Russia, Romania, Ukraine and Malta. At the same time, Cypriot banks have expanded into a number of related activities in Greece such as insurance, factoring and brokerage.



Key Banking Ratios Averages of 9 banks		
	2007	2006
Profitability:		
Return on equity	20.0%	11.0%
Cost to Income	46.0%	52.2%
Dividend payout ratio *	45%	49%
Growth:		
CAGR of operating income	55%	
% income on non-interest income sources	38%	33%
Loan quality:		
Non Performing loans / Total loans	5.8%	8.7%
_		
Liquidity:	0.70	0.71
Loans to deposits	0.79	0.71
Capital:		
Capital Adequacy Ratio	12.1%	13.2%
Tier 1 Ratio	9.5%	10.0%
Overseas assets as % of total assets	44%	43%

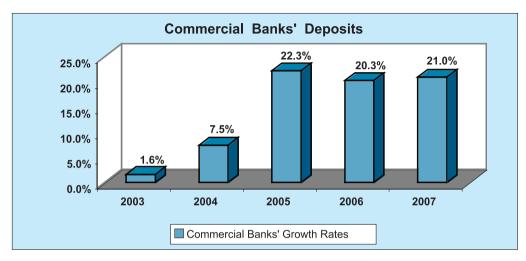
^{*} ratio for 2007 relates to proposed dividends

Source: Information collected from Member Banks (9 out of 10 member banks)

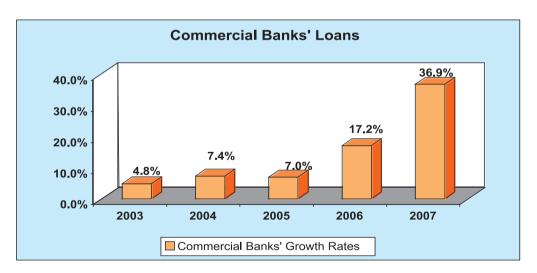
Within 2007 the nine banks managed to nearly double their return on equity to 20% by significantly increasing operating income while reducing their cost to income ratio (see table above). Additionally, the banks managed to diversify their activities further by reducing their reliance on interest income sources as well as slightly increasing their percentage of overseas assets. The quality of the loan portfolio has improved as non-performing loans declined to 5.8% (2006: 8.7%).

Financial Intermediation

In 2007, deposits and loans by Commercial Banks grew by 21.0% and 36.9% respectively, compared to growth rates of 20.3% and 17.2% in 2006 (see bar chart below).



Source: Central Bank of Cyprus



Source: Central Bank of Cyprus

Loans by Commercial Banks grew by an impressive 36.9% in 2007. This strong credit growth has supported consumer spending throughout 2007 as well as demand in the real estate sector.



Bank Credit by Sector

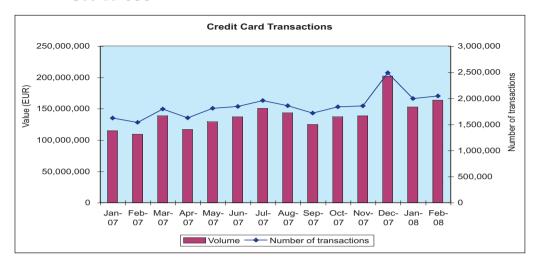
	End of period balances € 000		Outstanding amount as a % of total		Annual % change	
	2006	2007	2006	2007	2006	2007
Public institutions	585,642	911,421	2.9%	3.3%	8.0%	55.6%
Agriculture	185,411	219,077	0.9%	0.8%	1.2%	18.2%
Mining	48,623	53,141	0.2%	0.2%	-1.1%	9.3%
Manufacturing	920,533	979,138	4.6%	3.6%	2.7%	6.4%
Transport and						
communications	200,345	360,889	1.0%	1.3%	18.8%	80.1%
Foreign & domestic trade	2,595,788	2,824,193	13.0%	10.3%	-2.2%	8.8%
Building & construction	3,758,558	5,293,598	18.8%	19.4%	25.6%	40.8%
Tourism	1,554,501	1,769,103	7.8%	6.5%	7.1%	13.8%
Personal & professional	10,108,117	14,909,362	50.6%	54.6%	24.8%	47.5%
Bills Discounted						
Local	4,600	3,146	0.0%	0.0%	7.3%	-31.6%
Foreign	2,768	1,432	0.0%	0.0%	2.7%	-48.3%

The biggest increases in bank credit were attributed to the Manufacturing, Transport and Communications sector as well as to Public Institutions. In absolute amounts, the Personal – Professional sector and the Building and Construction sector absorbed the greatest amounts of new bank credit. The Personal – Professional sector now accounts for 54.6% of total credit.

At the end of September 2007, loans in euro as a percentage of total foreign currency loans reached 55.6%, loans in Swiss francs accounted for 35.6%, loans in dollars accounted for 3.6% and loans in yen accounted for 4.3%.

Credit Card Transactions

Source: JCC



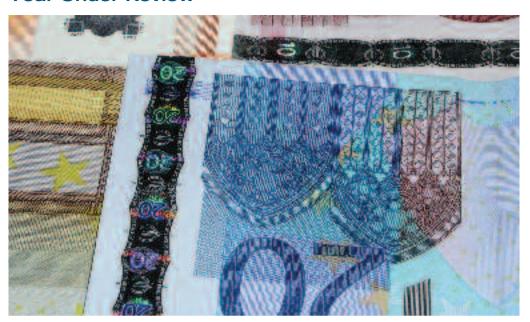
Credit card transactions have exhibited strong growth in 2007. During 2007, the total value of transactions in Cyprus by holders of credit cards issued in Cyprus amounted to €1.64 billion and the value of transactions of Cypriot cardholders abroad amounted to €771 million. The corresponding numbers of transactions were 21.9 million and 5 million respectively.

For the first two months of 2008, the value of worldwide transactions of Cyprus resident holders of cards issued in Cyprus increased by 35.9% compared to the corresponding period in 2007, and the number of transactions increased by 18.4%.

The average value of transactions in Cyprus by Cypriot card-holders was €75 in 2007 and €78 in the first two months of 2008. Cypriot card-holders spent abroad on average €154 per transaction in 2007 and €152 in the first two months of 2008.

Within 2007, there were around 350,000 debit cards in circulation in Cyprus and 450,000 credit cards. By the end of 2007, 43% of total credit cards in circulation in Cyprus had adopted the EMV standard, otherwise known as "chip and pin" cards. It is anticipated that by the end of 2008 all cards will be converted to "chip and pin" cards.

Year Under Review



■ EURO - Successful Adoption of the Euro

In July 2007, having satisfied all economic convergence criteria - the Maastrich criteria - the European Commission officially approved the application of the government of Cyprus to join the eurozone and adopt the euro as its official currency. At the same time they set the fixed conversion rate of the Cyprus Pound to Euro. On 1st January 2008 Cyprus joined the eurozone and successfully introduced the euro as its official currency.

The transition of the banking sector from the national currency to the euro was a challenging project, in terms of both logistical and technical preparations. The primary target was to complete successfully and on time the conversion of all IT systems and software and secondly to secure the smooth functioning of the financial market during the first days following the introduction of the euro.

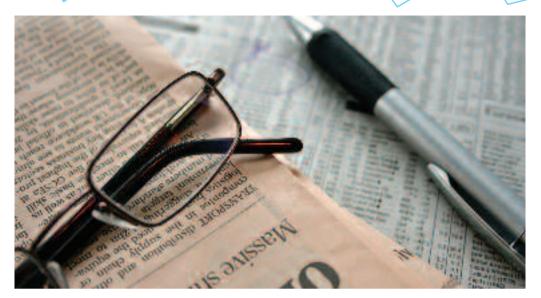
Throughout the year the Association and member banks worked intensively to complete all the necessary preparations for a successful changeover. The industry's contribution to the success of the project has been recognized and appreciated by both the Ministry of Finance and the Central Bank of Cyprus. The Association's Euro Committee held regular meetings to

discuss various legal and technical issues relating to the physical introduction of the euro notes and coins. Specific mention must be made to all member banks' contribution to the following initiatives:

- · Campaign for the early withdrawal of national coins.
- Extensive advertising through electronic and other media.
- Organization of seminars and presentations to inform the public and businesses about the new currency.
- Sale of over 100,000 starter packs to the public and over 14,000 starter packs to businesses, comprising different euro denomination coins.
- Sub-front loading of over 1,370 businesses with euro notes and coins to assist them with cash transactions during the first days following the introduction of the new currency.
- ATM withdrawal of €10 and €20 notes from late afternoon on 31st December 2007.
- Opened a number of branches to the public for specific hours on 1st January 2008 to enable the public to exchange national currency notes and coins to euro.
- Adoption of the Fair Pricing Agreement introduced by the Euro Observatories.

The Association and its member banks held regular meetings with the Central Bank of Cyprus and discussed various issues concerning the banking sector's technical aspects of the preparations. Additionally, the Association was a member of the Euro National Coordinating Committee together with representatives from the Central Bank of Cyprus, the Ministry of Finance, the Chamber of Commerce, Consumer Associations and political parties.

Undoubtedly, the banking sector contributed immensely towards the successful introduction of the euro. The cost to the banks in terms of system upgrades, human capital (training provided and overtime paid) and loss of income from the abolition of the Cyprus Pound, amount to tens of millions of euro. Despite the financial burden, it is our belief that the adoption of the euro will be beneficial for Cyprus. The long-term benefits, for both the public and businesses, far outweigh the short-term costs as this is another step towards European integration.



Markets in Financial Instruments Directive (MiFID)

By 1st November 2007, the Markets in Financial Instruments Directive (MiFID) became implemented throughout the European Economic Area. The implementation of MiFID is the cornerstone of the European Commission's Financial Services Action Plan which aims towards the fulfilment of a unified and coherent single market with regard to financial services. MiFID monitors the provision of investment services and activities across the EU. It is intended to open up EU financial markets to competition as well as to enhance consumer protection in investment services.

As of the effective date, MiFID has replaced the Investment Services Directive. The new Directive has affected all entities operating in the financial markets including our Member Banks, investors, exchanges, brokers, dealers, investment companies, asset managers, custodians, investment advisors as well as IT companies.

MiFID retains the principles of the EU 'passport' introduced by the Investment Services Directive (ISD) but extends its scope to cover investment advice and commodity derivatives and it also introduces the concept of 'maximum harmonization' which places more emphasis on home state supervision. Maximum harmonisation is intended to prevent EU member states from gold-plating EU requirements detrimental to a level playing field. Another change is the abolition of the 'concentration rule',

meaning that Member States no longer require investment firms to route client orders through regulated markets.

In Cyprus, MiFID has been transposed into national legislation on 1 November 2007 through the introduction of the "Law which provides for the provision of investment services, the exercise of investment activities, the operation of regulated markets and other related matters" (Law 144(I)/2007). As part of the new regulation's consumer protection measures, our Member Banks as well as Cyprus Investment Firms became involved in a significant re-categorisation exercise impacting all existing clients for each investment business. This provided an opportunity to better understand client needs and behaviour in terms of product preferences and risk tolerance. Furthermore, it provided an opportunity for companies to reassess and standardise customer identification, acceptance and categorisation procedures across business units in order to realise potential cost reductions.

Additionally, investment firms had to carry out an extensive review of existing retail client agreements to comply with new MiFID requirements and introduce new suitability and appropriateness assessments. In the area of conflicts of interest, MiFID introduced significant changes which required investment firms to formalise and record their approach to conflicts management.

As a response to the requirement for obtaining best execution for their clients, investment firms faced the challenge of determining the best possible result for different types of clients with respect to different financial instruments. Following that, investment firms also needed to determine how to demonstrate that the best possible result has been obtained and communicate this to customers. In addition, they had to overhaul their IT systems to comply with storage of relevant data for at least five years and recorded telephone orders for at least a year.

Overall, it can be seen that MiFID has a major impact in the way the financial service sector is regulated as well as upon the systems, documentation and order-handling procedures of investment firms. Throughout 2007 the Association together with its member banks strived to implement these new requirements in practical ways that are cost efficient, market sensitive and do not import high levels of legal uncertainty and regulatory risk into customer relations and market dealings.



Banking Supervision Committee

The Basel II Capital Accord is an international initiative that sets out new rules for cross-border active banks in relation to the risks they are exposed to. The introduction of consistent capital adequacy regulations aims to ensure the financial soundness of the banking institutions and to further strengthen the soundness and stability of the international banking system.

In 1998 the Basel Committee introduced the Basel Capital Accord (Basel I), which sought to strengthen the soundness and stability of the international banking system by requiring higher capital ratios. Following extensive consultation with banks and industry groups, the Basel Committee issued the Capital Adequacy Framework (Basel II) in order to modernise the existing capital requirements framework and make it more comprehensive and risk sensitive. Basel II is more sensitive to the real risks and it takes into account many modern financial institutions' risk management practices.

The Basel II Capital Accord consists of three mutually reinforcing pillars: Pillar 1 sets the minimum capital requirements for credit, market and operational risk, Pillar 2 requires banks to assess their capital requirements in

relation to these risks, and Pillar 3 improves market discipline by requiring banks to publish certain details regarding their capital and risk management.

The Committee of European Banking Supervisors (CEBS), consisting of all European banking supervisors, promotes coherent application of the Basel II Capital Accord and plays a key role in promoting convergence in the implementation of the capital adequacy reform in Europe. The Central Bank of Cyprus, as the national supervisor, is responsible for determining all relevant application details and overlooking the application and compliance of Basel II by locally based banks.

During 2007 the Central Bank of Cyprus published several Capital Adequacy Directives and Guidelines, regarding credit risk, market risk, operational risk, interest rate risk, country risk, stress-testing, Pillar II (ICAAP), Pillar III and COREP. The Association and its member banks met regularly to analyse and discuss the content of these Directives and Guidelines, formed common views and subsequently held consultation meetings with the Central Bank of Cyprus. Additionally, the Banking Supervision Committee held meetings to discuss and identify the divergences of rules or regulations between the two Capital Adequacy Directives issued by the Central Bank of Cyprus and the Bank of Greece, and informed the local supervisory authority. The objective of this exercise was to align as much as possible the two Directives in order to assist member banks that operate in Greece to apply it consistently. The two supervisory authorities are expected to hold discussions and decide whether to proceed with the necessary amendments. Lastly, the Association held several meetings with member banks to discuss the European Banking Federation's "Laundry List of Changes to the CRD" and the "National Discretions List". The outcome of these meetings was then forwarded to the European Banking Federation for further collective consultation with European supervisory bodies.

Following the Central Bank of Cyprus' publication of the official Capital Adequacy Directive, which became effective as of 1st January 2007, two member banks used the Standardised Approach method to calculate credit risk capital allocation. The remaining banks opted to postpone its application, by making use of the relevant discretion provided in the Capital Adequacy Directive, until 1st January 2008. Their decision was based mainly on technical reasons, as the calculation of the minimum capital requirements

requires the implementation of various changes to the banks' internal IT systems. As of 1st January 2008 all member banks comply with the new Capital Adequacy Directive. The minimum amount of regulatory capital for credit risk has been set at 8% of all risk-weighted assets.

The Association considers the issue of the Future Architecture of European Banking Supervision to be very important, as it sets the parameters of the future supervisory models in a consolidated European banking sector. Member banks were updated on the various proposals and suggested models discussed within the European Banking Federation and formed a preliminary stance on the issue. This has been communicated to the European Banking Federation which is expected to form the common position of the European banking industry on the matter.

The Association will continue to support member banks in their efforts to comply with all existing and upcoming supervisory and other regulations, and will continue to be actively involved in shaping the local banking industry's future.



Banking Supervision, a Work in Progress

Background

The establishment of the single market, whereby financial institutions are free to provide cross border services, plus a common eurozone currency, has changed the banking scenery and practice over the years. Evidence of this is the emergence of Pan-European banks. It must be noted that even though Pan-European institutions encompass a comparatively small number of institutions, they account for a disproportionate share of total assets. These institutions are therefore the channels for distribution of capital and associated risk across the borders in the EU and hence are of particular importance for the stability of the entire market. So, the emergence and steady increase in the number of Pan-European banks, signal that the problem of systemic risk is becoming more acute. The costs on governments when the risk of a cross-border bank failing materialises are vast. Indicatively, a world-wide sample of 40 banking crises found that governments spend on average 13% of national GDP to clean up the financial system. The Scandinavian crisis in the 1990s amounted to a fiscal cost of 8% of GDP, while the Japanese crisis in the 1990s added up to a total of 20% of GDP. These experiences strengthen the argument for ex ante measures.

It is for this reason that this new trend has stimulated the debate on European arrangements for financial supervision and stability. This is because, while Pan-European banks are emerging, financial supervision and stability are still nationally rooted. Currently the set-up of financial supervision in Europe has not been designed with regard to the emergence of Pan-European banks and to crisis management. Instead, the current set-up consists of different and sometimes inconsistent regimes where responsibilities of Supervisors (home and host) and procedures can be unclear, while much duplication reporting requirements impose additional costs and confusion on banks. Part of the debate is the issue of who should bear the burden of any proposed recapitalisation should failures occur in large cross-border banks and the search to establish an appropriate division of labour between home and host Supervisors in the European Union. These issues require a total restructuring of banking Supervision models in order to become attuned to the new trends and needs.

The European banking industry has a key role in this debate and the ACCB participates by channeling its positions via the European Banking Federation. Currently, the European Banking Federation is working on different proposals, which aim to improve the current supervisory model. The final results will be used towards contributing to the more general debate.

The ACCB is in favour of steadily moving towards a new Supervisory Model, the Consolidating Supervisor Model. Below follows a brief description of this Model.

The Consolidating Supervisor Model Scope

- This model applies to cross-border financial groups only.
- · Both solo and group level supervision are applied.

Responsible Bodies

- The Consolidating Supervisor is the home supervisor of the parent company of the cross-border banking group.
 This means that each national supervisor, will be acting as a Consolidating Supervisor and as such it will be responsible to supervise its own registered banks in its own territory and also their operations abroad (branches, cross border and subsidiaries).
- Central to this model is the College of Supervisors. It consists of the supervisors of the Member States where the group has significant activities. It will be used as a pool of exchange of information and expertise. This arrangement ensures that host supervisors will have a saying in the supervision of foreign banks operating in their territory.

Description

- The Consolidating Supervisor enjoys overall governance of supervisory responsibility for the group.
- It is responsible for ensuring that the College functions properly and delivers a uniform and consistent supervisory process.
- It proposes solutions when opinions are diverging and, when consensus cannot be reached in the College of Supervisors, it imposes a decision on the basis of the majority of views of College's members.
- This model is a cooperative arrangement between a banking group's supervisors built with Memoranda of Understanding (MoU) and Service Level Agreements (SLA) and stress-tested to see how regulatory powers operate in extreme events.
- The model is based on intensive dialogues, cooperation, coordination and commonly-agreed decisions between the supervisors involved.
- If a host supervisor disagrees with the consolidating supervisor's decision, the mediation mechanism may be initiated with comply-or-explain safeguards.

Concluding Remarks

The model above does provide answers to important issues such as duplication costs from reporting requirements and sets clearer lines on the responsibilities, while giving a saying on all relevant Supervisors to voice their concerns. However, the most stressing issues such as practicability of the model and cost on supervisors, deposit protection schemes, lender of last resort operations and most importantly burden sharing of cost in a crisis situation remain unanswered. Resolving the problem should be a top priority for banks, their Supervisors and governments. After all, the goal of ensuring a healthy environment for financial services in Europe is not only in the interest of the financial industry, but also in the interest of the EU's economic stability as a whole.



Money Laundering

The Association plays an instrumental role in the process of the review and update of the Anti-Money Laundering Legislation and has developed a close cooperation with the Central Bank and the government towards that end.

Latest Developments

Third Anti-Money Laundering Directive

The Third EU Directive on the prevention of the use of the financial system for the purpose of money laundering 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 and Terrorist financing 188(I)/2007 (Consolidated AML Legislation). In addition, under the said Law, the Central Bank has issued a Directive for the prevention of money laundering and terrorist financing (Directive) which is envisaged to revise and replace the existing Guidance Note.

The Association has taken part in a series of consultation processes with the Central Bank of Cyprus in relation to the finalization of the above mentioned legislation and directive and hence welcomes the agreed text of these documents.

Furthermore a series of meetings of the Anti-Money Laundering Committee of the ACCB are in progress which deal with the implementation of the Consolidated AML Legislation and the Directive by the member banks. During these meetings a detailed examination of the main parts of the new regulatory framework takes place and suggestions in relation to the correct and effective implementation are exchanged, especially in relation to the changes to be upheld by the Banks in their procedures, systems and methodology.

The Third Anti-Money Laundering Directive builds on existing EU legislation and incorporates into EU law the June 2003 revision of the Forty Recommendations of the Financial Action Task Force (FATF), the international standard setter in the fight against money laundering and terrorist financing. Furthermore, it reproduces much of the Second Anti money Laundering 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 Directive is applicable to the financial sector as well as lawyers, notaries, accountants, real estate agents, casinos, trust and company service providers. Its scope also encompasses all providers of goods, when payments are made in cash in excess of €15.000. Those subject to the Directive need to:

- Identify and verify the identity of their customer and of its beneficial owner, and to monitor their business relationship with the customer;
- Report suspicions of money laundering or terrorist financing to the public authorities - usually, the national financial intelligence unit; and
- Take supporting measures, such as ensuring a proper training of the personnel and the establishment of appropriate internal preventive policies and procedures.
- Introduce additional requirements and safeguards for situations of higher risk (introduction of risk-based approaches to the identification of clients).

New Risks

The Directive takes account of modern risks and explicitly covers terrorist financing and vulnerable sectors (i.e. 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, i.e. 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

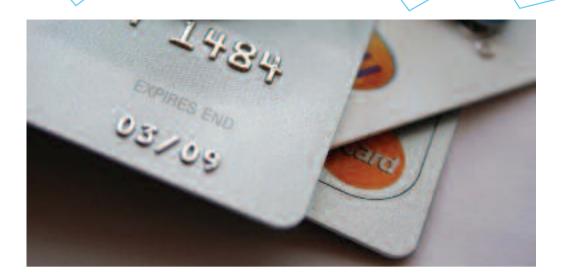
It specifically covers the reliance of institutions on third parties and the mutual recognition of customer due diligence procedures between member states. Reliance is defined as permitting one regulated institution to rely on another to undertake the customer identification and verification responsibilities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

Cyprus Implementation-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.

Recent Matters dealt with by the Anti-Fraud Anti-Money Laundering Committee of the Association following the request of the European Banking Federation:

- European Commission's draft communication on cyber crime.
- Report on the risk-based approach of the electronic advisory group and Wolfsberg GROUP Statement on Money Laundering and Corruption.
- Joint Money Laundering Steering Group Revised Guidelines.
- Assessment of the Functioning of the Consolidated Electronic List of Persons, Groups, and Entities subject to (CFSP related) Financial Sanctions.
- European Commission Consultation Paper on the Processing of Personal Data and EU-Anti-Money Laundering Rules.



Single Euro Payments Area (SEPA)

The introduction of the Euro has set the base for a single market of goods and services within the European Union (EU) and has promoted the implementation of the Lisbon Strategy which aims for the European economy to become the most competitive and most dynamic economy in the world.

Considering the above, the European Central Bank has concluded that the integration of domestic electronic payments systems is also very important for the efficient functioning of the financial markets and the boosting of the European economy. It is worth noting that electronic payments constitute a vital segment of the total European payments, since their volume accounts for 70% of the total domestic payments and 99% of the total cross-border payments (on an EU average). After ascertaining that the fragmentation of domestic electronic payment infrastructures prevents competition and hampers EU development, the European Commission and the European Payments Council (EPC) tried to find ways of harmonizing the national payment systems, thereby achieving lower payment costs and greater transaction efficiency.

Following two years of design and preparation and having the support of the European Central Bank, the European Payments Council (EPC) has developed a revolutionary project named SEPA (Single Euro Payments Area). All 27 EU member states plus Switzerland, Norway, Iceland and Liechtenstein have committed to participate in SEPA and offer its three main products: Credit Transfers, Direct Debits and Payment Cards (Debit and Credit Cards).

The SEPA Credit Transfers Scheme (SCT) was launched on a pan-European basis on the 28th of January 2008. SEPA Cards Framework has also started to be implemented through the issue of the EMV (Chip & Pin) Cards. Its migration is expected to be completed once European citizens are able to use their Debit or Credit cards at any ATM or Point of Sale terminal at all member countries and bear the same costs irrespective of the country of issue of the card. The pan-European launch date of the SEPA Direct Debits Scheme (SDD) has been targeted for the beginning of November 2009. However, in view of the delay in the approval of the Payment Services Directive (which is the legal framework on which SDD and all other Payment systems will be based), the November 2009 deadline may eventually be extended.

SEPA will go through an adaptation period of almost three years (from the 28th of January 2008 until the 31st of December 2010), whereby both SEPA as well as the existing national payment systems will be able to co-exist and be used by Banks and their customers. From the 1st of January 2011 however, full SEPA migration must be achieved.

SEPA is expected to provide a series of benefits to all involving stakeholders such as Banks, Consumers, Businesses and the Public Authorities.

Despite their initial investment, Banks are expected to benefit from SEPA in the longer term, as it is anticipated to provide cost savings resulting from simplification of procedures, economies of scale, reduction of errors and better negotiations with service providers. In addition, Banks will be able to further expand their businesses by offering their customers value-added services such as electronic invoicing and mobile banking.

With SEPA, European citizens will no longer need to maintain more than one Bank account, since electronic payments within the EU will be as easy, as quick and will bear the same costs as national payments (for transactions of less than €50.000). For example, SEPA could be applied for paying rent for relatives studying abroad, paying for holidays from home, or 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.

Businesses will be able to perform euro-denominated payments centrally from a single Bank account in one EU country, without having to maintain different Bank accounts in each country they deal with. This will enable them to consolidate their payments more efficiently and perform better liquidity management.

Through SEPA, the Public Authorities will be able to receive Taxes and Social Insurances as well as pay salaries and pensions to government employees by electronic means, rather than by cheques or cash. By effecting electronic payments, Public Authorities will be able to save costs, since they will no longer need to maintain the same number of 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.

Over the last two years the ACCB took an active role in the design and preparation of SEPA, as well as the timely launch of the SCT. In particular, four SEPA Committees have been created. one responsible for the monitorina implementation of SEPA Direct Debits & Credit Transfers Schemes, one for the Cards Framework and another for the examination of the legal aspects of the project (Legal Support Working Group). A Communication Committee has also been created, whose aim is to inform all involving stakeholders (through presentations, press releases and interviews) about the nature and benefits of SEPA and induce them to become early adopters. Furthermore, a National SEPA Steering Committee (NSSC) was set up under the auspices of the Central Bank of Cyprus. NSSC is composed of executives from the Banking Community, the Public Authorities, the Business Community and the Consumer's Association. Its aim is to monitor the whole implementation process and secure successful migration by the deadlines set by the EPC.

The ACCB also undertook the responsibility of becoming SEPA's National Adherence Support Organization (NASO) whose role is to examine the Adherence Agreements of the Financial Institutions wishing to apply for SEPA participation, ensure that they fulfil all the necessary prerequisites and submit them to the EPC for final approval. NASO is also the link between the SEPA participators and the EPC, for any matters arising before or after adherence.



Creation of a "Code of Practice on Switching Personal Accounts" between Banks

The switching of customer accounts between Banks, is a trend that became especially popular by the public over the last years. Gone are the days when a customer was loyal to his original Bank and remained with it for a long period of time. According to data published by the European Commission, Cyprus has one of the highest account switching rates amongst the European Union's (EU) member states, as its percentage of mobility reaches 10.33% which is the fourth highest in the EU after Spain, Portugal and Slovakia.

The reasons for which a customer may wish to switch his account from one Bank to another are:

- A better deal with the new Bank as far as interest rates or other facilities are concerned.
- The level of service of the current Bank is not satisfactory.
- The current Bank did not approve the granting of a new product (e.g. a new loan).
- The current Bank could not offer a specific new product.
- The location of the new Bank is more convenient.

Bearing the above in mind, the ACCB took the initiative to develop a "Code of Practice on Switching Personal

Accounts". The Code covers Fixed Deposits, Notice Accounts, Savings Accounts and Current Accounts belonging to physical persons. It does not cover accounts bearing Overdraft facilities, guarantees or any other form of commitments. The main scope of the Code is to enable customers to switch their accounts through simplified and understandable procedures and complete the whole account switching process within 15 working days, without bearing any costs. Among others, the Code includes the main commitments of the participating Banks and the 4 steps that need to be followed by both the Banks and the customers, in order to complete the procedure in due time.

The drafting of the Code was effected by an Ad Hoc Committee which comprised of representatives from the ACCB and its 10 member Banks. The final version of the Code was approved by ACCB's Executive Board and will be implemented in the second half of 2008.

The creation of the Code is expected to have a positive impact to both Banks and their customers, for the following reasons:

- It will enable customers to easily switch their accounts, which will help them save time and avoid mistakes or misunderstandings with the Banks.
- It will enhance the relationship between Banks and their customers, as it promotes transparency and mutual understanding between the two parties.
- It will boost competition between Banks, which in the long term could lead to the offering of more choices to customers, the reduction of prices and the provision of higher quality products and services.



Electronic Cheque Clearing System

The Association of Cyprus Commercial Banks is leading a banking initiative for the adoption of a new electronic cheque clearing process. Due to improvements in technology, cheques can now be captured in the form of images and transmitted electronically between financial institutions, thus putting an end to the physical exchange of cheques between the collecting and the paying bank.

Electronic cheque clearing processes have been adopted worldwide including the United States, Canada, Singapore, Spain, United Kingdom, Malaysia, India, South Africa and many more.

In order to facilitate the successful adoption of the new electronic process, a technical interbank-Committee has been formed under the auspices of the ACCB. The Committee, which is composed of experts and representatives from member banks, has worked on various aspects of this initiative and prepared a comprehensive proposal for the transition of the current manual cheque transportation to electronic cheque clearing. The Committee's proposal was approved by the Association's Board of Directors in the summer of 2007. Current plans call for the system development and testing to be ready by the end of 2008, with full implementation to be completed in the first half of 2009. The new electronic based process will be adopted by most commercial banks as well as the co-operative societies in Cyprus. In a few years, it is anticipated that all financial institutions will participate in this efficient technological deployment, thereby achieving implementation within the whole banking industry.

Today in the local clearing system, the actual physical cheques are exchanged between financial institutions daily. With the electronic cheque process, the exchange of physical cheques will cease. When a customer presents a cheque at a branch, the clearing centre of the collecting bank will scan the cheque and will create an image as well as a data file that will be transmitted to the dispatcher company (the Dispatcher). The Dispatcher will proceed to the necessary security controls and will transmit both files to the financial institution that holds the account on which the cheque was written. The original paper cheque will no longer be exchanged manually but will be retained at the collecting bank. The drawee (paying) institution will have access to the files much faster than the manual exchange process and will decide whether to honour the cheque based on this electronic information. Transactions will be settled on the basis of electronic data.

This new procedure will shorten the time taken to clear cheques, thereby improving efficiency and customer service. Currently, cheques take five working days and sometimes longer to clear. With electronic cheque data transmission, the clearing time frame will be shortened. Moreover, the new electronic system has the potential for new products, such as Express Clearing of cheques, new software and services for the combat of fraud and many more.

The electronic transfer of cheques is based on the provisions of the Bills of Exchange Act which was amended in 2002 as a result of ACCB's efforts. Nevertheless, in order to facilitate the shift to the electronic processing system, another legislative amendment concerning the status of returned cheques has to be approved by the Parliament. It is anticipated that this bill will be discussed at the House of Representatives before the Summer 2008.

It is evident from other countries' experiences that the introduction of this technology has positive effects. Long and inefficient clearing cycles are detrimental to the smooth functioning of the economy. The usage of new technology and electronic methods of clearing in the local banking industry reduces clearing times and provides better customer satisfaction. By the beginning of 2009, the framework for modernizing Cyprus's clearing process for cheques should be complete, paving the way for both financial institutions and their customers to enjoy the benefits of greater efficiency and convenience.

The ACCB



Organizational Structure

The Association of Cyprus Commercial Banks is governed by a Board of Directors whose members are appointed by the member banks. The Board of Directors appoints yearly, on a rotation basis, a Chairman and a Vice-Chairman.

The Director General who is appointed by the Board of Directors and heads a team of professional and highly qualified staff, manages the running of the day-to-day activities of the Association, makes recommendations to the Board regarding the Association's policies and internal organization, reports on major issues of its operation and supervises all tasks which have been delegated to him by the Board of Directors, according to the Constitution of the Association.

In order to meet the needs of its members and operate efficiently and proactively, the Association has established the following Permanent Inter Bank Advisory Committees:

- Committee for Legal Affairs
- 2. Banking Operations & Policies
- 3. Economic & Statistical Affairs
- Financial Markets
- 5. International Chamber of Commerce

- 6. Fraud & Money Laundering
- 7. Treasury & Risk Management
- 8. Banking Supervision
- 9. Consumer Affairs
- 10. Communications & Crisis Management

The Permanent Interbank Advisory Committees and Ad hoc Committees analyse information on a broad range of issues concerning banking and financial activities and act as advisory bodies to the Board of Directors. These Committees examine various issues make recommendations to the Board and subsequently implement the Association's policies according to the Board's decisions. ACCB Committees are composed of representatives of member banks at the highest possible management level in the hierarchy of banks and are delegated with sufficient authority to make decisions.

In addition to the above, senior staff of the Association also participate in the various standing committees and working groups of the European Banking Federation (EBF). These delegates examine in depth the issues dealt by the Committees they represent, participate in meetings of the EBF abroad and inform member banks of the developments taking place within the European banking sector.

Mission

Following Cyprus's accession to the European Union and the subsequent harmonization of the domestic financial sector, the major objective of the Association is the coordination of banking policies and the formulation of common positions on several legislative and financial issues.

In this sense, the mission of the Association is to become a major player on the part of the private sector in evaluating and formulating suggestions on the economic, monetary and financial development in the light of the globalization process of the world market and the increasing intensity of competition anticipated in the financial sector. The constant changes in the structure of international banking render the role of the Association essential in timely evaluating the impact of global reforms on the domestic banking sector and in promoting the expanding needs of the local banking community.

Membership

The Association of Cyprus Commercial Banks is a non-profit professional body representing the interests of the banking industry and is supported by subscriptions from its members.

Membership of the Association is open to any institution legally authorized to operate as a registered bank, whether local or foreign, in Cyprus, which can provide commercial banking services under the Banking Law of 1997. Applications for new membership are subject to approval by the members of the Board of Directors of the Association.

The bank members of the Association offer a diverse range of products and services. Beyond the traditional deposit and lending services, banks have established their own subsidiaries providing short and medium term credit, hire purchase finance facilities, investment services (such as asset management, investment advice and brokerage) factoring and invoice discounting services, electronic and telephone banking, leasing, private banking as well as all types of insurance services.

Cyprus banks are financially sound, they have engaged in a process of continuous upgrading of their technology systems in specialized areas of operations, and regard their human resources not only as an essential factor for the high level of services offered to customers but also important to meet successfully the challenges lying ahead. Beyond their traditional economic and financial engagement, banks have shown commitment to social responsibility by participating and supporting a variety of cultural and social events in Cyprus.

Realizing that there are challenges and more opportunities abroad, banks have sought expansion beyond the boundaries of the island. Today the banking sector is characterized by an extensive network abroad having acquired or established branches, subsidiaries and representative offices in Greece and other European countries, the USA, Canada, Australia and Africa.

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