



CYPRUS

National Assessment of Money Laundering and Terrorist Financing Risks

October 2018



CONTENTS

	<u>Page</u>
ACRONYMS	3
INTRODUCTION	5
EXECUTIVE SUMMARY	8
SECTION 1 - MONEY LAUNDERING RISK	17
1.1 ML THREAT ANALYSIS	18
1.2 NATIONAL VULNERABILITY TO ML	35
1.3 BANKING SECTOR VULNERABILITY	63
1.4 SECURITIES SECTOR VULNERABILITY	77
1.5 INSURANCE SECTOR VULNERABILITY	81
1.6 OTHER FINANCIAL INSTITUTIONS' VULNERABILITY	84
1.7 DNFBPs' VULNERABILITY	96
SECTION 2 – TERRORIST FINANCING RISK	109
INDEX OF TABLES	118



MAIN ACRONYMS USED

Advisory Authority	The Advisory Authority for Combating Money Laundering and Terrorist Financing established under section 56 of the Prevention and Suppression of Money Laundering and Terrorist Financing Law 188(I)/2007 as subsequently amended
AML/CFT Law	The Prevention and Suppression of Money Laundering and Terrorist Financing Law 188(I)/2007 as subsequently amended
ASP Law	Law Regulating Companies Providing Administrative Services and Related Matters 196(I)/2012
CBA	The Cyprus Bar Association
CBC	Central Bank of Cyprus
CySEC	Cyprus Securities and Exchange Commission
goAML	The FIU's data system
DCE	Department of Customs and Excise
ICCS	Insurance Companies Control Service
ICPAC	Institute of Certified Public Accountants of Cyprus
LEA	Law Enforcement Authorities
MOKAS	The Cyprus FIU
Moneyval	The Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism of the Council of Europe
MER	Mutual Evaluation Report
TCSPs	Trust and Company Service Providers
4 th EU AML Directive	Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015



DISCLAIMER

The National ML/TF Risk Assessment of Cyprus has been conducted as a self-assessment by the competent Cypriot authorities, using the National Money Laundering and Terrorist Financing (ML/TF) Risk Assessment Tool developed and provided by the World Bank. The World Bank team's role was limited to: 1) delivery of the tool; 2) providing guidance on the technical aspects of the tool; 3) review of draft NRA documents and providing feedback to assist in the accurate use of the tool. The data, statistics, and other information populated into the National ML/TF Risk Assessment Tool templates, as well as the findings, interpretations, and judgments under the scope of the National Risk Assessment process, belong to the Cypriot authorities and do not reflect the views of the World Bank.



INTRODUCTION

Pursuant to the FATF recommendation for countries to identify, assess and understand the money laundering and terrorist financing risks they are facing, as well as the obligations stemming out of article 7 of the 4th AML EU Directive¹, Cypriot authorities decided in 2014 under the remit of the Advisory Authority for Combating Money Laundering and Terrorist Financing established under section 56 of the AML/CFT Law² to conduct an assessment on a national scale of the money laundering and terrorist financing risks that undermine the integrity and stability of the Cypriot economy, financial system and society in general, with a view to understand these risks and form an appropriate and targeted action plan with remediation measures.

Even though this is the first specific ML/TF risk assessment undertaken by the Cyprus Authorities, nevertheless, issues affecting different sectors have been on the agendas of the relevant authorities and stakeholders for some time now as the AML/CFT Law contains provisions on the application of a risk based approach, as seen in the references to simplified and enhanced due diligence measures. Moreover, the directives issued and the supervisory approach followed by supervisory authorities adopt the concept of risk.

After careful consideration of the options available, the Advisory Authority decided on implementing the World Bank methodology for the first ever national risk assessment or NRA in short³. The project was managed by the Central Bank of Cyprus ('CBC') and the Cyprus FIU ('MOKAS') and engaged all competent authorities and government services which are represented on the Advisory Authority. Additionally, the private sector was mobilised in order to enhance the understanding of the practical factors which contribute to risk. The project was initiated in July 2015 with the organization of the introductory workshop with the participation of all those implicated and the experts of the World Bank. Since that time, workshops, meetings, data gathering exercises and surveys took place in order to capture as much data available as possible in order to assist the assessment.

In a nutshell, the model adopted in the NRA comprises the recognition and assessment of the national money laundering threat on the basis of analyses of the illicit proceeds of crime and of the national vulnerability to money laundering as depicted by the national combating ability as

¹ <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32015L0849>, article 7

² <http://www.law.gov.cy/Law/MOKAS/MOKAS.nsf/All/8D5B6DF6DC5D5815C2257BE1002A2848?OpenDocument>

³ <http://www.worldbank.org/en/topic/financialmarketintegrity/brief/antimoney-laundering-and-combating-the-financing-of-terrorism-risk-assessment-support>



well as the vulnerability of various economic sectors to money laundering risks. The threat level recognised and the overall vulnerability assessment determine the final risk assessment. One of the strong advantages of the tool is that it allows for flexibility and tailoring out to the specificities of each sector and provides for the support of views and assessments by statistical analyses, experts' input and market contribution. Terrorist financing forms part of a separate module in the tool of the World Bank and, hence, an analysis of the risks run in Cyprus for financing terrorist acts was also conducted and incorporated in the overall analysis.

Following through the structure of the World Bank risk assessment tool, this report consists of two sections, the first addressing money laundering issues and the second addressing terrorist financing. Section 1.1 below is a detailed analysis of the money laundering threat and is followed by the analysis of the money laundering national vulnerability. In subsequent sections, the assessments of various financial and non-financial sectors are laid out (mentioning them in the order in which they come up are the banking sector, the securities sector, the insurance sector, the sector of other financial services and the designated non-financial business professions or DNFBPs). With these, section one of the report is concluded and is followed by section two which presents the terrorist financing analysis. Finally, a number of appendices give relevant and useful information on what is referred to in the main body of the report.

Of equal importance is the action plan which derive from the findings of the assessment and which are presented in a consolidated action plan as a separate document. Actions that need to be undertaken in order to close the gaps and shortcomings identified during the NRA are an additional feature of the risk assessment tool utilised and will fall under the responsibility of each competent authority separately but also the Advisory Authority.

It is hoped that the true potential of the World Bank tool has been unlocked during the painstaking months that followed the initial workshop of July 2015 and it is with sincere appreciation that the work performed by all stakeholders is commended herein. Finally, the support and understanding of the World Bank experts who assisted the Cypriot authorities in achieving this goal is gratefully acknowledged.

Above all, what needs to be recognised is that this deliverable is only the beginning of a continuous effort which will include refinement and improvement of all those measures already taken but also the adoption of additional measures which will reinforce the combating of money laundering and terrorist financing in Cyprus, thereby contributing to the international efforts to inhibit at their root those actions and activities that fester and erode economic and social welfare and progress.



Finally, the Cyprus authorities concluded their assessment prior to the publication of the European Commission's first ever Supranational Risk Assessment⁴ which assesses the vulnerability of financial products and services to risks of money laundering and terrorist financing at EU level. It has been decided that the results of the Supranational Risk Assessment will be taken into consideration on the occasion of the first update of the Cyprus' National Risk Assessment.

⁴ http://ec.europa.eu/newsroom/just/item-detail.cfm?item_id=81272



EXECUTIVE SUMMARY

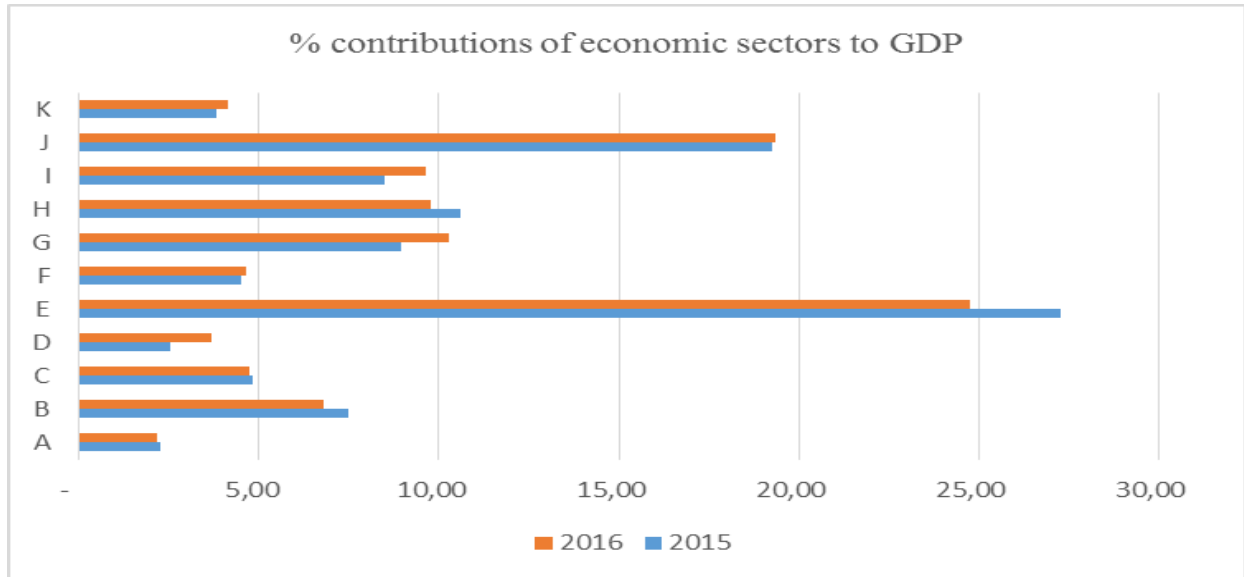
Introduction

The first assessment of the risks emanating from money laundering and terrorist financing for Cyprus was conducted using the World Bank methodology, which has as its main pillars the assessment of the related threats to the country and the analysis of the vulnerabilities both on a national level but also from the point of view of the main financial and economic sectors. The combination of the assessed level of threat and vulnerabilities gives the overall assessment of money laundering and terrorist financing risks.

While the main focus of the assessment was the country's financial systems, the broader picture and the general economy formed the essential boundaries of the exercise. Evidently, one cannot claim to have understood the inherent risks without attempting to comprehend as a starting point the circumstances of the country, economic, political and social. The makeup of the economy and the financial sector is a key element which was used in the analysis by the assessors. The breakdown of the constituent contributors to the GDP of the country were considered; the relative contributions to GDP by the various sectors for 2015 and 2016 (*Source: National Accounts, Final Data 2015 and Revised Data 2016, Statistical Service of Cyprus*⁵) can be seen as a snapshot in the following graph. Those sectors which are statistically listed as contributing the most to the economy have been included in the NRA project and have been analysed using input from the authorities and the private sector alike, using data and information obtained from various sources and by different means.

5

http://www.mof.gov.cy/mof/cystat/statistics.nsf/economy_finance_11main_en/economy_finance_11main_en?OpenForm&sub=1&sel=1



Legend for Sectors:

- A Agriculture, forestry, fishing
- B Mining, quarrying, water supply, sewerage & waste management and remediation, electricity, gas, steam and air conditioning supply
- C Manufacturing
- D Construction
- E Wholesale & retail trade, repair of motor vehicles and motorcycles, transport, storage, communication, accommodation & food service activities
- F Information & communication
- G Financial & insurance activities
- H Real estate activities
- I Professional, scientific and technical activities, administrative and support service activities
- J Public administration and defense, compulsory social security, human health and social work activities
- K Activities of households as employers, undifferentiated goods and services producing activities of households for own use

Apart from its tourist industry, Cyprus is probably best known for the development of an international financial center, offering international business facilities. The expansion of the international business sector in Cyprus is largely due to the country's strategic geographical location, at the crossroads of three continents, its advanced professional services sector, its legal framework which is closely based on the English common law, as well as on the existence of a wide network of treaties with other countries for the avoidance of double taxation. The importance of services to the Cyprus economy has grown substantially in recent decades and together with tourism is one of the major sources of income in the Cyprus' economy.



Review of the results of Cyprus' first NRA

As part of the national risk assessment process, state authorities, law enforcement authorities and private sector representatives cooperated by giving their expert knowledge, statistical data as well as ML/TF vulnerabilities and threats which have been identified through the years, in the respective sectors.

Workshops were organised with representatives of all stakeholders and representatives of the World Bank as part of the project.

Threat, Vulnerability, Risk Identification and Assessment

Risk can be seen as a combination of three factors: threat, vulnerability and consequence.

During the process to identify the threats and vulnerabilities relevant to Cyprus, information, including statistical data was provided by stakeholders across the public and private sectors.

Additionally, the Mutual Evaluation Reports of Moneyval as well as other published reports including academic researches, were taken into consideration.

The information was analysed and assessed during workshops and meetings and threats and vulnerabilities were identified based on a number of risk factors, relevant to each sector.

Such factors were amongst others, the nature and scale of the sectors, products and services of the sector, investigations, prosecutions, court orders, as well as requests sent and received in the area of international cooperation, between Cyprus and other countries.

The results were thoroughly discussed regarding the findings and the ratings which finally were given for each sector.

The overall findings were the basis for the elaboration of the report and the relevant Action Plan to mitigate the problematic areas including measures, focusing on the higher risk situations.

ML Threat

The international engagement of the financial system and the economy in general have introduced a heightened risk factor for attempts to abuse the financial system and ancillary service sectors by criminals for the purpose of laundering illicit proceeds and the financing of terrorist acts. Hence, the analysis of the ML threats has differentiated between those threats originating abroad from the domestic sources of threats.



Regarding the latter, Cyprus is considered as a relatively low domestic crime country, criminal conduct generating illicit proceeds is inevitably present. Fraud and related offences committed within the Cypriot jurisdiction were found to pose a high ML threat, while drug offences and corruption pose a medium to high ML threat. Tax evasion (direct and indirect taxes), theft and related offences, cigarettes/tobacco smuggling and human trafficking were identified as introducing ML threat of a medium level. Of lower risk levels are the smuggling of counterfeit goods and market manipulation. The assessors have noted the national strategy against corruption government initiative in their analysis as a measure which could inhibit crimes and the associated ML threat.

External ML threats were found to be linked not to jurisdictions identified by the FATF as high risk because economic and financial interaction takes place with FATF compliant jurisdictions. Specifically, Cyprus mainly interacts with countries with which it has signed double tax treaties for the avoidance of double taxation or with which traditionally has close bonds and increased trading activity. From the analysis conducted, it emerged that the banking sector is the one with the highest potential threat of being primarily used for ML, followed by Trust and Company Service Providers ('TCSPs') or lawyers and accountants when offering companies and trust administrative services which presents a medium-high ML threat, since this sector appeals predominantly to an international clientele. The real estate sector carries a medium level ML threat with external origins.

ML Vulnerability

A distinct part of the assessment relates to the overall national ML vulnerability of the country. This comprises both the national ML combating ability, assessed on the basis of numerous factors (such as the quality of AML policies and strategies, the legal framework which impacts the combating of ML, the effectiveness of the institutions responsible for the combating of ML, capacity and resources dedicated to this fight, border controls, domestic and international cooperation, the availability of lines of defence and the strength of financial integrity barriers, tax enforcement, the availability of reliable identification tools, independent information sources and the availability and access to beneficial ownership information) and the main economic sectors' vulnerability. The analysis of this wide spectrum of national institutions and their practices concluded that both the sectorial vulnerability and national combating abilities averaged out to a medium level thus forming an overall national ML vulnerability of medium level.



The report highlights the effective cooperation at national level on matters pertaining to the fight of ML, through specific fora such as the Advisory Authority and the Special Technical Committee of the financial sector, the close and extensive cooperation of the FIU and LEA with their foreign counterparts, albeit with limitations to the resources at their avail. Similarly, the commitment of the authorities in international cooperation with counterparts abroad is highlighted.

A number of factors surrounding the work accomplished by investigators, prosecutors and the judicial authorities were analysed in assessing the effectiveness of these institutions vis-à-vis their ML combating ability. The high degree of integrity and independence of financial crime prosecutors, LEA and DCE investigators as well as the judicial system were found to reinforce considerably the national ML combating ability. Awareness of LEA and DCE investigators, financial crime prosecutors and judges is identified as needing enhancement since the complexity of ML cases emerging requires a breadth of knowledge. More specifically, for investigators the need for increased awareness is important so as to consider, in the framework of conducting criminal investigations with respect to predicate offences, the possibility of commission of ML offences through the conduct of “parallel” financial investigations in more cases. Specialised training is thus a recommendation for investigators, prosecutors and the judiciary, as well as the need for more resources.

Border controls and DCE regime and control framework, including the transportation of cash which is by nature appealing to ML crimes, were reviewed as a separate chapter.

Lines of defence in the fight against ML such as independent audit functions were also examined and found to be of high quality.

The concept of financial integrity was analysed, focusing on the quality of business and professional ethics as well as tax transparency. Legislation and mechanisms are found to be in place to provide for transparency of financial matters of citizens and residents, including legal arrangements registered in Cyprus and the sharing of information by the Tax Authorities and LEA. Specifically on the effectiveness of the tax system and underlying the fact that tax crime is a predicate offence, the assessors came across the important gap between the theoretical level of taxes and what is actually collected by the government and have highlighted the need for further measures to close this gap in line with the draft Tax Department’s Strategic Plan 2017-2020. Within the same context, it was acknowledged following a specific analysis that the level of formalization of the Cypriot economy is at a high level, thus avoiding the many pitfalls of the so-called grey economy.



Finally, the high degree of effectiveness for matters relating to the availability of reliable identification tools, independent information sources and the availability and access to beneficial ownership information were gauged as consisting important defences in the national ML combating ability.

ML Vulnerability of individual financial sectors

The assessment of the ML vulnerability of different financial sectors was assigned to distinct groups comprising both competent authorities and representatives of the private sector. The individual sectors studied are banking, securities, insurance, financial institutions other than those falling in the aforementioned sectors and the so-called designated non-financial businesses and professions or DNFBPs (encompassing real estate agents, dealers in precious metals and stones, lawyers, accountants and trust and company service providers). For each sector, a number of variables were reviewed which make up the prevailing legal and regulatory framework as well as the implementation of policies and practices. The variables analysed included the comprehensiveness of the relevant legal framework, effectiveness of supervision procedures and practices, availability and enforcement of administrative sanctions, availability and enforcement of criminal sanctions, availability and effectiveness of entry controls, integrity of banks' staff, relevant knowledge of banks' staff, effectiveness of compliance function of licensed institutions, effectiveness of suspicious activity monitoring and reporting and the level of market pressure to meet high AML standards. Additionally, representative products from each sector which were perceived as inherently presenting vulnerabilities to ML risks were reviewed.

The banking industry is clearly targeted by criminals to lay and consolidate their illicit proceeds. The overall assessed ML threat for the banking sector in Cyprus was high, and the overall vulnerability of this sector was rated as medium, thereby averaging to an overall ML risk for the banking sector of medium high. Because of its international exposure, the Cypriot banking sector is considered as being more vulnerable to threats from international illicit activities rather than local crime. Also, reliance by credit institutions on third parties or 'business introducers' for customer identification procedures and customer due diligence measures (albeit on the proviso that these business introducers operate in the EEA, are subject to mandatory professional registration legally recognised and are subject to supervision regarding their compliance with the EU AML directives) has meant that there have been instances where difficulties arose in obtaining first-hand information that would enable credit institutions to construct a comprehensive economic profile of their customers. Against the identified vulnerabilities of the



banking sector, the adequacy of the regulatory and supervisory framework of the CBC coupled with the internal control systems of banks were found to be interwoven into an overall supporting control environment, thus providing an important defense mechanism. Resource limitations of the supervisor, the need for specialised training and the optimisation of IT technology in transaction monitoring were identified as areas requiring attention.

For the securities sector under the remit of CySEC, which has experienced significant growth in the last decade, the ML threat was assessed as medium low. The comprehensive framework for licensing and registration requirements for the securities firms and the focus of the local regulator on the effectiveness of the operation of the compliance function at supervised entities were highlighted. The vulnerability of the sector was assessed separately for different market players. Investment firms which are online brokers/dealers offering through an electronic trading platform trading of contracts for differences and binary options mainly in currency pairs, commodities and equity indices were seen to exhibit a medium high ML vulnerability because of their engagement with non-face-to-face customers and the deep liquidity of the products they offer which can be attractive to criminals; however, a mitigating factor recognised is the fact that additional controls are introduced on such business since these licensed institutions mostly accept small deposits from each client transferred through regulated banks or payment service providers. Traditional investment firms offering investment advice and portfolio management services to their customers because of their appeal to international clientele were also assessed as posing a medium to high ML vulnerability. Lastly, fund managers offering their services amongst others to high net worth individuals with a relatively small size when compared to traditional investment firms were found as posing medium ML vulnerability.

Compared to the rest of the financial sector, life and non-life insurance activity, supervised by the Superintendent of Insurance, represents a smaller portion and the risks associated with ML are considered low with no systemic impact to the economy. Life insurance businesses were assessed as posing low ML vulnerability. Weaknesses identified include shortcomings in the application of CDD with regards to customers with whom there is a long standing working relationship, as well as the limited use of AML/CFT automated systems by insurance undertakings. The assessors considered the ML risks for the non-life sector in Cyprus as not significant.

Under the other financial institutions category, the assessors looked at the ML threats and vulnerabilities of, amongst others, money transfer businesses, businesses acquiring transactions for payment by the use of debit and credit cards and electronic money services. The recent cases of the abuse of financial systems by criminals and especially terrorist financiers where money transfer businesses and prepaid cards were employed were taken into consideration. The overall



ML risk arising from the sector in Cyprus was assessed as medium low mainly due to its size. The strong licensing regime in place for such businesses by the competent authority, which is the CBC, was recognised. Shortcoming in resources and the supervisory tools were identified. Specifically, for money transfer businesses, evidently outgoing transactions are significantly higher than incoming and the existence of legal immigrant workers especially from eastern Europe and south east Asia who regularly remit funds to their families is an important factor that was identified as these consumers traditionally use money transfer businesses to send money to their dependents, predominantly via international household names who have local agents. Card acquiring activities are admittedly connected to card fraud, a factor identified. Electronic money issuers face heightened ML risks due to the non-face-to-face nature of their customers however the regulatory limits make it difficult for criminals to use such products to store illicitly gained wealth. This sector is deemed to be at its infancy in Cyprus with a very low contribution to the economy.

Regarding the DNFBP sector, the following are noted:

- (a) The initiatives of the regulatory bodies of lawyers and accountants in strengthening procedures and enhancing AML/CFT knowledge amongst practitioners have been noted.
- (b) With reference to the trust and company services providers which is an important sector of the economy with an international clientele dimension, the fact that these market players are supervised by three bodies, namely ICPAC, CBA and CySEC, gives rise to weaknesses such as having different AML directives by each supervisor for the same type of business which for the purposes of AML is regulated by one single law or the lack of a unified communication platform where supervisors can exchange information on sanctioned, stricken-off and rejected/declined firms to secure access to the profession and prevent the firms from continuing their activities by registering under another body once they were banned from one of the three bodies.
- (c) Real estate agents are also obliged to adhere to the AML/CFT Law and are currently under the supervision of the FIU. The degree of AML awareness amongst market players and the necessity to bring in the realm of the AML/CFT Law construction developers since they also perform sales of immovable property raised consideration. Moreover, with the recent proposed amendment of the AML/CFT Law, for the purpose of transposing the provisions of the 4th EU AML Directive into domestic legislation, the FIU will cease to remain the Supervisory Authority for this sector.
- (d) Betting activities were also assessed from the AML perspective. The assessors recognised that important building blocks have been laid given that the activity regulating



legislation is very recent and an AML road map has been designed by the National Betting Authority which is the competent authority for online betting and betting stores.

(e) Internationally, non-profit organizations (NPOs) have been abused for the financing of terrorist acts and for this reason they were included in the review. In Cyprus, there are five main types of NPOs, namely non-profit companies, charities, foundations/institutions, societies/associations and clubs. The enactment of a new law governing the activities of such vehicles in July 2017 will contribute to more effective regulation and monitoring than in the past and also consider the overall ML/TF risk in the sector to be medium-low while recognising the lack of intelligence, indication or evidence for instances of fund raising in support of international terrorism.

Terrorist financing

The last section of the report is dedicated to terrorist financing. Despite the fact that Cyprus has not been confronted with any violent terrorist incidents in the last three decades (no native terrorist designations have taken place), the political commitment of the country in joining forces with the international community in the fight against terrorism and terrorism financing is evident with the enactment of national legislation in line with the international standards and EU relevant legislation and the adoption of the National Counter Terrorism Strategy in 2014. The proximity of the country to areas of intense conflict has been taken into account by the Authorities. The number of suspicious activity reports from supervised entities and law enforcement exchange of information on terrorist financing are on the low side. This together with the non-existence of receipts of mutual legal assistance requests for terrorist financing and the minimal number of convictions for terrorist acts in the recent years do not provide sufficient material to form typologies on this matter. Additional training of all reporting entities in relation to terrorist financing techniques, methods and trends is suggested to raise awareness.



SECTION 1 – MONEY LAUNDERING RISK

OVERALL ASSESSMENT OF ML RISK

The assessors of the overall **ML threat** have reached a conclusion on the basis of the information collected, comprising statistical and other contextual data and references. The overall ML threat has been assessed as **Medium High**, comprising of domestic threat assessed to be of **Medium** level and external threat assessed to be of **High** level. The openness of the Cyprus economy to international business has been gauged as having an overriding bearing towards the overall assessment of medium high level of threat.

The overall **ML vulnerability** of the Cypriot economy has been assessed as **Medium**, after taking into consideration all the mitigating factors interwoven in the comprehensive AML/CFT framework of all competent authorities.

The combination of the **overall ML threat of Medium High** with the **overall ML vulnerability of Medium level**, using the following risk map derived from the World Bank methodology tool, leads to the outcome of an **overall ML risk of Medium High**.

OVERALL MONEY LAUNDERING RISK IN THE JURISDICTION

OVERALL THREAT	H	M	M	MH	H	H
	MH	M	M	MH	MH	H
	M	ML	M	M	MH	MH
	ML	ML	ML	M	M	M
	L	L	ML	ML	M	M
		L	ML	M	MH	H
		OVERALL VULNERABILITY				

Source: World Bank

The findings and details that underlie this assessment are set out in the following sections.



1.1 ML THREAT ANALYSIS

While Cyprus is considered to be a relatively low domestic crime country, criminal conduct generating illicit proceeds is inevitably present. Cyprus has developed an international financial center as one of its important economic sectors, offering international business facilities. The expansion of the international business sector in Cyprus is largely due to the country's strategic geographical location, at the crossroads of Europe, Africa and Asia, its advanced professional services sector-offering legal, trust, company, accounting and auditing services- its legal framework, closely based on the English common law, as well as on the existence of a wide network of treaties with other countries for the avoidance of double taxation. The importance of services to the Cyprus economy has grown substantially in recent decades and together with tourism is one of the major sources of income in the Cyprus' economy.

On one hand, the size of the financial and professional services sector of the open Cypriot economy have made Cyprus an attractive place for legitimate financial activity for businesses across the globe. On the other hand, these activities have increased the danger and risk for possible abuse of Cyprus' financial system and ancillary service sectors for criminal activities and, in particular, for the purpose of money laundering (ML) and terrorist financing (TF).

In analyzing the threat factors, the following, among others, have been mainly taken into consideration:

- The nature and extent of relevant domestic predicate offences, their type and the illegal proceeds generated domestically.
- The external threat, proceeds of crime generated abroad and laundered domestically.

Additionally, previous mutual evaluation reports, follow up reports, available academic reports as well as other reports of international organisations and the experience of the relevant stakeholders were taken into consideration in assessing the threat factors.

In this respect, it is worth recalling the 4th round MER of Cyprus by Moneyval on anti-money laundering/ counter of terrorism issues (September 2011)⁶ where it is stated that:

“Cyprus has a record of relatively low level of crime [...] the Advisory Authority has identified a number of risks and vulnerabilities. According to its assessment, the main risks emanate from international business activities at the layering stage, money laundering activities usually taking place through banking or real estate transactions, while it is considered that risks at the

⁶ [http://www.coe.int/t/dghl/monitoring/moneyval/Evaluations/round4/CYP4_Sum_MONEYVAL\(2011\)02_en.pdf](http://www.coe.int/t/dghl/monitoring/moneyval/Evaluations/round4/CYP4_Sum_MONEYVAL(2011)02_en.pdf)



placement stage are being mitigated by the legal requirements in place regarding dealers in foreign currency, restrictions on foreign ownership of property and the limited role of cash transactions.”

ML THREATS OF DOMESTIC ORIGIN - CRIMINAL OFFENCES GENERATING ILLICIT PROCEEDS

Predicate offences for money laundering in Cyprus

According to section 5 of the AML/CFT Law

“ 5. Predicate offences are:

- (a) All criminal offences punishable with imprisonment exceeding one year, as a result of which proceeds have been derived which may constitute the subject of a money laundering offence as defined by section 4.
- (b) Financing of Terrorism offences as these are specified in Article 4 of the Financing of Terrorism (Ratification and other provisions) Laws of 2001 and 2005, as well as the collection of funds for the financing of persons or organisations associated with terrorism.
- (c) Drug Trafficking offences, as these are specified in section 2 of this law”.

As explained above, the proceeds of crime laundered in Cyprus, may derive both from predicate offences committed within the jurisdiction as well as from offences committed abroad. External threat/international exposure will be considered separately from the domestic one.

The domestic predicate offences included in the analysis carried out for the purposes of this report are the most common proceed generating offences in Cyprus, based on the experience of all stakeholders, as well as on the statistical information on crime held by the Cyprus Police.

Furthermore based on the 4th Moneyval MER, the offences under examination were also identified as the most common proceeds-generating ones. The relevant excerpts from the 4th Moneyval MER report are the following:

- par.7 "...the major sources of criminal proceeds: financial crime, fraud, including investment fraud, theft and drug trafficking offences. Proceeds of crime are derived from both domestic and foreign predicate offences..."



- par. 58 "... According to the Police, the main predicate crimes for money laundering offences include theft, forgery, fraud, obtaining money by false pretenses, drug trafficking and prostitution..."
- par.249 "...Although not having information on the predicate offences of the cases successfully indicted, the evaluators could establish that based on the information in relation to convictions triggered by STRs, the underlying predicate offences linked with the ML investigations of FIU that resulted in successful trials are the following: fraud, obtaining money by false pretenses, drug offence, theft..."

The statistics kept by the Cyprus Police in relation to investigations, prosecutions and convictions for the money laundering offence unfortunately do not indicate the underlying predicate offence. This, of course, is a deficiency, as far as the keeping of the statistical information is concerned, since a significant component of statistical information in establishing a link between specific predicate offences and the money laundering offence is missing. Nevertheless, an analysis has been conducted on the number of cases investigated, the convictions for each predicate offence, the amounts involved and the existence of freezing/confiscation orders, on the basis of which the level of threat for money laundering from specific offences could be deduced. In addition, the results of the typologies analysis carried out on money laundering cases, involving domestic predicates, indicated specific underlying predicate offences, such as fraud, corruption and drug offences.

The overall domestic ML threat level, as it is illustrated in the following paragraphs, is assessed to be medium.

Based on the results of the statistical information gathered and the aforementioned analysis, the following criminal offences committed within the jurisdiction pose a high money laundering threat:

- fraud and related offences

The following offences pose a medium to high money laundering threat:

- drug offences
- corruption

The following offences pose a medium money laundering threat:

- tax evasion (direct and indirect taxes)



- theft and related offences
- cigarettes/tobacco smuggling
- trafficking of human beings (sexual and labour exploitation).

The following offences pose a medium to low money laundering threat:

- counterfeit goods' smuggling.

The following offence poses a low money laundering threat:

- market manipulation.

Criminal offences with a high level of ML threat

Fraud and related offences

Fraud and its various types (common fraud, internet fraud, investment fraud, obtaining money by false pretenses), are the most common predicate offences committed domestically and constitute a major source of criminal proceeds in the country.

Fraud is increasingly conducted online. Statistics collected comprise relevant data for the period 2011-2015 regarding the crimes of fraud and cybercrime (which includes internet fraud and other financial related crimes through internet). The widespread use of internet has increased the risk of abusing the web for criminal purposes, such as identity theft, business data and record theft and of course for various other forms of fraud.

Identity theft and “phishing” is another form of internet fraud observed whereby fraudsters create phony websites and by using different methods, they gain access to accounts and transfer amounts from the accounts of unsuspected victims. The accounts into which the amounts are deposited may belong to intermediaries who act as money mules and agree to the use of their accounts for a small commission. This *modus operandi* has been identified as high risk by both the FIU and the police; both of them having issued a relevant warning to the public, according to which special attention should be given in business proposals through internet with unclear purpose which include transactions from and to foreign countries.

Investment fraud is also another type of fraud committed in Cyprus, whereby physical or legal persons offer various investment plans which are proved to be a scam or illegal pyramid schemes. Such plans usually offer unrealistic high capital returns, not feasible in the real market. Pyramid schemes have been criminalised with an amendment of the Criminal Code in 2015 (The Criminal Code Law, CAP. 154).



From proceeds generating point of view, considering the freezing/restraint orders issued by Cyprus courts following relevant applications made by the FIU in domestic cases investigated by the police for the period 2011-2016, it is evident that fraud offences are one of the most common domestic offences for which freezing orders have been obtained; the others being corruption and drug offences.

Criminal offences with a medium to high level of ML threat

Drug offences

The Cyprus Anti-Drugs Council coordinates the National Drug and Alcohol Strategy. The strategy adopted refers to the overarching political framework and priorities for the period 2013-2020. Its aim is to contribute to the reduction of drugs demand and drugs supply in Cyprus, as well as, to the reduction in the social risks and harms caused by drug and alcohol use. The strategy is structured around two policy areas: drug demand reduction and drug supply reduction and has three cross-cutting themes: coordination, international cooperation and research, monitoring and evaluation.

The Cyprus Police and especially the Drugs Law Enforcement Unit (DLEU) has the overall responsibility to combat and eliminate the supply of narcotic drugs entering the country through airports, sea as well as through crossing points to and from the areas of the Republic of Cyprus not under the effective control of the Government of the Republic of Cyprus. The DLEU on a national level cooperates with the Cyprus Customs Authorities, the Cyprus Post Authorities, other Police departments, the FIU, as well as with the private sector. On international level with foreign police attachés based in Cyprus and the neighboring countries in the Middle East region, Europol and Interpol.

The annual report of the Cyprus Anti-Drugs Council (2015)⁷ refers to a survey among the general population (2012) according to which, cannabis remains the most commonly used illegal drug in the general public (approx. 10%). Cocaine, even though its use remains at low levels, constitutes the most popular stimulant substance. Use of cocaine, at least once in a life time, was reported by the 1,3% of the general public in the age group of 16-34 which corresponds to almost 8.000 people.

Even though in drug trafficking cases there have been parallel financial investigations resulted in freezing and confiscation orders, however, the authorities involved need to concentrate more on the issue of financial analysis, asset-tracing and freezing and confiscation of illegal proceeds derived from drug offenses. More resources, training and increase of awareness need to be

⁷ Annual Report of the Cyprus Anti-Drugs Council (2015) - http://www.ask.org.cy/index.php/en/file/VCEfqSt8qJ_GpdeP_+CepO==/



added in this area so as to effectively apply the provisions of the AML/CFT Law and the provisions of the criminal procedure law for the tracing, identification, freezing and finally confiscating proceeds of drug offences, not only as a form of punishment but also as an effort to reduce the supply of illegal substances.

On the basis of the analysis provided, drug related offenses are considered to be medium to high risk for money laundering.

Corruption offences

Corruption seems to be one of the domestic predicate offences for the purposes of money laundering, generating illegal proceeds.

Reference is made to the EU Anti-Corruption Report, dated 3.2.2014, COM (2014)38 final, Annex 13,⁸ prepared by the European Commission whereby the relevant part on Cyprus contains some useful information. According to the Report, opinion polling based on perception surveys has shown a strong perception that the level of corruption is considerable.

GRECO evaluation report on Cyprus (fourth evaluation round - Corruption prevention in respect of members of parliament, judges and prosecutors)⁹ adopted in June 2016, states that “...*It would appear that general awareness about corruption in Cyprus has increased over the years but although Transparency International’s Corruption Perception Index has ranked Cyprus among countries less affected by corruption (32 out of 168), other surveys indicate that corruption is perceived to be widespread in the country; ...*”

In the case of corruption, under-reporting or non-reporting makes the scale of the problem and the monetary values involved difficult to estimate. In addition, in a case of corruption there is usually a win-win situation whereby none of the parties involved is willing to file a report. Figures show a steady increase year by year in the number of cases investigated. From the statistical information gathered, a major increase for the year 2013 in the number of corruption cases investigated by the police is observed. A reasonable explanation could be that this was probably due to the economic crisis, which led to the collapse of the second biggest domestic bank and a massive and drastic haircut on the depositors of the biggest domestic bank, together with a bail out agreement. Citizens and also monitoring mechanisms gradually became more sensitive in reporting cases which might be related to corruption.

⁸ http://ec.europa.eu/dgs/home-affairs/e-library/documents/policies/organized-crime-and-human-trafficking/corruption/docs/acr_2014_en.pdf

⁹ [http://www.coe.int/t/dghl/monitoring/greco/evaluations/round4/Eval%20IV/GrecoEval4Rep\(2016\)7_Cyprus_EN.pdf](http://www.coe.int/t/dghl/monitoring/greco/evaluations/round4/Eval%20IV/GrecoEval4Rep(2016)7_Cyprus_EN.pdf) - GRECO fourth evaluation round on Corruption prevention in respect of members of parliament, judges and prosecutors



It should be mentioned that the Auditor General has in the course of the past three years brought to light a number of instances of corruption in the public sector which led to police investigations under the instructions of the Attorney General, resulting to some convictions.

A draft bill has been prepared by the Ministry of Justice and Public Order for the protection of “whistle - blowers” i.e. the persons who report instances of corruption.

The fact that corruption is one of the domestic predicate offences generating illegal proceeds is also evident from the number of court freezing orders following applications made by the FIU regarding criminal cases investigated by the Police.

In addition, according to the data held by the FIU, corruption is one of the main offences for which the FIU cooperates with the Cyprus Police for the purposes of tracing and freezing of illegal proceeds and in the exchange of information. Also, it is one of the offences for which the FIU receives STRs/SARs from reporting entities.

The political will and commitment to effectively address and combat acts of corruption is evident by the recently formulated National Strategy against Corruption. In particular, the Council of Ministers by its Decision with File No79.425 dated 09.09.2015, decided the draw up of a National Strategy against Corruption. For this purpose, a Committee has been set up under the coordination of the Ministry of Justice and Public Order, which has advanced in the preparation of the National Strategy.

The said Committee, in concluding the Strategy took into account the provisions of relevant International Conventions on Corruption which Cyprus has ratified, the recommendations of GRECO, the European Commission and the United Nations, the good practices of other countries, existing laws and the outcome of consultations with stakeholders from the public and private sectors. The objectives of this strategy can be summarised as follows:

- To demonstrate the magnitude of the current actions against corruption
- To identify the high risk areas of corruption and the vulnerable areas of influence from acts of corruption, in the public as well as the private sectors.
- To improve the mechanisms of protection against corruption activities and to enhance the moral values in important Offices.
- To restore and reposition full transparency aiming at combating money laundering, acts of bribery, corruption and related activities.
- To prioritise, as well as to co-ordinate the actions which the Republic will take for addressing corruption.



The National Strategy against Corruption was approved by the Council of Ministers on 28 June 2017.

Criminal offences with a medium ML threat

Tax offences

The revised 2012 FATF Recommendation 3 expands the list of designated categories of offences with the inclusion of tax crimes related to direct and indirect taxes. Similarly, the 4th EU AML Directive includes tax crimes related to direct and indirect taxes within the scope of criminal activities, as an expansion of predicate offences. Tax crimes (fraudulent evasion of taxes) are predicate offences for the purposes of the AML legislation. Also VAT evasion is also a predicate offence for ML purposes.

The Tax Commissioner¹⁰ has the legal right to compound tax related criminal offences. When the taxpayer requests the compounding of the criminal offense, the Tax Commissioner usually accepts the request according to the usual practice. In cases where the compounding is not accepted by the Tax Commissioner or the tax payer does not request compounding, the investigation unit continues with the criminal investigation process and the case is forwarded to the legal section of the Tax Department in order to evaluate the evidence gathered for filing the case before the criminal court.

The difference between the theoretical amounts of taxes due and the amount the government actually receives, i.e. the tax gap, has not been estimated by the Cypriot tax authorities.

VAT Cases

VAT cases have been filed before the criminal court not for VAT evasion but for the lesser offence of failure to pay VAT which is punishable with up to 12 months imprisonment and/or pecuniary penalty and, thus, not falling under the predicate offence definition.

Based on the VAT Law no. 95(I) of 2000, any registered person that fails to: (a) submit the VAT Return, section 46(10), (b) submit the Recapitulative Statement, section 46(11B), (c) pay the due amount as declared in the VAT Return, section 46(9), (d) pay the audit assessment issued section 46(11) and (e) deposit a bank warranty, section 46(8), commits a criminal offence and is prosecuted. In addition to the penalties imposed, the Tax Department based on Law no. 81(I) of 2014, amending

¹⁰ As from 1st July 2014 the Inland Revenue Department and the VAT Service have been integrated into the Tax Department headed by the Tax Commissioner.



the basic VAT Law, may place a MEMO on the immovable property without court order and garnishes the bank accounts with the consent of the Attorney General's Office.

Inland Revenue Cases

The Assessment and Collection of Taxes Law no. 4 of 1978 as subsequently amended provides for the obligation of the taxpayer to submit tax returns and any other documentation provided in the law or required by the Tax Commissioner. Companies and individuals that do not file their tax returns or omit to submit other documentation (i.e. capital statements) required by the Tax Department, are prosecuted. The prosecution for legal entities includes prosecution of company's directors as well. The cases are withdrawn from the court only when the taxpayer submits the required tax returns/documentation and pays the penalties.

The Debt Management Unit and the Tax District Offices are entitled to enforce collection measures. Withholding taxes are criminally prosecuted. The collection of other direct taxes cannot be criminally prosecuted, but there are other collection measures enforced provided by the Collection Law no. 31(I) of 1962 as amended with Law no. 80(I) of 2014. The Tax Department uses civil actions against debtors, issues writ on movable property and place a memo on the immovable property without court order. Furthermore, the Tax Department also proceeds to the garnishment of the bank accounts with the consent of the Attorney General's Office.

It has to be noted that the Tax Department policy is uniform for all taxpayers. International businesses are treated in the same way as local businesses and there is no segregation in the tax base. Therefore, prosecution procedures are uniform for all taxpayers.

Theft and related offences

Analyzing the statistics gathered regarding the relevant data for 2011 – 2015 for the crimes of theft and robbery, it is evident that this kind of proceed generating domestic crimes pose a risk for money laundering. For the purposes of this assessment, the offence of obtaining money by false pretenses which appears in the statistics under the same category as theft and robbery have already been taken into consideration when analyzing the fraud factor, above.

The data collected in relation to the offences of theft and robbery, does not provide a clear picture of the extent and magnitude of the ML threat these offences pose, since the available statistics do not include the amounts involved. Thus, even though the number of cases is considered to be high, it is difficult to reach any conclusions as to the volume of the generated



proceeds. From the Cyprus Police information gathered, a considerable percentage of these cases involve less substantial, in terms of proceeds, sums.

Although, as explained above, the average amount involved per case could be relatively small, the fact that burglary is the most frequent offence investigated by the police, leads to the conclusion that this kind of offences against property should be escalated to “medium” in relation to ML risks.

Trafficking in human beings

This category of offences and the statistics gathered include offences in relation to trafficking in human beings for the purpose of labour or sexual exploitation and sham marriages.

This type of offenses usually relates to financial gains. There is an increasing trend on the number of investigated cases which are also of transnational nature involving a number of persons as perpetrators or victims.

The level of cooperation between the relevant Police unit and FIU has been minimal so far and, thus, a new base of cooperation should be considered in order to evaluate the level of the ML involved in this type of offences and explore freezing and confiscation possibilities of illegal proceeds obtained.

Smuggling of tobacco

The Department of Customs and Excise (DCE) is responsible for the imposition and collection of duties and taxes on goods, the safeguarding of the supply chain of goods, the enforcement of restrictions and prohibitions on goods imported, exported or in transit and the facilitation of legitimate trade, the support of business activities’ development and the protection of the consumers health and safety.

The DCE may cooperate with the Police and the FIU in certain cases for possible application of the AML/CFT Law for freezing and confiscation purposes.

The investigation of cases of cigarettes/tobacco smuggling falls under the competence of the DCE. It refers to the fraudulent evasion of payable import duties, excise duties and VAT.

Based on the data examined there was a relatively low level of seizures for the years 2011-2012 in the number of cases and in the quantity and the value of seized items.

However an increasing trend was recorded during the years 2013-2016 (6 months).



In terms of prosecutions and convictions, the number of cases is relatively low due to the fact that, according to the Customs Code Law, the Director of DCE has the power to compound and settle out of court any offense falling under its competence. This practice is followed in most of the cases in order to secure public revenues and save administrative cost and time.

Criminal offences with medium to low level of ML threat

Smuggling of counterfeit goods

This category of offences refers to the control of movement of goods infringing intellectual property rights.

It is worth noting that during the years 2012-2014, the amount of seized counterfeit goods was over €3mio per year while for the year 2012 the value of seized goods reached the amount of €4,6mio. However, it has to be pointed out that the mentioned values correspond to the estimated values of the products as if these were the original ones and not to the value of the counterfeit products seized by the authorities. Therefore it is not possible to estimate the taxes involved.

In terms of prosecutions and convictions, the number of cases is relatively low due to the fact, as already mentioned, article 88 of the Customs Code Law 94(I) of 2004 as subsequently amended bestows powers to the Director of the DCE to compound and settle out of court any offense falling under its competence. This practice is followed in most of the cases in order to secure public revenues and save administrative cost and time.

Criminal offences with a low level of ML threat

Market manipulation according to statistics provided poses low ML threat as during 2011-2015, there was a very low number of cases investigated by the Police.

Gambling

Further to the above offences gambling cases have also been considered.

Even though the number of investigations for the years 2012-2016 for gambling offences was relatively high nevertheless from information held by the relevant police department in charge for combating offenses related to illegal gambling, it seems that the money seized by the police during the investigation of these offenses are relatively small amounts that were found on the



spot during the search and arrest procedures. These are mainly gambling offences using illegal “casino machines” or gambling in illegal gambling premises.

ML THREATS - FOREIGN ORIGIN

Even though Cyprus has a relatively low level of domestic crime from a ML point of view, it is nevertheless, as a financial center exposed to external money laundering threat i.e. money laundering of proceeds derived from the commission of predicate offences outside the jurisdiction. Cyprus is exposed to external money laundering threat as foreign criminals may seek to transfer criminal proceeds through Cyprus, mainly through the Cyprus banking system, or may seek to use professional services offered in Cyprus to facilitate their aims. A small number of cases have been identified where criminals not only seek to transfer their criminal proceeds through Cyprus but also to launder within the country, for example, in the real estate market.

The overall external ML threat level, as it is illustrated in the following paragraphs, is assessed to be high.

Threat has also been identified in relation to the transfer of criminal proceeds derived in Cyprus to other countries in an effort to conceal the criminal nature of these proceeds, to facilitate further criminality or to evade freezing or confiscation measures.

For evaluating the external threat factor, several statistical data has been taken into consideration. Of significant importance is the data on Mutual Legal Assistance requests submitted to Cyprus by foreign countries and vice versa, the data held by the FIU regarding requests for information/spontaneous reports received or sent by the FIU, as well as the data on the proceeds frozen or confiscated on the basis of foreign requests. Information on the Customs cash declarations and information held by the Tax Authorities were also considered.

Statistical information held by the FIU

The FIU keeps comprehensive data on the incoming-outgoing FIU requests/spontaneous reports, which shows the countries sending or receiving such requests on an FIU to FIU basis. Such information for the years up to 2015 is illustrated in the annual reports published by the FIU.

Foreign Mutual Legal Assistance (‘MLA’) Requests received



According to the data collected by the Ministry of Justice and Public Order which is the central authority for receiving and sending Requests for Mutual Legal Assistance, there has been an increase not only in the number of Requests received for the years 2011 to 2015 but also in the amounts concerned.

Proceeds frozen or confiscated on the basis of foreign predicates

Criminal proceeds were frozen in Cyprus during 2011 – 2016 in relation to criminal offences committed in foreign jurisdictions. These relate to domestic court freezing orders obtained by the FIU following MLA Requests submitted by foreign authorities, as well as from the registration in Cyprus of foreign freezing orders following relevant applications made by the FIU before the court, either through the MLA procedure or the EU Council Framework Decision 2003/577/JHA for the freezing of the proceeds of crime.

In the majority of the incoming MLA Requests received, which relate to the tracing of illegal assets, proceeds are located in or have been transferred through bank accounts held with banks in Cyprus, mainly in the names of companies, either registered in Cyprus or abroad. A further analysis of the freezing orders issued or registered in Cyprus on the basis of incoming MLA Requests, indicates that the majority of the companies whose assets have been frozen are registered abroad, whereas, a smaller number are Cyprus registered companies.

There have been few instances where foreign authorities have requested the restraint of real estate property in Cyprus held by the accused or convicted persons or related companies.

In assessing external threat, consideration has also been given to the following information in relation only to the countries examined for the purpose of this report:

Department of Customs and Excise cash declarations

The Department of Customs and Excise (‘DCE’) is the national authority responsible for collecting the cash declarations at the points of entry/exit of the Republic of Cyprus for the amounts exceeding €10,000 (or any other currency equivalent) in cash or gold for investment purposes.

The DCE has adopted the Common Declaration Form drafted by the European Commission within the framework of the EC Regulation 1889/2005 of the European Parliament and the



Council on control of cash entering or leaving the Community¹¹. In Cyprus, the scope of the said Regulation has been extended to apply for intra community cash movements as well.

All persons entering or leaving the Republic of Cyprus carrying amounts above the set threshold of €10.000 are obliged to submit the Common Declaration Form ('CDF') at designated customs points located at ports and airports of the country, before passing official customs controls. According to the mandatory fields of the CDF the declarant has to indicate briefly both the origin (source) and intended use of the cash / monetary instruments. In the event of false, inaccurate or incomplete information provided, the signatory of the form is considered not to have fulfilled the obligation and is liable to penalties or have cash detained or confiscated by DCE.

All cash declarations and recordings (in cases of non-compliance) are being registered into an electronic database at the points of entry/exit of the Republic of Cyprus. This data is transmitted also in electronic form at the DCE Headquarters for further processing and statistical analysis.

The DCE submits to the FIU currency declarations and seizures which are considered as suspicious for further analysis. Moreover, the FIU has direct access to the DCE's cash declaration database and the database of cash seizures in order to be utilised in the process of its analytical work.

Data held by the Tax Department on incoming and outgoing requests with other Member States

Based on the Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of Value Added Tax, all Member States are bound by information exchange requirements.

The majority of incoming requests concern verifications of transactions where no fraud is suspected. At the same time, companies taxable in Cyprus are mainly micro – small – medium companies that do not initiate the transactions, but are involved in the chain. Consequently, due the small size of the economy, the number of requests are initiated by Cyprus to other Member States is limited.

General Observation for the external ML threat

As already explained, it is observed that, as expected, Cyprus faces an external ML threat. The available statistical data gathered tends to show that Cyprus is not exposed to high risk

¹¹ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2005:309:0009:0012:EN:PDF>



jurisdictions such as those listed by the FATF, since almost all of financial interaction takes place with FATF compliant jurisdictions. Specifically, Cyprus mainly interacts with countries with which it has signed double tax treaties for the avoidance of double taxation or with which traditionally has close bonds and increased trading activity.

The attention and focus on international business activities should continue being a priority for the financial system of Cyprus, particularly by applying effectively the preventive measures of the AML/CFT Law. Furthermore, recovery of criminal proceeds has always been a priority in the Cyprus AML system and great importance is given by the Law Enforcement Authorities on international cooperation in cross border AML cases to assist in the identification, freezing and confiscation of illegal assets traced or channeled through Cyprus.

ML prosecutions on the basis of foreign predicate offences

The issue of ML prosecutions on the basis of foreign predicate offences should be further considered by LEA, the Law Office of the Republic of Cyprus and the Ministry of Justice and Public Order in order to enhance successful investigations/prosecutions. Further training of those involved will be of great importance towards this end.

Irrespective of the above, there are of course cases where the criminal trial/procedure in the foreign country is already ongoing and the money remains frozen in Cyprus for the purposes of future confiscation. A confiscation order to be issued in the foreign country will eventually be sent to Cyprus for registration and enforcement resulting in the final deprivation of the illegal proceeds.

Outgoing ML threat

Laundering in foreign jurisdictions of illegal gains obtained domestically.

Asset tracing abroad of domestically generated proceeds has not been until the very recent years a strong parameter in criminal investigations. There have not been many instances of assets been frozen abroad as a result of MLA requests submitted by Cypriot authorities for predicate offences committed within the country, the proceeds of which were transferred abroad or for the tracing of corresponding value property of the suspect in cases where no available property was traced within the country. Few instances of freezing property abroad was the result of requests sent in EU Member States for which the underlying offences were fraud and corruption.



Even though it is recognised that Cyprus LEA have taken significant steps to improve its capacity to trace and recover assets overseas, nevertheless more effort and resources should be administered in this area. In this respect, LEA need to make further and better use of the EU Asset Recovery Offices, in cases of assets tracing within the EU in addition to the possibilities of the MLA procedures.

It is worth mentioning that, the incorporation into the AML/CFT Law of the two EU Framework Decisions on freezing and confiscation namely the Council Framework Decision 2003/577/JHA on the execution in the European Union of orders freezing property or evidence and the Council Framework Decision 2006/783/JHA on the application of the principle of mutual recognition to confiscation orders, enable faster and more effective cooperation on the recovery of illegally obtained proceeds or of corresponding value property.

Exchange of information and effective cooperation between the Asset Recovery Offices established in all EU Member States as well as the use of FIU and Police channels, also contributes in this effort.

Domestic ML Threat vs. External ML Threat

As already mentioned, there is a widely accepted presumption that even though Cyprus has a relatively low level of domestic crime, it is nevertheless exposed to an external money laundering threat. Several factors have been considered so as to justify this presumption.

One such factor is the amount of the illegal proceeds frozen. Comparing the value of the proceeds frozen in cases involving domestic predicate offences with the value of the proceeds frozen in cases where the predicate offence was committed in a foreign jurisdiction but proceeds were traced in Cyprus, it became evident that the latter amount is much higher than the amount frozen for domestic predicate offences.

Also, the fact that the majority of the STRs and SARs received by the FIU from reporting entities relate to entities with business activities outside Cyprus, involving citizens of foreign jurisdictions, strengthens the position that the external ML threat is higher than the domestic one.

This finding is further corroborated by the fact that the number of the incoming MLA Requests is much higher than the number of the outgoing ones.

On the basis of the aforementioned, domestic threat level has been assessed as Medium whereas external threat level as High. Consequently, this leads to the assessment that the overall ML threat level is Medium High.



Sectors most exposed to ML threat

The sectors which have been included in the threat analysis, are also among those examined in the modules assessing vulnerability in this NRA report. For determining the sectorial ML threat, the findings of the analysis of a number of cases combined with the size of each sector or its share in the economy, as well as the estimated, to the extent possible, of undetected ML activities occurred in the sectors were taken into consideration.

From this analysis and the experience of all stakeholders involved, it emerged that from all the financial sectors considered, the banking sector is the one with the highest potential threat of being primarily used for ML. Trust and Company Service Providers ('TCSPs') or lawyers and accountants when offering companies and trust administrative services is a financial sector presenting a medium high ML threat.

The following table summarises the sectorial ML threat assessment results:

ML THREAT SECTORAL ASSESSMENT	Risk rating				
	L	ML	M	MH	H
Banking					X
Securities		X			
Insurance	X				
Remittance			X		
Real Estate			X		
Dealers of Precious Metals and Stones	X				
Auditors and Accountants (auditing and accounting services only)	X				
Lawyers (litigation only)	X				
TCSPs (supervised by CySEC)				X	
TCSPs (supervised by ICPAC)				X	
TCSPs (supervised by CBA)				X	
Betting Activities	X				



1.2 NATIONAL VULNERABILITY TO ML

Overview

A variety of factors have been considered in order to measure the overall national ML vulnerability of the country. These factors, were examined under the prism of the main economic sectors' vulnerability (as analysed by experts of each sector including regulators, supervisor and the private sector) and the national ML combating ability. The latter was assessed on the basis of numerous factors and variables, encompassing a wide spectrum of national institutions and their practices, with a view to obtain an understanding of their effective use of the legal framework in place.

A detailed reference to the national ML combating ability is included in this section of the report, whilst the analyses of the various economic sectors are set out in subsequent sections of the report.

Quality of AML Policy and Strategy

Cyprus effectively formulates its national AML policy and strategy through the Advisory Authority for Combating Money Laundering and Terrorist Financing (Advisory Authority), initially established by the Council of Ministers and subsequently through legislation¹², which functions as a policy making/advisory body for anti-money laundering and terrorist financing measures. The Advisory Authority is presided by the Attorney General of the Republic or the Head of the FIU as his representative and with the enactment of the proposed amending law of the AML/CFT law, it will be presided both by the Ministry of Finance and the FIU. Its powers entail among others the following:

- Informs the Council of Ministers of any measures taken and the general policy applied against money laundering and terrorist financing offences.
- Advises the Council of Ministers about additional measures which, in its opinion, should be taken for the better implementation of the AML/CFT Law.

The Authority is composed of representatives of the FIU, the Supervisory Authorities of the financial sector, the Ministry of Finance, the Tax Department, the Department of Customs and Excise, the Ministry of Foreign Affairs, the Ministry of Justice and Public Order, the Cyprus Police, the Department of Registrar of Companies and Official Receiver, the National Betting Authority, the Association of International Banks, the Association of Commercial Banks and

¹² Section 56 of the AML/CFT Law.



other professional bodies, organisations or services which the Council of Ministers may prescribe.

According to the findings of the Moneyval 4th MER, “the Advisory Authority appears to be an effective forum for policy type of co-operation and exchange of information and coordination on AML/CFT matters”¹³. It is the common belief of the constituent bodies that, throughout the years the Advisory Authority has been active, it has proved to be an effective body for strategic coordination between all stakeholders in the area of AML/CFT. Since its establishment, it has been meeting regularly to address strategic and coordination issues in the development of the national AML/CFT policy and strategy, including the drafting of legislative amendments often through the formulation of Ad Hoc Groups for specific issues.

Additionally, a Special Technical Committee has been in operation since 2010, comprising of representatives of all supervisory authorities of the financial sector, with a view to achieving uniformity and coherence in the regulatory framework governing supervised persons with regard to AML/CFT measures. The Special Technical Committee also meets regularly to address mainly operational issues in relation to the supervision of regulated entities.

As part of the Cyprus Economic Adjustment Programme with its international lenders, Cyprus had undergone an additional in-depth analysis of its AML/CFT legal framework in the summer of 2012 by the IMF, using as a basis the Moneyval MERs, the 2012 FATF Recommendations and related Interpretive Notes, as well as the relevant legislation, treaties and best practices. As a result of this exercise, relevant legislative amendments were fast-tracked and enacted in December 2012 and to a lesser extend in 2013.

At the same time, in April 2013, Cyprus proceeded with an in depth assessment of the effective implementation of Customer Due Diligence (CDD) requirements by banks through corresponding evaluations by Moneyval and Deloitte Italy as an independent audit firm. It is noted that such focused evaluation processes were carried out for the first time in Cyprus and never in any other country. The outcome indicated a generally solid level of compliance across the banking sector and effective implementation of customer due diligence measures¹⁴. On these

¹³ Report on Fourth Assessment Visit “Anti-Money Laundering and Combating the Financing of Terrorism” on Cyprus, doc. no.: MONEYVAL(2011)2, dated 27/9/2011, MONEYVAL Committee, Council of Europe, paragraph 720.

[http://www.coe.int/t/dghl/monitoring/moneyval/Evaluations/round4/CYP4_Sum_MONEYVAL\(2011\)02_en.pdf](http://www.coe.int/t/dghl/monitoring/moneyval/Evaluations/round4/CYP4_Sum_MONEYVAL(2011)02_en.pdf)

¹⁴ A relevant Moneyval press release on this work, as well as its report can be found at the Moneyval website link at:

[https://wcd.coe.int/ViewDoc.jsp?p=&Ref=DC-PR086\(2013\)&Language=lanEnglish&Ver=original&Site=DC&BackColorInternet=F5CA75&BackColorIntranet=F5CA75&BackColorLogged=A9BACE&direct=true](https://wcd.coe.int/ViewDoc.jsp?p=&Ref=DC-PR086(2013)&Language=lanEnglish&Ver=original&Site=DC&BackColorInternet=F5CA75&BackColorIntranet=F5CA75&BackColorLogged=A9BACE&direct=true)



two assessments, the Council of Europe had also commented¹⁵, amongst other, that “*The experienced Moneyval assessors in this special assessment were all of the view that problematic issues would be found in any country that is subject to a similarly intensive exercise*”.

Notwithstanding the generally non-negative findings in the two assessments, the assessors identified some shortcomings and areas needing improvement, offering recommendations for the strengthening of the shortcomings identified. The government, in collaboration with the programme partners (European Commission, IMF, European Central Bank) and all stakeholders, set up an Action Plan to strengthen the legislative and implementation aspects of a) preventive measures of obliged entities with respect to CDD measures, b) transparency and timely access to information on beneficial ownership of trusts c) strengthening the capacity of supervisors and developing off-site and on-site tools and procedures for a fully-fledged risk-based approach AML/CFT supervision¹⁶. This Action Plan has been successfully and fully implemented.

Subsequently to the Moneyval’s Special Assessment on the customer due diligence measures in the banking sector, Cyprus has implemented its recommendations, as mentioned in a specific report published on the 8th December 2015¹⁷.

The functions of the Advisory Authority as prescribed in the law, the participation in it of representatives of the executive (Ministry of Finance, Ministry of Foreign Affairs and Ministry of Justice and Public Order), as well as the measures already taken at national level in the field of AML/CFT especially in drawing and fully implementing an AML/CFT Action Plan on customer due diligence and entity transparency drawn up in collaboration with programme partners of Cyprus (who positively reported on its implementation), demonstrate a strong political commitment and support to fight against ML/TF.

The work of the Advisory Authority was also pivotal in discussing the initiation of a National Risk Assessment that would enable Cyprus to shed more light in vulnerabilities and threats of the system and direct corrective actions where required.

Although this is the first structured National ML/TF Risk Assessment undertaken by the Cyprus Authorities, a number of risks and vulnerabilities have been identified in the past by the

¹⁵ https://search.coe.int/cm/Pages/result_details.aspx?ObjectID=09000016805c705d

¹⁶ The action plan and its implementation can be found in the EU Commission’s Report, Annex 2 - http://ec.europa.eu/economy_finance/publications/eeip/pdf/ip009_en.pdf, also Cyprus country Report, http://ec.europa.eu/europe2020/pdf/csr2016/cr2016_cyprus_en.pdf

¹⁷ http://www.coe.int/t/dghl/monitoring/moneyval/countries/cyprus_EN.asp



Advisory Authority, which promoted a risk based approach. In this respect, the AML/CFT Law contains provisions on the application of a risk based approach, as seen in the provisions for simplified and enhanced due diligence measures and additionally, the directives issued and the risk- based supervisory tools and approach by the financial sector supervisors also adopted the concept of risk as a guiding principle. On the basis of the above, the quality of AML/CFT Policy and Strategy is considered to be high.

Effectiveness of ML Crime Definition

Criminalization of ML is considered as comprehensive in view of the fact that it is applicable to all serious offenses, including tax crimes. ML is a separate offence and extends to self-laundering, covering also third party laundering. The penalties provided for are assessed as dissuasive and proportionate when compared to penalties for other serious offenses. Criminal penalties are also applicable to appropriate offenses ancillary to the offense of money laundering, applying both to natural and legal persons¹⁸.

Comprehensiveness of Asset Recovery Laws

The asset recovery regime can be described as comprehensive since it enables the competent authorities to seize, freeze and confiscate proceeds and instrumentalities of crime¹⁹. The provisions on freezing and confiscation in the AML/CFT Law extend to the proceeds and instrumentalities of ML and its predicate offences as well as property of corresponding value. Property held by third parties may also be frozen and confiscated. LEA, including the FIU, are legally empowered to identify and trace proceeds or property and are permitted to carry out rapidly provisional measures, such as freezing, to prevent the transfer or disposal of the proceeds. Additionally, the AML/CFT Law ensures that the rights of bona fide third parties are safeguarded.

The confiscation procedure provides for the shifting of the burden of proof to the accused, who has to demonstrate on the balance of probabilities the legitimate source of the assets/property.

The AML/CFT Law entails also extended confiscation provisions.

Parts IV and IVA of the AML/CFT Law provide for the registration and enforcement of foreign freezing and confiscation orders issued in other countries, including third countries and EU Member States. If certain conditions are fulfilled, it is possible to register and enforce in Cyprus freezing and confiscation orders obtained in foreign countries. If such a registration order is

¹⁸ Section 4 of the AML/CFT Law criminalises the ML offence.

¹⁹ The provisions on confiscation, freezing and restraining the proceeds of crime are set out in Part II of the AML/CFT Law.



issued by the court, the confiscation or freezing order becomes enforceable as if it had been made by a domestic court.

According to the findings of the 4th MER by Moneyval, Cyprus has a generally comprehensive, robust and well balanced confiscation and provisional measures regime which gives competent authorities the ability to freeze and confiscate assets in appropriate circumstances²⁰.

The effectiveness of the asset recovery regime provided for in the AML/CFT Law is demonstrated by the number of the court orders obtained in investigated cases, as well as the registration and enforcement of foreign orders.

Quality of FIU Intelligence Gathering and Processing

The FIU was established according to Section 54 of AML/CFT Law²¹ and became operational in January 1997. Section 55 of the same law sets out, in detail, the composition and functions of the FIU. The FIU is a multidisciplinary unit established within the structure of the Law Office of the Republic and is staffed by officials from the Attorney General's Office, the Police and the Department of Customs and Excise as well as financial analysts. Currently, it is composed by a total number of 20 persons, including its Head and administrative staff.

The FIU functions effectively and has adequate capacity, including enhanced IT facilities to trigger and support ML intelligence analysis and has independence and autonomy to perform its activities without fear or favour²². The current human resources of the Unit allow for relatively satisfactory undertaking of its functions. However, taking into consideration the growing numbers of SARs/STRs received in the last years, the growing numbers of requests for information from foreign counterpart units and other competent authorities including MLA Requests received, the FIU's central role in freezing and confiscation and the increased commitments of the FIU in international fora, as well as the enhanced role of the FIUs based on the provisions of the 4th EU AML/CFT Directive, the current human resources of the FIU should and will be reinforced to enable the FIU to better exercise its functions. In this regard, the current structure of the FIU needs also to be revised and consequently additional budgetary needs should be addressed. This issue has already been addressed by the Ministry of Finance.

²⁰ Report on Fourth Assessment Visit "Anti-Money Laundering and Combating the Financing of Terrorism" on Cyprus, doc. no.: MONEYVAL(2011)2, dated 27/9/2011, MONEYVAL Committee, Council of Europe, paragraph 4 and paragraph 125, [http://www.coe.int/t/dghl/monitoring/moneyval/Evaluations/round4/CYP4_Sum_MONEYVAL\(2011\)02_en.pdf](http://www.coe.int/t/dghl/monitoring/moneyval/Evaluations/round4/CYP4_Sum_MONEYVAL(2011)02_en.pdf)

²¹ This law was amended and consolidated with the AML/CFT Law.

²² The fact that the FIU functions within the Law Office of the Republic, headed by a representative of the Attorney General of the Republic, safeguards and guarantees the autonomy and operational independence of the FIU. According to Section 113 of the Constitution of Cyprus, the Law Office of the Republic is an independent office from the executive.



The powers and functions of the FIU address successfully all the elements of FATF Recommendation 29. In particular, the FIU is the authority responsible for gathering, evaluation and analysis of suspicious transaction reports relevant to laundering offences, associated predicate offences and terrorist financing²³. The Unit disseminates to the Police and other Governmental Services, as the Tax Department and DCE, if deemed desirable, information and material (a) for the purposes of conducting investigations whenever there are reasonable grounds for believing that a money laundering offence, other offences or terrorist financing offences have been committed or (b) for intelligence purposes²⁴. Information may also be disseminated to Supervisory Authorities²⁵ for possible actions in implementation of their competencies under the AML/CFT Law and for possible disciplinary actions in case of lawyers. The FIU has access to financial, administrative and law enforcement information, including through an application to the court for obtaining a Disclosure Order²⁶. It may also request certain financial information without the need of a disclosure court order. The FIU may also request financial information from obliged entities that have not filed STRs and also additional financial information from reporting entities.

It may issue directives for the better exercise of its functions and issue instructions to persons engaged in financial and other business activities for the suspension or non-execution of a transaction, or the monitoring of the movement of a bank account, whenever there is reasonable suspicion that the transaction is connected with money laundering or terrorist financing. These powers may also be exercised in case of requests submitted to the FIU by foreign competent Authorities. Other functions of the FIU include application to the court for freezing and charging orders²⁷.

The FIU is a member of the Egmont Group since June 1998. It cooperates with foreign counterpart FIUs and can exchange information with any type of Unit of other countries (judicial, police, administrative), without the need of a MoU. It has the ability to submit spontaneous information to its foreign counterparts based on its STRs/SARs analysis. This is very important since a vast majority of the STRs/SARs received relate to foreign entities or foreign natural persons.

Finally, the FIU actively participates in various international fora in the area of ML/TF and asset recovery and acts as the Head of Delegation in Moneyval plenaries.

²³ Section 55(1)(a) of the AML/CFT Law and Section 9 of the Law No. 29 (I) 2001 on the Ratification of the UN Convention on the Suppression of the Financing of Terrorism.

²⁴ Section 55(1)(b) of the AML/CFT Law.

²⁵ Section 59 (9) of the AML/CFT Law.

²⁶ Sections 55(2)(c), 45, 46, 68B of the AML/CFT Law and Section 4 of the Criminal Procedure Law (Cap.155).

²⁷ Sections 14 and 15 of the AML/CFT Law) and confiscation orders (Sections 6-13 of the AML/CFT Law.



Reporting suspicious transactions

Obligated entities as prescribed in the Law have to report to the FIU any information or other matter when ascertained or have reasonable suspicions that another person is engaged in money laundering or terrorist financing or that the transaction may be connected to such activities. The obligation to report to the FIU includes also the attempt to execute such suspicious transactions²⁸. In this respect, the FIU receives annually and analyses an increasing number of STRs and SARs. As indicated by statistical data, the majority of these reports are submitted by the banking sector, while other sectors lag significantly behind in reporting, though during the years 2013-2015 an increase of DNFBPs reporting with respect to lawyers and accountants is noted.

Special attention should thus be given to the continuation of training and raising awareness of the whole non-financial sector with regard to the identification and submission of STRs/SARs.

Capacity and Resources for Financial Crime Investigators

ML investigations are carried out by Police investigators. Investigators of the DCE conduct investigations on customs related financial offences.

Serious financial crime cases are usually investigated by the Economic Crime Investigation Office of the Department of Combating Crime at the Police Headquarters. Financial crime cases are also undertaken by the District Crime Investigation Departments (CIDs). Police investigators receive training on financial crime and money laundering. However, it has been identified that the Economic Crime Investigation Office of the Cyprus Police has additional needs with respect to human and technical resources.

Investigations carried out by the DCE focus on customs' offences that could be connected to money laundering offences.

Financial crime investigators have powers to use compulsory measures for the production of records held by financial institutions, DNFBPs and other natural or legal persons, for the search of persons and premises, for taking witness statements, for the seizure and obtaining of evidence and they also cooperate effectively with other domestic and international investigative agencies and a mechanism is in place to ensure that investigative authorities have the means to identify assets without prior notice to the owner.

²⁸ Section 69 (d) of the AML/CFT Law.



The competent authorities conducting investigations are able to use a wide range of investigative techniques for the investigation of money laundering, associated predicate offences and terrorist financing, including undercover operations, accessing computer systems and controlled delivery. However, by virtue of Article 17 of the Constitution, intercepting communications is only allowed for a very limited range of criminal offences, not including money laundering and terrorist financing. Thus consideration should be made as to expanding the application of intercepting communications to cover also these criminal activities.

Additionally, awareness of Police and DCE investigators should be enhanced, so as to consider in the framework of conducting criminal investigations with respect to predicate offences, the possibility of commission of laundering offences. In this respect, law enforcement authorities should conduct “parallel” financial investigations in more cases, when deemed necessary, especially in serious cases, alongside or in the context of a traditional criminal investigation.

Integrity and Independence of Financial Crime Investigators (including Asset Recovery)

Financial crime investigators act free from undue influence and enjoy sufficient operational independence and autonomy. On the basis of no allegations with regard to integrity breaches of FIU and DCE investigators and the extremely low number of cases against police investigators, it may be concluded that financial crime investigators display high professional standards and act with integrity.

There are legal provisions to safeguard the integrity of the investigators. Investigations into possible money laundering and asset forfeiture appear to be instituted without interference, political or social pressure, corruption, intimidation or abuse of office. There is no indication that investigations into allegations of ML offenses by powerful members of society and high-profile criminals are not instituted and concluded in an objective and professional manner and, additionally, there is no indication or allegation that the FIU and police investigators abuse their powers.

With regard to police investigators in general, on the basis of the statistics provided it may be concluded that the level of corruption amongst police officers is low. It is noted that in this regard, any allegations or complaints against police investigators, including corrupt practice in the performance of their duties or bribery may be submitted to an Independent Commission responsible for the Investigation of Allegations and Complaints Against the Police, which was established by virtue of Law no. 9(I)/2006.



Additionally, within the Police, the Police Professional Standards, Audit and Inspection Directorate is missioned to secure professional standards within Cyprus Police, by improving and upgrading its internal practices and procedures and by introducing and implementing mechanisms for preventing, controlling detecting and suppressing the deviant and/or delinquent behaviors of its members that damage its credibility and reliability. The duties and responsibilities of this Directorate include collection, recording, processing, evaluating and examining all information related to deviant and/or delinquent behavior by members of the Police that comes to its attention, including through anonymous sources and maintains cooperation with the Independent Commission responsible for the Investigation of Allegations and Complaints against the Police.

A recent legislation provides for the establishment of the Internal Affairs Service within the Police which will further enhance the current structures to effectively prevent and combat corruption within the Police.

Capacity and Resources for Financial Crime Prosecutions

There are no specialised financial crime prosecutors within the Law Office of the Republic even though in practice, the most experienced prosecutors deal with the serious financial crime cases. Prosecutors are members of the Law Office of the Republic. They possess adequate capacity and resources to prosecute financial crime, money laundering and predicate offences and additionally to respond sufficiently in respect of the procedure to obtain court provisional and confiscation orders. It should be clarified that confiscation procedure is carried out by the Prosecutors of the law Office of the Republic with the assistance in some cases of the lawyers of the FIU especially if the FIU has obtained a freezing Court order. The perspective of law enforcement agencies with respect to the capacity and resources of prosecutors in general is that they possess the necessary capacity and experience to sufficiently prosecute financial crime offences and in general money laundering offences. Furthermore, prosecutors receive training both in Cyprus and in other countries or International Organisations.

Additionally, legal provisions are in place to ensure access of the prosecutors to all necessary documents, information and evidential material for use in prosecutions.

However, taking into consideration the complexity of financial crime, money laundering and terrorist financing cases, prosecutors should receive more training focused on these topics and on the freezing and confiscation of illicit proceeds.



Integrity and Independence of Financial Crime Prosecutors

There are legal provisions in place to safeguard and preserve the integrity of Public Prosecutors and Legal Officers of the Law Office of the Republic, including FIU legal officers (prosecutors). Safeguards are also in place to secure that prosecutions of alleged money laundering and related financial offenses are instituted without interference, political or social pressure, corruption, intimidation or abuse of office. Moreover, it should be noted that prosecutors operate under the auspices of the Attorney General of the Republic whose independence is guaranteed by the Constitution.

No allegations were reported with respect to integrity breaches by public prosecutors or by legal officers of the Law Office of the Republic including FIU prosecutors and no criminal proceedings were initiated during the period 2011-2016 against prosecutors with respect to acts of illicit enrichment, corruption and bribery, with the exception of only one case.

The Transparency International recognises that *“The Judiciary in Cyprus is held in high esteem by the general public as they are generally considered incorruptible.”*²⁹

The GRECO Fourth Evaluation Report “Corruption prevention in respect of members of Parliament, judges and prosecutors” adopted at 1st of July, 2016³⁰, contains certain recommendations as corruption prevention measures with respect to prosecutors which need to be addressed.

Capacity and Resources for Judicial Processes

The Judicial system functions effectively. This is supported by the qualifications required for their appointment and the positive perception of law enforcement authorities with regard to the capacity of judges in the adjudication of cases regarding financial crime and other predicate offences.

However, considering the complexity of financial crime, money laundering and terrorist financing, judges should receive more training focused on these topics, as well as on freezing and confiscation.

Integrity and Independence of Judges

²⁹ Transparency International Report on Anti-Corruption Measures in Cyprus, March 2013, page 10

³⁰ [http://www.coe.int/t/dghl/monitoring/greco/news/News2016/News\(20160727\)Eval4_Cyprus_en.asp](http://www.coe.int/t/dghl/monitoring/greco/news/News2016/News(20160727)Eval4_Cyprus_en.asp)



Judicial independence is safeguarded by the Constitution. The doctrine of the separation of powers precludes any intervention by the legislature or the executive in the administration of justice and the exercise of judicial control. The doctrine is well established all over the constitutional text, since there are separated Parts therein, each of which provides for the competences and powers of the legislative, executive and judicial authority.

According to the Constitution, Supreme Court judges “shall be permanent members of the judicial service and shall hold office until they attain the age sixty-eight” (Section 133.7). District Court Judges must retire at the age of 63³¹.

No allegations were reported with respect to integrity breaches by judges for the period 2011 – 2016, including both criminal proceedings and disciplinary measures.

As already mentioned Transparency International recognises that “*The Judiciary in Cyprus is held in high esteem by the general public as they are generally considered incorruptible.*”³²

Quality of border controls

Cyprus is an island with only air and sea borders. Border controls to the entry/exit points of the Republic of Cyprus are undertaken by the Police and by the DCE with respect to the areas under its competency. The controls undertaken and the relevant Laws and Regulations are in line with the EU acquis in this respect. The Schengen acquis with respect to the controls at external borders is applicable.

Entry/exit points of the Republic may be used in some cases as a route for smuggling trade in goods and drugs and in very few cases for illegal migration, however the measures undertaken by the authorities in relation to border controls are considered as sufficient to address the potential risks.

With respect to cash smuggling at entry/exit points, the analysis under variable “Effectiveness of Customs Controls on Cash and Similar instruments” and the statistical data provided illustrate a satisfactory ability to deter attempts for unauthorised transportation of cash.

An area of concern with regard to illegal migration and smuggling of goods and drugs is the “Green Line”³³ which though it does not constitute an external border of the Republic of Cyprus, it allows for the crossing of persons and goods to and from the areas of the island which are not

³¹ Section 8(2) of the Courts of Justice Law of 1960 (Law 14/1960), as amended.

³² Transparency International Report on Anti-Corruption Measures in Cyprus, March 2013, page 10

³³ Council Regulation (EC) No 866/2004 on a regime under Article 2 of Protocol No 10 to the Act of Accession.



under the effective control of the Government of the Republic of Cyprus. Nevertheless, Police and Customs Authorities conduct relevant checks.

Comprehensiveness of Customs regime on Cash and Similar Instruments

The DCE applies a comprehensive and well-designed legal and regulatory framework which allows for effectively informing travellers entering and leaving Cyprus about their declaration obligations and the consequences of any wrongdoing and allows the Department to effectively detect and deter any unauthorised physical cross-border transaction of cash covering both bearer negotiable instruments and currency, as well as gold, as provided for by EU Regulation 1889/2005. It is noted that national law covers also controls of intra-community cash movements and gold and Cyprus is one of the few EU Member States which applies this measure with respect to arrivals/departures from/to EU Member States as well.

Consideration is made to introduce an obligation for declaring precious stones and metals (other than gold), since there is a process of revising the EU Regulation 1889/2005, under which these items may be included in the definition of cash.

National legislation provides that when indication or reasonable suspicion arises for the commission of money laundering offences, the DCE reports the case to the FIU for further investigation, in line with EU Regulation 1889/2005.

Effectiveness of Customs Controls on Cash and Similar Instruments

The DCE informs all passengers with regard to limitations on cash transportation and their relevant declaration/disclosure duties as well as the legal consequences of any violations.

Screening procedures and equipment are in place in order to conduct the screening and random or risk-based physical search to detect unauthorised/illegal cash transportation by persons or vehicles and shipping containers entering or leaving the country are in accordance with the EU acquis in this respect.

However, according to the statistical analysis it seems that the effectiveness in the incoming and outgoing cash controls is not the same.

In this respect targeted cash controls for incoming passengers should be applied since controls are not equally effective for incoming and outgoing cash.



Effectiveness of domestic cooperation

The Advisory Authority for Combating Money Laundering and Terrorist Financing, as mentioned above, functions as a policy making body for anti-money laundering and terrorist financing measures and provides the forum for the necessary domestic coordination and cooperation³⁴.

Legislative provisions and practical arrangements are in place to allow for effective cooperation between the FIU, law enforcement authorities and prosecutors to combat money laundering and terrorist financing³⁵ and apply relevant freezing and confiscation measures.

There are sufficient legal provisions concerning cooperation between the FIU and reporting entities and this is applied in practice since the FIU provides proper feedback to reporting entities with respect to all SARs/STRs submitted³⁶. Sufficient legal provisions are also in place concerning cooperation between the FIU and the Supervisory Authorities³⁷ and this cooperation is implemented in practice through exchange of information leading to investigations, inspections and imposition of sanctions.

The existing legislation and practices with respect to domestic cooperation well supports the findings of the Moneyval 4th MER, that Cyprus has effective mechanisms for coordination and co-operation among all domestic AML/CFT stakeholders³⁸ and moreover, operational co-operation between the FIU and other law enforcement authorities which takes place at the working level seems to be well-balanced and operable³⁹.

Even though channels of cooperation do exist and these are efficient and effective, nevertheless space for improvement still exists in order to enhance this cooperation.

Effectiveness of International Cooperation

Cyprus is a party to and fully implements all international instruments provided for in FATF Recommendation No.36⁴⁰. Additionally, international instruments have been signed and

³⁴ The composition of this Authority is provided for in Section 56 of the AML/CFT Law.

³⁵ Section 55(1)(b) of the AML/CFT Law, Section 4(4) of the Customs Code Law of 2004 (L.94(I)/2004 as amended), Section 9 of the Control of Cash Entering or Leaving the Community and the Exercising of Intra-Community Cash Control Law 53(I)/2009, Section 24(2) of the Police Law of 2004 (L.73(I)/2004 as amended), Police Order no.3/40, paragraph 4.

³⁶ Section 55(1)(f) of the AML/CFT Law.

³⁷ Section 59(7) and 59(8) of the AML/CFT Law.

³⁸ Report on Fourth Assessment Visit “Anti-Money Laundering and Combating the Financing of Terrorism” on Cyprus, doc.no.: MONEYVAL(2011)2, dated 27/9/2011, MONEYVAL Committee, Council of Europe, paragraph 1.

³⁹ Cyprus Report on Fourth Assessment Visit “Anti-Money Laundering and Combating the Financing of Terrorism”, doc. no.: MONEYVAL(2011)2, dated 27/9/2011, MONEYVAL Committee, Council of Europe, paragraph 250.

⁴⁰ - United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Vienna Convention) (ratified by Law 49/1990).



ratified⁴¹ and various bilateral Conventions have been concluded, effecting mutual legal assistance in criminal matters. This cooperation is effected through the application of the provisions of the domestic law, namely the International Cooperation in Criminal Matters Law of 2001.

Joint investigation teams with competent authorities of other jurisdictions may be established, or the competent law enforcement authorities may participate to such teams, for the investigation of any criminal offence including money laundering, associated predicate offences and terrorist financing⁴².

Additionally, there were various instances where in the process of executing MLA Requests foreign investigators upon relevant request participated to the local investigations.

The central authority for receiving/sending MLA requests is the Ministry of Justice and Public Order, which maintains a case management system to monitor progress on requests sent for execution to the various law enforcement authorities. In cases of urgency, mechanisms are in place to ensure rapid execution and such requests may be received also via Interpol channels. The respecting Unit of the Central Authority is the International Legal Cooperation Unit, which is currently staffed with 5 officers.

Financial information may also be exchanged on an FIU to FIU basis and for EU Member States between Asset Recovery Offices ('AROs').

International cooperation in exchange of information in relation to combating serious crime, including money laundering, associated predicate offences and terrorist financing is effected through Interpol channels, FIU channels, Customs cooperation channels and tax information exchange channels. International law enforcement cooperation is also effected in implementation of the corresponding provisions of the European and International Conventions to which Cyprus

-
- United Nations Convention against Transnational Organized Crime and the Protocols Thereto (Palermo Convention) (Ratification Law 11(III)/2003).
 - United Nations Convention Against Corruption (Merinda Convention) (Ratification Law 25(III)/2008).
 - International Convention for the Suppression of the Financing of Terrorism (Ratification Law 29(III)/2001 as amended by Law 18(III)/2005).
 - Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime (Strasbourg, 08/11/1990) (Ratification Law 18(III)/95).
 - Convention on Laundering, Search and Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism (Warsaw, 16/05/2005) (Ratification Law 51(III)/2007).
- ⁴¹ - European Convention on Mutual Legal Assistance in Criminal Matters and its Additional Protocol (Ratification Law 2(III)/2000).
- Second Additional Protocol to the European Convention on Mutual Legal Assistance in Criminal Matters (Ratification Law 5(III)/2012 as amended by Law 19(III)/2014).
 - Convention on Mutual Assistance in Criminal Matters between the Member States of the European Union and its Additional Protocol (Ratification Law 25(III)/2004).

⁴² Joint Investigations Teams Law of 2004 (244(I)/2004 as amended by Law 98(I)/2011).



has acceded. With regard to cooperation with EU Member States, Cyprus implements the EU acquis in law enforcement cooperation including cooperation via Europol channels and has incorporated into national law all corresponding legislative instruments either through legislation or through adoption via relevant Decisions of the Council of Ministers.

Cyprus has also signed and ratified a number of Bilateral Agreements in this respect which provide, inter alia, for the exchange of information and other forms of cooperation.

With regard to international cooperation on tax matters⁴³ and Customs cooperation⁴⁴, Cyprus has a broad legal basis and mechanisms in place for providing mutual administrative assistance to its partners.

Cyprus has an exchange of information relationship with 64⁴⁵ jurisdictions through a network of Double Taxation Treaties (DTTs). The Republic of Cyprus has also signed The Multilateral Convention on Mutual Administrative Assistance in Tax Matters in 2014 which entered into force in April 2015. With these two instruments Cyprus is in a position to exchange information for tax purposes with more than 100 jurisdictions.

At the same time, Cyprus, as of 2014, has been a member of the Automatic Exchange of Financial Information initiative which is under the Global Forum mandate, aiming to tackle tax evasion and safeguarding transparency (Common Reporting Standard/Multilateral Competent Authority Agreement). Together with 61 jurisdictions and countries, Cyprus has signed in October 2014 the Multilateral Competent Authority Agreement (MCAA) which provides that two or more parties can mutually agree to exchange financial information automatically on an annual basis.

Cyprus is already involved in exchanging information automatically with other EU member states. This takes place under the scope of EU Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments.

Other legal basis by which Cyprus exchanges tax information is the Council Directive 2011/16/EU on administrative cooperation in the field of taxation which was amended by EU

⁴³ Double Tax Agreements, on EU Directives and on Multilateral Agreements such as the Convention on Mutual Administrative Assistance in Tax Matters.

⁴⁴ - Convention on mutual assistance and cooperation between customs administrations (Naples II) (Ratification Law 29(III)/2004).

- Council Regulation (EC) No 515/97 of 13 March 1997 on mutual assistance between the administrative authorities of the Member States and cooperation between the latter and the Commission to ensure the correct application of the law on customs and agricultural matters.
- Council Regulation (EU) No 389/2012 of 2 May 2012 on administrative cooperation in the field of excise duties and repealing Regulation (EC) No 2073/2004.
- Council Decision 2013/52/EU of 22 January 2013 authorising enhanced cooperation in the area of financial transaction tax (in relation to excise duties).
- Bilateral Agreements with third countries.

⁴⁵ http://www.mof.gov.cy/mof/mof.nsf/page26_en/page26_en?OpenDocument



Council Directive 2014/107/EU. The Directive was recently amended by extending the cooperation between tax authorities to automatic exchange of financial account information. The Directive provides inter alia for the exchange of banking information on request for taxable periods after 31 December 2010 (Article 18).

On the practical implementation of the Global Forum on Transparency and Exchange of Information for Tax Purposes standard, Cyprus has been assessed by the Global Forum, through the Peer Review Process. In the latest relevant report, the Supplementary Peer Review Report, Phase 2, Implementation of the standard in practice⁴⁶, adopted by the Global Forum Plenary in October 2015, Cyprus has been rated overall as Largely Compliant to the implementation of the standard, with 7 parameters rated as Compliant and 3 parameters rated as Largely Compliant. In this report it is stated that the authorities have successfully responded to 1061 requests from counterparts in the two-year review period July 2012 – 30 June 2014. According to the recently adopted by the Global Forum new terms of reference, Cyprus will preliminary be reassessed during the 1st half of 2019.

Supervisory Authorities of the financial sector and other business activities exchange information and maintain wide range of cooperation with foreign counterparts in a timely and effective manner, including providing assistance to foreign supervisory authorities. Information exchange can be made upon requests or spontaneously on issues falling within their respective competency and may include information on money laundering and terrorist financing⁴⁷.

Availability of Independent Audit

The Companies Law Cap. 113 provides that "Directors of the companies shall cause proper books of accounts to be kept which are deemed necessary for the preparation of financial statements in accordance with the Law." (article 141) and that "Directors of the companies shall cause for every company to make a complete set of financial statements, as this set is prescribed by the International Accounting Standards" (article 142). Therefore, as per the Company Law, all companies are obligated to prepare and submit their annual returns and

⁴⁶ <http://www.oecd.org/tax/transparency/cyprus-supplementary.pdf>

⁴⁷ Section 27(1) of the Business of Credit Institutions Law of 1997 to 2015 (http://www.centralbank.cy/nqcontent.cfm?a_id=11504), Section 29 of the CySEC Laws 2009 to 2015 (<http://www.cysec.gov.cy/en-GB/legislation/cysec/main-legislation/>).



financial statements with the Registrar of Companies, which follow the International Accounting Standards from as back as 1981.

The obligation to keep proper books and record, stems also from the Assessment and Collection of Taxes Laws (article 30) according to which, entities must prepare financial statements and audit them according to the adopted standards, which in the case of Cyprus are the International Accounting and International Auditing Standards. Indeed, the Cyprus Tax Department only accepts audited financial statements based on International Standards on Auditing (ISA) in relation to income tax Returns. The use of International Auditing Standards is also prescribed by the Auditors Law of 2017. Moreover, all auditors, are required to report on corporate governance matters, conflict of interest and threat to independence if such matters arise during the audit engagement.

The Cyprus Public Audit Oversight Board (CyPAOB), is the ultimate competent authority for the audit profession in Cyprus. The Institute of Certified Public Accountants of Cyprus (ICPAC) is the sole Recognised Body of Auditors to which the CyPAOB delegated all licensing authorities, as well as monitoring and disciplinary authorities that do not relate to Public Interest Entity (PIE) auditors. Both the CyPAOB and ICPAC regulate the accounting and auditing profession, providing an organizational framework to all professional accountants, as well as continual guidance to the members of ICPAC. ICPAC licenses all professionals who fulfill the criteria set by the Auditors Law of 2017 and the Regulations of the Institute. ICPAC also adopted the IFAC Code of Ethics for Professional Accountants as issued by the International Ethics Standards Board for Accountants (IESBA), as the ethical code of conduct for its members. ICPAC has the responsibility of monitoring its members and their firms via an audit monitoring review performed for all auditors and audit firms using the ISA's. ICPAC has also been designated as a competent authority through the AML/CFT Law and is responsible to monitor the compliance of all licensed firms and insolvency practitioners with the provisions of the Law, via the AML Rules and Regulations.

There has been one documented case relating to integrity breach in the last few years that has resulted in imposing restrictions of the audit license of the practitioner. There are also two more cases whose assessment is in progress with the disciplinary committee of the ICPAC.

Taking the above, into consideration, the availability of Independent Audit is considered to be very high.

Level of Financial Integrity



Financial integrity focuses on the quality of business and professional ethics as well as tax transparency. Legislation and mechanisms are in place to provide for transparency of financial matters of citizens and residents, including legal arrangements registered in Cyprus, and the sharing of information by the Tax Authorities and Law Enforcement Agencies.

The Cyprus Tax System has been reformed with effective date the 1st January 2003. The major objectives of the tax reform were:

- Harmonization with the EU acquis.
- Compliance with the EU Code of Conduct for Business Taxation and with the commitment to the OECD for the elimination of harmful tax practices.
- Modernization and simplification of the tax system.
- Reduction of marginal tax rates and broadening of the tax base.
- Reduction of the tax burden, in particular for middle and lower income classes, thus securing broad political support for the tax reform.

Since then, several sections in the tax legislation have been amended in order to be in line with the EU provisions or for implementation purposes. In accordance with Cyprus's commitment towards the OECD and the EU, all measures that were considered as harmful tax practices were abolished, and the updated legislation, which has already been approved by the EU, is in line with the EU Code of Conduct for Business Taxation.

LEA, in the framework of investigation of ML offences by a taxpayer, have access to information held by the Tax Department. In addition, the Tax Department shares information with international law enforcement and tax agencies through spontaneous queries, as envisaged in Article 26 of the OECD's Model Tax Convention. The Tax Department also has access to full financial records, after the Attorney General's approval, to trace the money flow.

In the field of trade, according to the records kept by the DCE, the compliance of the traders in relation to the irregularities found in their customs declarations for imports and exports is considered to be extremely high.

The professionals in Cyprus dealing with financial and taxation compliance mostly comprise of accountants/auditors, lawyers and administration service providers (ASPs).

Furthermore, based on domestic laws and regulations noted above, all limited companies and self-employed persons who generate revenue in excess of €70,000, should prepare and file audited financial statements on an annual basis and audit opinions should be based on the international financial reporting standards, thus as a result financial records are reliable, accurate and confirmed.



In the field trust and company services offered to third parties by lawyers usually having a role of Company Secretary or Director, the filing of tax returns and companies' annual returns of clients, are among the documents inspected by the Cyprus Bar Association and their absence is noted as a deficiency for the obliged entities, necessitating remedial action.

With respect to investment firms and companies providing administrative services, CySEC's licensing procedures include a 'fit and proper' test for all shareholders holding more than 10% of the regulated entity's capital [Sections 11-14 of the Investment Services and Activities and Regulated Markets Law of 2017 ('the Investment Services Law' 87(I)/2017) and section 8 of the Law Regulating Companies Providing Administrative Services and Related Matters of 2012 ('the ASP Law' 196(I)/2012)]. A 'fit and proper test' is also required for the members of the board of directors of investment firms and companies providing administrative services as per section 9 of the Investment Services Law and section 7 of the ASP Law, respectively. In addition, section 21 of the Commission Delegated Regulation (EU) 2017/565, as regards organisational requirements and operating conditions for investment firms and section 9 of the ASP Law require that the persons employed by the regulated entity must be of sufficiently good repute and have the necessary skills, knowledge and expertise for performing their assigned responsibilities.

Furthermore, Part 2 and Part 3, Chapter II (Operating conditions for investment firms) of the Investment Services Law includes provisions to ensure investor protection and provide the entities' obligations for market transparency and integrity.

As far as the insurance sector is concerned, the Law on Insurance Services and other Related Issues of 2002-2013, includes a 'fit and proper' testing for any person acquires directly or indirectly a qualifying holding in the capital or the voting rights of a Cyprus insurance company, with a percentage exceeding 10% or more. The 'fit and proper' test requires that such person has a good repute, good financial status, clean criminal record and the necessary expertise in order to fulfil its obligations and responsibilities as detailed in the aforementioned law.

With regard to the banking and the payments sector, it is pointed out that this is a highly regulated line of business in many aspects such as the shareholders of licensed institutions, the fitness and probity of management and the overall operational framework. For the significant credit institutions, it is also noted that the operational and regulatory framework lies within the remit of the Single Supervisory Mechanism under the European Central Bank.

International tax relations



In addition to Cyprus membership of the European Union which is set out above, highlights of other international relations in tax matters are set out below:

1. Network of double tax treaties

Currently, there are 64 DTTs in force, covering most European Countries, the USA, Canada, China, India, South Africa, Singapore, Russian Federation, Ukraine and various Arab countries.

2. Multilateral Convention on Mutual Administrative Assistance in Tax Matters

The Multilateral Convention on Mutual Administrative Assistance in Tax Matters was signed by the Republic of Cyprus in 2014 and entered into force in April 2015. Cyprus, as one of the countries that have signed the Convention, is committed to full exchange of information in tax matters, signaling its determination to work together with all other signatory countries towards moving to the next phase of full transparency and exchange of information in a globalised world.

3. Common Reporting Standard/Multilateral Competent Authority Agreement

Along the same lines, Cyprus, as of 2014, has been a member of the Automatic Exchange of Information initiative which is under the Global Forum mandate, aiming to tackle tax evasion and safeguarding transparency. Cyprus has signed together with 61 jurisdictions and countries, the Multilateral Competent Authority Agreement (MCAA). The MCAA specifically provides that two or more parties can mutually agree to exchange financial account information automatically on an annual basis.

Out of these 61 signatories, 48 belong to the group collectively known as the Early Adopters Group (Cyprus is included), who have committed to early adoption of the new global Common Reporting Standard and which provides for specific timelines for implementation, with the first exchange of information taking place in 2017. To that respect Cyprus has incorporated into its regulatory and legal framework as of 1/1/2016 the relevant provisions that regulate the effective implementation of the CRS. This is in the form of Decree.

4. FATCA

Cyprus and USA signed on the 2nd of December 2014 the Intergovernmental agreement for the implementation of the US Foreign Account Tax Compliance Act, encouraging better tax compliance by preventing US Persons from using banks and other financial organizations to avoid US taxation on their income and assets. This is considered as a step forward to enforcing transparency, combating tax evasion and enhancing, inter alia, the political and economic ties between the two countries.

5. Global Forum Phase 2 Supplementary Report



The initiation of a supplementary of the OECD in 2014 review, resulted in the compilation of a Supplementary Report on Cyprus following an onsite visit performed by a Global Forum assessment team. The conclusion of the report is of an overall rating of Largely Compliant, recognizing the significant progress made and compliance with the standard.

Assessing the above, the Level of Financial Integrity is considered to be high.

Effectiveness of Tax Enforcement

As from 1st July 2014, the Inland Revenue Department and the VAT Service have been integrated into the Tax Department.

The Tax Department is staffed by persons with appropriate training and skills to perform their duties. Some constraints raised from the shortage of staff, are expected to be minimised, taking into consideration that the new organizational structure of the Tax Department intends to develop a function based organization instead of tax based organization, operating under simplified and clear processes, based on worldwide best practices to achieve economies of scale.

Constraints arising from the concurrent unification process have impacted on the audit programme of the Tax Department, but the Design and Monitoring Units have worked towards the implementation of a targeted audit program for 2017 and 2018.

The current tax legal framework provides for obtaining any kind of information either for direct or indirect taxes. Administrative penalties of €100-€200 are either imposed for late submission of returns, or for any document requested by the Commissioner, or any other obligation provided by the tax legislation. Non submission of income tax returns is also prosecuted before the court. There are also interests, penalties and surcharges for late payments and also collection enforcement measures for non-payments, i.e. MEMO on immovable property, Writ, garnishing bank accounts etc. The intention of the Tax Department is to increase the amount of the administrative penalties, in order to render them more dissuasive. In this regard, a relevant amendment of the Assessment and Collection of Taxes Law will be pursued.

Furthermore, the Tax Department also proceeds to the garnishment of the bank accounts with the consent of the Attorney General's Office. This measure was introduced in 2014 and was exercised during 2015 on a pilot basis resulting to approximately €1mil garnished amount.

The Tax Commissioner has the legal right to compound tax related criminal offences. When the taxpayer requests the compounding of the criminal offense, the Tax Commissioner usually accepts the request according to the usual practice. The standing policy of the Tax Department is to achieve an out of court settlement to avoid court procedures which are time consuming,



considering also the difficulties in establishing a criminal offence and the working hours required to properly investigate a case.

With respect to VAT cases (not compounded or compounded), this policy has proved quite effective since, the total amount eventually recovered is almost half, compared to the amount evaded.

With respect to Inland Revenue cases, according to the Tax Authorities no prosecutions were made in relation to fraudulent evasion of taxes, with the exception of one case which was investigated by the Police and finally prosecuted. The strategy of the new Tax Department is to proceed with a limited number of criminal prosecutions on annual basis and publish the results.

Only recently, non-payment of withhold taxes (PAYE, special contribution for defence) has been included to the provisions for a criminal offence and this has not been exercised yet. It is expected to be exercised soon, due to the experience on prosecutions for non-payment of VAT.

The Tax Department maintains also close cooperation with the Police and the FIU. At least two requests per week are submitted to the Tax Department that may refer to a number of individuals or legal persons. Tax Department supplies this information and gives access to the files of the investigated persons and its officers testify about the tax information.

The challenges that lay ahead in a newly restructured, reorganised and integrated Tax Department are evident and should be addressed in order to establish a well-functioning organisation that encourages, inter alia, tax compliance, effective debt collection, efficiency of the tax administration, reducing administrative costs to government through economies of scale.

One main issue that hinders the operations of the Tax Department is the lack of functional integration. Still formal operational planning is limited and integrated frontline services are yet to be adopted, but signs of progress have begun to show. A functional organization structure has been developed but is not yet operating in the District Offices which have not been formally integrated. This is a time consuming process as it entails also physical integration. Nevertheless it is one of the priorities for the Tax Department, elevated at the Executive Management Team level.

Another main challenge that constitutes one of the pivotal pillars of a modernised Cyprus Tax Department is the introduction of an IT system that will support the integrated tax administration. A project to procure and implement a new IT system began in April 2016 and a high level timeline for the next steps, procurement, evaluation, and implementation has been developed, with rollout now anticipated during 2020-2021.



Taxpayers' compliance is also part of the Tax Department vision where a comprehensive compliance program directing activity across all heads of revenue is essential. A compliance strategy linked to the Tax Department's strategic goals has not yet been finalised which would incorporate a range of activities including legislation changes, taxpayer services, process changes as well as audit activity.

At the same time the formal risk assessment process needs to mature further in order to properly articulate how resources will be applied to priority risks across all core tax obligations and how the results will be measured and monitored. Management is proactive in discussing the risks and allocating resources to manage them.

The Tax Department acknowledging the above challenges, has steered its actions on certain focus areas which are reflected in the draft Tax Department's Strategic Plan 2017-2020 (and the accompanied supporting operational action plans).

Assessing the above, the Effectiveness of Tax Enforcement is considered to be medium.

Level of Formalization of the Economy

Introduction

Informal economy is that part of the economy that is characterised by irregular and illegal business. It may be viewed as 'grey' economy (as business that can be legalised by taking certain actions) and as 'black' economy (which cannot be legalised).

For Cyprus, estimates of the size of black/underground economy, where tax non-compliance arises from, do not suggest that income tax evasion in Cyprus is higher on average than for other countries. Nevertheless, empirical findings regarding the size of the black economy should be cautiously interpreted, since the margins of error often associated with them are wide. In addition, it is not only the size of tax evasion but also its sources and distribution that matter (Pashardes & Polycarpou, 2008)⁴⁸.

Empirical findings

In literature, attempts to estimate the size of the shadow economy are based on various approaches and this results in very different empirical findings. The discussion over the 'appropriate' methodology to investigate the shadow economy is still open. There are in general three different methods of assessment (F. Schneider, 2012):

⁴⁸ Pashardes, P., Polycarpou, A. (2008) 'Income Tax Evasion, Inequality and Poverty', Cyprus Economic Policy Review, Vol. 2, No. 2.



(i) *Direct procedures at a micro level that aim to determine the size of the shadow economy at a particular point in time (survey method).*

(ii) *Indirect procedures that make use of macroeconomic indicators in order to proxy the development of the shadow economy over time.*

(iii) *Statistical models that use statistical tools to estimate the shadow economy as an 'unobserved' variable.*

Income under-reporting is difficult to measure as the motivation behind non-compliant acts is to prevent the revelation of true income. Researchers have tried handling this by drawing on information available in national accounts, tax audit data, tax amnesty data and survey data.

In the case of Cyprus, work in this area is quite limited. Some estimates on shadow economy can be found in work by the Economics Research Centre of the University of Cyprus (CyERC), in papers by F. Schneider (and via World Bank) and there is also an estimate by the Statistical Service of Cyprus (Cystat) on non-observed economy.

Firstly, Cystat has estimated the non-observed economy for Eurostat. According to the ESA 2010 manual and other methodological improvements, the revised National Accounts data (10/2014) include an estimation of illegal activities.. The estimated Gross Value Added (GVA) adjustments for the non-observed economy in 2010 amount to €507.8 mio or 2.66% of GDP.

Secondly, CyERC in its paper titled “Income Tax Evasion, Inequality and Poverty⁴⁹”, used a consumer demand based method to estimate the extent to which households in Cyprus under-report their income and has found it to be around 6.7% to 8.1% of GDP.

Lastly, reference is made to the work by Professor Friedrich Schneider on the shadow economy (Schneider *et al*, 2011⁵⁰ and Schneider, 2015⁵¹) which infers that the size of the shadow economy in Cyprus is at 24.8% of GDP in 2015, down from 25.7% of GDP in 2014. Note that the 2014-2015 figures are based on projections.

Since the shadow economy cannot be directly measured, the above mentioned work uses indicators that best capture and reflect the characteristics of shadow economy activities, in particular the Multiple Indicators Multiple Causes (MIMIC) model.

⁴⁹ Pashardes, P., Polycarpou, A. (2008) ‘Income Tax Evasion, Inequality and Poverty’, Cyprus Economic Policy Review, Vol. 2, No. 2, pp. 37-49.

⁵⁰ Schneider, F., Buehn, A., Montenegro, C.E. (2011) ‘Shadow Economies All over the World: New Estimates for 162 Countries from 1999 to 2007’, in: Handbook on the Shadow Economy, chapter 1, Edward Elgar.

⁵¹ Schneider, F. (2015) ‘Size and Development of the Shadow Economy of 31 European and 5 other OECD Countries from 2003 to 2015: Different Developments’, working paper.



Note that caution has to be taken when using indirect methods, as there is wide agreement among experts⁵² that they over-estimate undeclared work and measure the whole shadow economy. Additionally, this methodology ignores the specific characteristics of each country and this can cause either a positive or a negative bias in the results.

Nevertheless Professor Schneider's data give an idea in international comparison as the numbers are updated and widely recognised.

Given the above information, if one were to speculate on the percentage of the grey/black economy in Cyprus, a reasonable estimate would be between 10%-15% of GDP.

Causes of grey/black economy and tax evasion

The causes of informal economy, even though no in depth analysis survey has been conducted in Cyprus, from anecdotal evidence can be attributed to the following:

- High level of self-employment and payment of informal contracts (including wage contracts⁵³).
- Prevalent use of cash for the payment of relatively small amounts but on a large scale (restaurants, doctors, handy men for home improvement, car mechanics etc.).
- Preventive measures and enforcement actions that are not adequate to elicit compliance.
- Generally low awareness amongst the population on the damage of tax evasion and the belief that tax income will not be put to good use by the state in providing high quality public goods and services.
- Crime proceeds.

From a tax legislative perspective, the tax rates are not overly burdensome thus expected to elicit compliance: 12.5% corporate income tax rate with effective tax rate for corporations between 23%-27% when taking into consideration tax on dividends, deemed or actual and the income tax rate for individuals up to 35% for individuals for income over €60.000 with the first €19,500 tax free.

Measures that could be taken to minimise undeclared economy

Certain measures have been taken by the authorities to minimise the informal economy such as the creation of Large Taxpayers Office in the Cyprus Tax Department, the linking of the VAT

⁵² http://ec.europa.eu/europe2020/pdf/themes/07_shadow_economy.pdf

⁵³ Relevant reference in Policy Brief on Informal Entrepreneurship - <http://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=7756>



database and the direct taxation database and the extended use Third Party Information. Assessing the above, the Level of Formalization of the Economy is considered to be very high.

Availability and Access to beneficial ownership information

Beneficial ownership is defined in Section 2 (1) of the AML/CFT Law as “*The natural person or natural persons, who ultimately own or control the customer and/or the natural person on whose behalf a transaction or activity is being conducted*”. The beneficial owner includes, in the case of corporate entities, the natural person or natural persons who ultimately own or control a legal entity through direct or indirect ownership or control of a sufficient percentage of the shares or voting rights in that legal entity, including through bearer share holdings, a percentage of 10% plus one share be deemed sufficient to meet this criterion, or in the case of legal arrangements (such as trusts) the natural person or natural persons who exercise control 10% or more of the property of a legal arrangement or entity.

Companies

The obligation to identify the beneficial owner includes the express obligation to identify the ultimate owners of at least 10% of the company. This does not only refer to legal entities registered in Cyprus, but covers all entities under the management/provision of services, be the service providers. Documentation in respect of the CDD carried out must be maintained by the service provider for at least five years after the end of its business relationship with the person for whom they act⁵⁴.

It is noted that as from December 2012, with the enactment of the Law Regulating Companies Providing Administrative Services and Related Matters (Administrative Services Law) all persons providing company services, such as company formation, holding shares on behalf of others, company secretary etc. have to be regulated and supervised⁵⁵ in addition to lawyers and accountants already covered by the AML/CFT Law. The supervisory authorities for the administrative service providers are CySEC, ICPAC and the CBA.

Additionally, given the provisions of the Administrative Services Law⁵⁶, the company secretary of a Cypriot company must always be resident in Cyprus, thus readily accessible to the competent authorities, including the FIU. The Department of Companies Registrar and Official

⁵⁴ Section 68 AML/CFT Law.

⁵⁵ Section 4 of the Administrative Services Law.

⁵⁶ Sections 4 and 2 of the Administrative Services Law.



Receiver maintains a register with information and data on private and public companies, partnerships, business names, overseas companies and branches of foreign companies which operate in Cyprus. This information includes the registered shareholders, the directors and the company secretary. Basic information is available through the official website free of charge. Further information can be obtained for a fee.

Trusts

In connection to other legal arrangements such as trusts, the Law for Regulating Companies Providing Administrative Services and Related matters of 2012 provides that, any person who is providing services of management and administration of trusts must identify and verify the identity of beneficial owners of the trust, including accurate and up to date information on the trustees, settlors, protectors, investment advisors, accountant, tax consultants, the activities of the trust and any other person who exercises effective control over the trust. This information is available for disclosure and inspection by the relevant supervisory authority at any time.

Furthermore, the abovementioned law provides that trust information should be kept in a register as long as the trust arrangement is governed under the Cypriot law. In this connection, the CBA, ICPAC and CySEC each maintain a separate trust register for trustees which fall under their respective supervision. These trust registers contain information on the name of the trust, the name and full address of every trustee, the date of the establishment of the trust, the date of any change in the law governing the trust and the date of the termination of the trust. Even though this information is not publicly available, the supervisory authorities can access the registers and may exchange information for the purposes of carrying out their supervisory duties under the aforementioned law and also the AML/CFT Law.

LEA and the FIU have adequate powers of access to beneficial ownership information⁵⁷. Additionally, beneficial ownership information can be accessed in a timely manner by the tax authorities and adequate legal provisions and procedures to this effect are in place.

It may, thus, be concluded that the existing legal framework and procedures, indicate transparency relating to beneficial interests in corporations, trusts or similar entities and the availability and access to ownership information as far as companies are concerned is deemed as high. It is noted that in its 4th Round MER Cyprus, Moneyval had concluded that the CDD requirements, which include identification of beneficial owners, have been rated as largely compliant. Comprehensive information on the structure, management, control and beneficial

⁵⁷ Sections 45-46, 55(2)(c) and 68B of the AML/CFT Law and Section 6(1) of the Criminal Procedure Law (Cap.155).



ownership in corporations, trusts and similar vehicles is available and can be accessed in a timely manner by competent authorities. Such information is available to AML-regulated institutions, businesses and professions to facilitate their Customer Due Diligence requirements.

Further actions such as the completion of the process of striking off inactive companies from the Companies' Registry and timely sanction procedures where non-compliance is observed, are expected to further enhance the existing framework.

Additionally, with the implementation of the 4th EU AML/CFT Directive, which foresees the creation of a central register of UBOs and the introduction of trust registers where UBO information will be held, the timely access to the beneficial ownership information will be further enhanced.



1.3 BANKING SECTOR VULNERABILITY

The banking sector in Cyprus is an important contributor to the economy, estimated at about 8% of GDP⁵⁸. As the cash/grey economy is not considered to be significant in Cyprus, Cypriot nationals use the available banking services as their primal channel for effecting financial settlement of commercial transactions and payments as well as to store their cash reserves and derive their loan funds. Since early 1980s and as part of the efforts to revitalise the economy, following the blow effected from the military invasion by Turkey in 1974, it has been an inter-temporal governmental goal to develop Cyprus as a hub for international business, taking advantage of the stable and robust legal framework, convenient time zone for three continents, economic climate, technology and expertise of human resources. The development of the banking system with an international flair was, thus, both a prerequisite but, at the same time, a tangent goal. The geographical position of the island served as a natural gateway of the Middle East and the East to Europe and beyond, something which is depicted in the current mix of banks operating in Cyprus today. As a result, the client base of banks (or ‘credit institutions’ as named in the relevant legislation) is a mix of domestic and foreign nationals, both natural and legal persons.

The Central Bank of Cyprus (‘CBC’) is the authority supervising the licensed credit institutions operating in Cyprus. The CBC is also the competent authority under the anti-money laundering legislation for credit institutions in Cyprus. There are 35 credit institutions operating in Cyprus and one representative office of a bank from a non-EU member state. Out of those 35 credit institutions, 7 are local, 3 are subsidiaries of credit institutions from other EU member states, 2 are subsidiaries of credit institutions from non-EU member states, 6 branches of credit institutions from EU member states and 15 branches of credit institutions from non EU member states. A register of all authorised credit institutions is available on the Central Bank of Cyprus (CBC) website⁵⁹.

Credit institutions in Cyprus offer a wide range of traditional banking products and services, the main being deposits, loans, cash transactions, wire transfers (inwards/outwards), trade finance, client accounts and, on a smaller scale, private banking and wealth management. Correspondent banking services used to be offered at the time when the local currency was the Cyprus pound, mainly to branches of banks from third countries operating in Cyprus. Regarding the customer

⁵⁸http://www.mof.gov.cy/mof/cystat/statistics.nsf/economy_finance_11main_en/economy_finance_11main_en?OpenForm&sub=1&sel=2

⁵⁹ <https://www.centralbank.cy/en/licensing-supervision/banks/register-of-credit-institutions-operating-in-cyprus>



base of these institutions, this is made up of not only Cypriot residents and nationals (natural and legal persons) but also of foreign nationals and companies registered in Cyprus and abroad, belonging to foreign corporates and nationals both with and without a physical presence on the island. Additionally, it must be indicated that there are companies which are registered in Cyprus and engage in international trade, whose business activities are reflected in national statistics, without however having the corresponding financial component of the transaction flowing through the Cypriot banking system⁶⁰.

The size of the banking sector suffered an abrupt contraction in March 2013 with the closure of the second largest credit institution and the imposition of bail-in on the largest credit institution. Total deposits from non-MFIs were reduced to €47bn at the end of 2013 from the €70bn figure at which they stood in December 2012. Since 2014, banks have been reporting that they have closed a significant number of customer accounts. In fact, 2013 has seen a turning point in the banking industry in many respects. As a result of the 25th March 2013 Eurogroup Decision, an assessment of the effectiveness of the KYC/CDD procedures in Cypriot banks was carried out jointly by Moneyval and Deloitte Italy⁶¹. In the meantime, Cyprus entered a lending program and a MoU with ‘Troika’ which continued to conduct quarterly reviews on the various elements of the MoU, including the AML/CFT issues, until late 2015⁶² when the program was successfully closed. An AML/CFT action plan was also agreed upon⁶³ and adhered to by all parties concerned.

For the purposes of the national risk assessment exercise, it was decided to take on board the expertise of representatives from both the regulator and the credit institutions themselves, thus inviting experts from the banking associations⁶⁴ and experts from a number of credit institutions to join the working groups carrying out the assessment.

In part, information was readily available to allow the drawing of fairly safe conclusions, especially from data and statistics maintained by the regulator. The expert judgment of the regulator was relied upon due to the fact that during 2014-2016 **full scope onsite examinations in all credit institutions** were conducted thus providing a wealth of information to be relied upon. Offsite reviews of data submitted by all credit institutions to the regulator were also analysed. Additionally, surveys were conducted to gather data and views from the supervised institutions to reinforce the analysis.

⁶⁰ More information can be obtained from <https://www.centralbank.cy/en/statistics>

⁶¹ http://www.coe.int/t/dghl/monitoring/moneyval/Countries/Cyprus_en.asp

⁶² <http://www.imf.org/external/pubs/cat/longres.aspx?sk=43649.0>

⁶³ <http://www.imf.org/external/pubs/ft/scr/2013/cr13293.pdf>

⁶⁴ <http://www.acb.com.cy/cgibin/hweb?-V=index& FSECTION=9000& FLANGUAGE=en&-dindex.html& VSECTION=0000& VLANGUAGE=en> and <http://www.aibcy.com/>



The assessors selected a representative list of products offered by credit institutions in order to establish some key characteristics which would have a bearing in the vulnerability of institutions to ML/TF. For each product, a number of factors were considered, namely their Total Value, the Average Transaction Size, the Client Base Profile, the Existence of Investment/Deposit Feature, the Level of Cash Activity and the Frequency of International Transactions. These statistics were largely drawn by the database of the CBC.

The products selected by the assessors were private banking, deposits, loans, cash deposits and cash withdrawals, wire transfers (inwards/outwards), credit cards, trade finance, client accounts and correspondent banking accounts (Vostro accounts). Apart from statistics on the use of these products, the assessors reviewed other vulnerability factors that would enhance the ML/TF risk such as the possibility of anonymous or omnibus use of the product/service, the existence of known ML typologies on the abuse of the product/service, the possibility to use the product/service in fraud or tax evasion schemes, the difficulty in tracing the transaction records of the product/service, the possibility of non-face-to-face use, the possibility of delivery of the product/service through agents and the existence of any additional, product-specific AML/CFT Controls. Of these products, the more risky products were deposits, loans and wire transfers as these were found to entail a medium high risk of abuse.

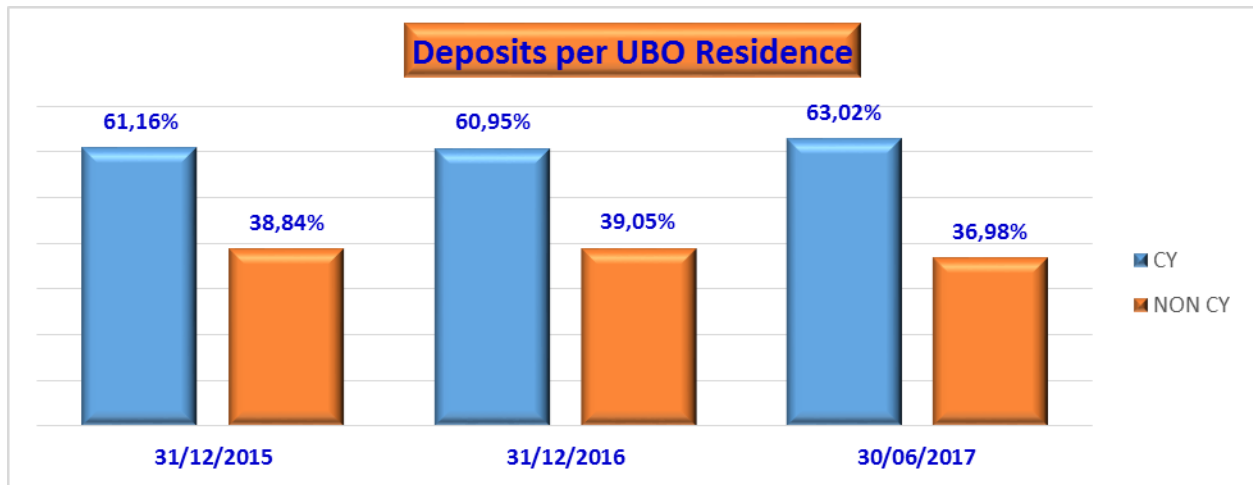
Threats to and vulnerabilities of the banking sector

Based on the overall assessed ML threat for the sector, rated as High, and the overall sectoral vulnerability derived from the analysis of various factors, rated as Medium, the overall ML risk for the sector is perceived to be Medium High.

Because of its international exposure, the Cypriot banking sector is considered as being more vulnerable to threats from international illicit activities rather than local crime. Access to the banking system by legal entities with characteristics such as unclear economic activity, lack of physical presence apart from the legal place of business, registration in jurisdictions with limited tax transparency, no employees etc. was identified as one of the factors importing a higher risk. In the case of companies registered in Cyprus which presented some of the above characteristics, a number of comforting elements were recorded such as the obligation to declare the beneficial owner and to have audited financial statements. Nevertheless, the higher risk identified had to be recognised and taken into consideration. Below, table 1 depicts the mix of deposits per the beneficial owner residence, differentiating Cypriot and Non-Cypriot residents.



Table 1 - Resident and non-resident deposits



Source: CBC database

The above exhibit a decrease of deposits by foreign UBOs between 2015 and June, 2017, a trend which is expected to continue.

Also, reliance by credit institutions on third parties for customer identification procedures and customer due diligence measures (albeit on the proviso that these operate in the EEA, are subject to mandatory professional registration legally recognised and are subject to supervision regarding their compliance with the EU AML directives) has meant that there have been instances where difficulties arose in obtaining first-hand information that would enable credit institutions to construct a comprehensive economic profile of their customers. This was assessed as entailing a higher risk for the banking sector.

Against the identified vulnerabilities of the banking sector, the regulatory and supervisory framework and the internal control systems of credit institutions, interwoven into an overall supporting control environment, were identified as an important defense mechanism.

Legal and Supervisory Framework

The Legal and Supervisory Framework governing AML/CFT is in line with the EU acquis communautaire and in certain cases it went beyond the minimum requirement (such as requirements for domestic PEPs which was in the relevant law before it was recognised by the EU directive).



Cyprus is a member of the Moneyval Committee of the Council of Europe. Moneyval's assessments make extensive reference to the legal and supervisory framework applied by the CBC, thus for the purposes of the national risk assessment it was deemed unnecessary to repeat the information that is readily available on the public Moneyval reports⁶⁵. Furthermore, the AML/CFT Law and the Central Bank Directive on the Prevention of ML/TF⁶⁶ (the "CBC AML Directive") have been amended in 2013 in order to adopt the 2012 FATF Recommendations and the recommendations of the special Assessment conducted by Moneyval and Deloitte in 2013. The CBC amended the applicable regulatory framework for the reliance on third parties by credit institutions in April 2016, thereby imposing the necessity to establish direct contact with customers introduced by third parties not later than three months from the account opening date and also the obligation to request from customers that are legal entities, the submission of financial and/or management accounts at the on-boarding process and during the review procedure in order to be in a position to construct their customer's economic and business profile. As part of the Troika MoU program, the CBC issued a number of AML/CFT Guidelines to credit institutions to address issues such as the construction of customer business profile, customer risk profile, ongoing monitoring, training and tax evasion. The said Guidelines were issued in February 2014 after the fourth issue of the CBC AML Directive in December 2013. Moreover, all credit institutions are required to comply with EU Regulation on information on the payer accompanying transfers of funds which first entered into force on 1st January 2007.

The CBC is empowered by section 59(4) of the AML/CFT Law to issue directives. These directives determine the details and specify the way of applying the provisions of the AML/CFT Law by the supervised institutions and require the formulation and implementation of procedures and systems for the effective prevention of ML/TF risks. Also, the Law in its section 59(5) obliges the CBC to monitor, assess and supervise the effective implementation of the legal and regulatory framework.

Effectiveness of Supervision Procedures and Practices

The quality of the AML/CFT supervision by the CBC has been strengthened in the past few years and is expected to be further enhanced through the employment of more resources that will sharpen the efficiency and effectiveness of the onsite and offsite inspections and the taking of appropriate measures on the part of the regulator.

⁶⁵ http://www.coe.int/t/dghl/monitoring/moneyval/Countries/Cyprus_en.asp

⁶⁶ <https://www.centralbank.cy/en/legal-framework/licensing-supervision/regulations-directives/directives-and-regulations-regarding-anti-money-laundering-measures/directive-to-credit-institutions-for-the-prevention-of-money>



In this respect, it is noted that the AML/CFT Section of the CBC was reorganised and strengthened on 1/1/2013 with additional members of staff and continues to plan for more reinforcements. The ability of the CBC to hire staff hampered due to a number of factors such as the general prohibition on the wider governmental sector for new recruitment (due to limitations on budgets).

The supervisory framework consists of both onsite examinations and offsite reviews of all credit institutions. It is noted that as part of the Troika AML plan, the CBC undertook to conduct full scope examinations of all credit institutions during the three year period of 2014-2016. This was a particularly strenuous task due to the staff limitations mentioned above. The capacity of CBC during on-site inspections was complemented by the use of external auditors selected via a tender procedure. The scope of the audit firms' work was specified by the CBC which maintained the full control of work done. It is expected that this practice will continue in the short term at least.

The CBC, with the technical assistance of the IMF, has designed and developed in 2013 a risk-based assessment methodology and tools for offsite and onsite supervision, which are tailored to the business model adopted in Cyprus and particularly address the high risks inherent in this banking model. Onsite tools are comprised of a number of audit programs which are used during onsite examinations to record data and information as to the level of compliance by supervised institutions by the AML/CFT legal and regulatory framework. The AML/CFT Section is updating and enriching the programs thematically for other areas and reviews the current audit programs with hindsight of the recent supervisory activity,

In relation to offsite supervision, the CBC designed, developed, and adopted, a risk assessment methodology and related tools that provide for:

- a comprehensive analysis of inherent ML/TF risks within the following risk factors: customers, products & services, geographic locations/areas, and delivery channels;
- an assessment of the internal control environment that should be in place to mitigate and/or control the inherent ML/TF risks, as identified and measured;
- institutional risk profiles;
- specific AML/CFT supervisory strategies (adapted to institutional risk profiles).

This tool is populated by data submitted by all credit institutions on a six monthly basis and the mechanics of the loading of the data is currently the objective of automation by the IT department of the CBC. An in-house modeling specialist was consulted with a view to calibrating the model's robustness.



As it was decided that during the three year cycle of onsite examinations, all banks were to be visited and placed under a full scope audit, the tool was not used. Currently, the tool is under review by a modeling specialist with a view to calibrating its modelling robustness. Once this calibration is completed, it is expected that all building blocks of the tool will be revisited drawing on the results of the full scope onsite examinations of 2014-2016 and the statistical data submitted by credit institutions in order to formulate an updated risk position of the banking system.

Besides the program of onsite and offsite supervision, the AML/CFT Section undertakes one off tasks on the basis of negative public information or other types of alerts including investigations of reported cases of misuse of the banking system. These tasks enrich the knowledge of staff on the risks surrounding credit institutions and form part of the offsite assessments. In this respect, credit institutions are obliged to submit to the CBC copies of the relevant annual compliance reports as well as their annual risk assessment reports. These reports are examined by the CBC and form the basis of questioning the respective institutions on various issues, while they are an important information source for the population of the parameters of the offsite tool.

Overall, the supervisory framework applied by the CBC is considered as containing all necessary elements that would lead to effectiveness in supervision, however staff and other resource limitations may not allow the CBC in applying the required intensity of supervisory actions.

Entry controls, fitness and probity issues

The entry to the market is governed by the Business of Credit Institutions Laws of 1997 as subsequently amended⁶⁷. In this respect, the CBC has issued a policy statement and guidelines the purpose of which is to provide prospective applicants with the necessary information concerning the submission of an application to obtain a banking business license⁶⁸. With the introduction of the Single Supervisory Mechanism ('SSM') of the European Central Bank ('ECB'), ultimate authorization powers lie with the SSM and the ECB.

In addition to the above, article 18 of the Business of Credit Institutions Laws provides that members of the board of directors of credit institutions have to be assessed and approved by the regulator. The CBC has issued a Directive to authorised credit institutions on the Assessment of the Fitness and Probity of the members of the Management Body and Managers under sections 11(3C), 18 and 41 of the same Laws. Furthermore, the European Central Bank has issued the Fit

⁶⁷ <https://www.centralbank.cy/en/legal-framework>

⁶⁸ <https://www.centralbank.cy/en/licensing-supervision/banks/licensing-of-banks>



& Proper policy stances which were approved by the SSM Supervisory Board and have been adopted by central banks of Eurozone countries.

The fitness and probity assessment varies depending on the country of origin of the credit institution concerned. For significant credit institutions the fitness and probity approval is granted by the SSM. The same applies for subsidiaries of significant credit institutions operating in Cyprus. For these cases, the CBC acts as a point of entry and upon the submission of an application it notifies accordingly the SSM. The CBC, after performing a preliminary assessment of the candidate involved, files a proposal to the SSM with a relevant suggestion and the SSM then proceeds with their own assessment. The CBC has no involvement in the fitness and probity assessment process for managers of branches of credit institutions from EU member states, while it has the absolute responsibility for managers of subsidiaries or branches of credit institutions from third countries.

Availability and enforcement of administrative and criminal sanctions

The AML/CFT Law and, in particular, its section 59(6) allows supervisory authorities to impose administrative measures to supervised entities in cases where failures of compliance with the legal framework are identified. These measures include the requirement for the supervised person to take such measures within a specified time frame as may be set by the supervisory authority in order to remedy any weaknesses identified, the imposition of administrative fines, the amendment, suspension or revocation of the license of operation, the requirement to proceed with the dismissal or removal from their position of any director, manager or officer including the Compliance Officer and the Head of the Internal Audit and Compliance Units whenever it is established that the failure to comply was due to their fault, intentional omission or negligence and the imposition of an administrative fine to a director, manager or officer or to any other person whenever it is established that the failure to comply was due to their fault, intentional omission or negligence.

The AML/CFT Law also allows supervisory authorities to publicise the imposition of administrative measures against any legal or natural entity. The CBC may also report possible violations of sections 27 and 68C of the AML/CFT Law to the competent authorities regarding criminal offences provided for in the above sections of the said law, if during the performance of its supervisory duties it comes to its attention that there are reasonable grounds to suspect that a person under its supervision is engaged in ML or TF offences.



Furthermore, section 44 of the Business of Credit Institutions Laws provides that, by or with the consent of the Attorney General, a prosecution in respect of any offence under the said Laws shall be instituted.

The CBC applies a written policy for the impositions of pecuniary fines on credit institutions where violation of or non-adherence to the provisions of the legal framework is identified. Since 2013, the CBC publishes all administrative fines imposed in credit institutions for failures to comply with the AML/CFT legal framework on its website.

Within the period 2011-2016, the supervisory activity by the CBC led to the imposition of pecuniary fines in 9 cases, the implementation of corrective measures within a specified time period in 15 cases and in one case the replacement of a Compliance Officer. In December 2015 the CBC proceeded with the revocation of a banking license of a branch from a non-EU credit institution.

All onsite examinations were followed by exit meetings after the completion of the fieldwork of onsite inspections, during which all findings were presented, with a view to allowing the credit institutions to start taking the necessary and required remedial actions immediately and without having to wait for the official report of the regulator which, in any case, undergoes legal vetting hence adding to the time needed till the final decision is reached. In addition to the above, administrative fine decisions are accompanied by related reports of the weaknesses identified during the onsite inspections addressed to the CBC's top management.

Even though the legal framework in place empowers supervisory authorities not only to proceed with the imposition of administrative fines but also to request the dismissal or removal of an officer who intentionally or unintentionally contributed to the failure of the credit institutions to comply with the legal framework (sections 27 and 68C of the AML/CFT Law regarding criminal offences), there is lack of statistical data on the imposition of criminal sanctions related to credit institutions' officers for AML/CFT related failures.

AML/CFT knowledge amongst credit institutions' staff

Staff training is one of the control functions that credit institutions must have in place as part of their AML/CFT control mechanisms.

The regulatory framework obliges supervised entities to apply adequate and appropriate systems and procedures in relation to ongoing training of their employees in the recognition and handling of transactions and activities which may be related to ML and TF. Furthermore, according to the CBC AML Directive provision, knowledge of credit institutions' staff is enhanced by the Money



Laundering Compliance Officer ('MLCO')'s provision of advice and guidance on the correct implementation of procedures and controls against ML/TF.

Credit institutions fulfill their obligations to provide training to their staff through in-house training courses delivered by the MLCO of the credit institution or competent third parties, or by participating in externally organised relevant seminars/fora/conferences or by implementing on-line training programs. However, it has been identified through findings of on-site examinations by the regulator that there is room for improvement, regarding the update of the syllabus as well as the effectiveness of training programs (e.g. frequency, tailoring and specialization, more case-study-scenario based topics etc.).

Overall, it is seen that credit institutions have increased their resources in related training and is expected that future assessments of this mitigant will merit higher ratings.

Credit institutions' staff integrity

It is considered that staff employed by credit institutions on the basis of qualifications and examinations/interviews act with integrity and do not collude with criminals or undermine the AML/CFT controls of their organizations by engaging in corrupt and illicit activities.

Furthermore, there are effective staff vetting programs in place upon commencement of employment and thereafter annually. The latter is also provided in the CBC AML Directive which imposes the obligation on credit institutions to apply explicit procedures and standards of recruitment and evaluation of new employees' integrity. In addition, each credit institution has in place its own integrity and conduct code. Training courses regarding the implementation of the integrity and conduct code as well as relevant disciplinary procedures for breaching of the said code are given to staff. A 'Banking Code' has been also issued by the Association of Cyprus Banks and has been endorsed by its members⁶⁹.

A survey among the largest credit institutions which was conducted by the CBC in October 2016, showed the following:

- a) Credit institutions apply mostly their own company standards when hiring staff and management.
- b) For the last four years there were eight fraud cases carried out by managers and or/staff,
- c) Credit institutions consider that the existence of the code of conduct, training programs and the ethical integrity culture amongst their staff are highly dissuasive for breaches of

⁶⁹ <http://www.acb.com.cy/cgi-bin/hweb?-A=163&-V=codes>



integrity by managers and staff, while any such cases lead undoubtedly to the dismissal of the manager/staff member involved.

- d) Finally, credit institutions consider that the sanctions regime in Cyprus is such that it deters breaches of integrity.

Effectiveness of Compliance Function

The AML/CFT Law and the CBC AML Directive, the Directive on Governance and Management Arrangements in Credit Institutions⁷⁰ and Directive on the Assessment of the Fitness and Probity of Members of the Management Body and Managers of Authorised Credit Institutions⁷¹, provide for an adequate framework regarding the establishment and operation of the Compliance Function of credit institutions.

Adherence to the above mentioned Directives by credit institutions is considered to be to a high degree both by the institutions themselves and the supervisor.

Specific internal compliance programs are included in the Compliance Charter of the credit institutions. These include systems for internal control, risk assessment and risk management which aim at preventing ML/TF from occurring in the organization.

The MLCO appointment is also governed by the AML/CFT Law and the above mentioned CBC directives aiming at establishing the MLCO's independence and seniority.

Internal Audit Units are obliged by means of the CBC AML Directive to review and evaluate, on an annual basis, the effectiveness and adequacy of the policy, procedures and controls applied by the credit institutions for preventing ML/TF and must verify the level of compliance with the provisions of the CBC's AML Directive and the AML/CFT Law. The internal auditors also monitor, on an ongoing basis, through progress reports or other means, the implementation of their recommendations on AML/CFT matters.

In addition, the external auditors of credit institutions are required to assess and report on the adequacy of the internal control framework, including the compliance function.

Furthermore, credit institutions are required to evaluate their internal control framework by an independent audit firm on a three year basis as provided in the CBC Directive on Governance and Management Arrangements in Credit Institutions.

⁷⁰ https://www.centralbank.cy/images/media/pdf/CORPORATE_GOVERNANCE_DIRECTIVE_EN.pdf

⁷¹ https://www.centralbank.cy/images/media/pdf/FitandProper_2014_EN.pdf



It is evident that senior management of credit institutions have paid increasing attention to the compliance function since the resources devoted have increased (more staff working in compliance, investment in the upgrade or acquisition of new monitoring and control systems). The opinion of the compliance function has been established as a necessary element in important decision making processes of credit institutions, such as the acceptance procedure of high risk customers.

Even though the role of the MLCO has been upgraded and credit institutions have increased the resources devoted to the compliance function, due to the continuous changes in the regulations and organizational structure of banks, as well as very demanding expectations from the compliance function, human resources are in constant need for reassessment and reinforcement.

Level of market pressure to meet AML standards

Within the Cypriot banking landscape, as the current legal and regulatory framework is applied equitably on all institutions operating in or from within Cyprus, there is pressure of equal treatment on all institutions to adhere to the common standards. The name and shame policy of the regulator when it comes to publicizing administrative actions and fines is an important stimulant of market pressure amongst credit institutions to strive for strict application of the prevailing legal and regulatory framework.

A very important factor which credit institutions take into consideration as part of the overall enhancement of the effectiveness of the AML compliance function is the value placed on maintaining functional relationships with their international commercial counterparts. In this respect, compliance with international AML standards is, thus, of foremost importance for credit institutions.

More specifically, credit institutions consider their correspondent banking accounts with international payment clearers as extremely valuable and necessary for their operations. The continuous pressure from such correspondent counterparts to fulfil specific cooperation conditions prescribed by their respective home regulators and by international standards, has a direct impact on management risk appetite and staff culture in relation to AML/CFT issues.

Credit institutions aim at maintaining such relationships in good shape and at the same time remain sensitive to the monitoring of international and national AML-related risks in line with the requirements imposed by their correspondents.

Cypriot banks have felt the effects of de-risking by major international clearers, a decision which was taken on a cost benefit analysis, weighing on one hand the stricter compliance requirements



imposed by foreign regulators and the financial benefits, on the other hand, from servicing a comparatively small market such as Cyprus.

It is nevertheless widely admitted by credit institutions that their correspondent banks have praised the compliance practices applied and the high degree of cooperation exhibited by Cypriot banks and have indicated that the decisions to stop correspondent relations were based on factors other than compliance.

Effectiveness of Suspicious Activity Monitoring and Reporting

The legal and regulatory frameworks provide for the submission of suspicious activities' reports by supervised entities to the Cypriot FIU. More specifically, section 63(1) of the AML/CFT Law states that '[...] persons carrying out financial or other business activities are required to apply continuous monitoring of the business relationships [...] and file a report to the FIU of any suspicious transactions or the attempt for a suspicious transaction.' Also, section 70 of the same laws provides that 'Persons engaged in financial and other business activities refrain from carrying out transactions which they know or suspect to be related with money laundering or terrorist financing before they inform the FIU of their suspicion [...]. If it is impossible to refrain from carrying out the transaction or is likely to frustrate efforts to pursue the beneficiaries of a suspected money laundering or terrorist financing operation, the persons engaged in financial or other business activities, must inform the Unit immediately afterwards'. Also, paragraph 7 of the CBC AML Directive provides guidance to credit institutions on the reporting of suspicious activities.

During the onsite inspections carried out by the regulator in the period 2011-2016, AML IT systems were specifically examined using the services of CBC's in-house IT audit specialists. Onsite inspections revealed that credit institutions have invested in IT packages that allow, enable and facilitate the monitoring of transactions. These systems also use information from commercial databases to identify PEPs and also employ specialised modules to screen transactions and customers against lists of persons and entities which are subject to the terrorist related sanctions of the UN and the EU. Statistics show that internal SARs and reports to the FIU exhibit an upward trend in recent years. Due to the evolving environment, the need to apply continuous calibration to the IT systems, alert scenarios and capabilities has been identified in cases where alert scenarios had not been revisited as required.

Although statistical data are available from the CBC through data collected from the onsite examinations, the statistical information used for the purposes of the national risk assessment was that provided by the FIU.



According to the FIU, prior to the implementation of the goAML the automated system for filing SARs, the quality of the SARs varied between credit institutions. With the implementation of the automated submission of SARs, the quality of these reports has improved visibly due to the mandatory fields which have to be completed, thus contributing to the completeness of the information on the persons and transactions involved and the level of detail disclosed

The use of technology in monitoring transactions is increasing, thereby introducing sophistication and refinement needed in alert scenarios. It has been evidenced that similar trends are marked in the cases of branches from third countries which, under the global threat of de-risking by international payment clearers, have had to invest in technology in order to reinforce their line of defense against criminal activity.

Concluding the above analysis, the risk elements which were derived from the NRA were not deemed to come as a surprise. This is evident by the action plans already implemented by both the regulator and the credit institutions themselves and which will continue to be reviewed by all those concerned.



1.4 SECURITIES SECTOR VULNERABILITY

The Cyprus Securities and Exchange Commission ('CySEC') is the authority responsible for supervising the securities sector and ensuring compliance of the securities firms with the relevant legislation, including the legislation for AML/CFT. The main participants of the sector can be broadly categorized into Cyprus Investment Firms ('CIFs') and Fund Managers. Most of those firms perform the majority of their transactions through foreign and international exchanges or over the counter markets ('OTC'). Trading in the Cyprus Stock Exchange ('CSE') is limited⁷² and restricted to CIFs or foreign regulated brokers who are members of the CSE.

Financial institutions providing investment services such as brokerage, portfolio management, investment advice etc. in relation to one or more financial instruments, are required to obtain a CIF authorization by the CySEC⁷³. Exempted from the above requirement are credit institutions offering any of the above services, which are supervised by the Central Bank of Cyprus. As at the beginning of 2016, CySEC had 181 active⁷⁴ CIFs under its supervision. The majority of CIFs, 109 in total, were online brokers/dealers offering Contracts For Difference ('CFDs') mainly in stock indices and commodities, currency pairs ('Forex') and binary options. The remaining 72 CIFs offered a variety of services, including brokerage, investment banking services, portfolio management and investment advice.

Financial institutions carrying out the activity of managing an investment fund are required to obtain authorization as per the provisions of the legislation regulating the fund industry. As at the beginning of 2016, CySEC had a total of 13 active Fund Managers under its supervision.

All institutions under the supervision of CySEC are subject to the same AML/CFT regulatory obligations.

The overall ML risk of the Securities sector was assessed as Medium.

Threats to the Securities Sector

The main threat to Cyprus securities sector derives from international activities and the potential misuse of the sector by international criminals aiming to launder illicit funds. Cyprus is an established international hub and the firms operating in the securities sector are mainly involved into investment services activities performed through foreign and international exchanges or over the counter markets.

⁷² The annual turnover of Cyprus Stock Exchange was approximately EUR 150 million in 2015, EUR 70 million in 2014 and EUR 60 million in 2013.

⁷³ For more information please refer to: Investment Services and Activities and Regulated Markets Law of 2017, available at <https://www.cysec.gov.cy/en-GB/legislation/services-markets/epcy/>

⁷⁴ The term active refers to authorized firms that have already commenced business. The total number of authorised firms is available at CySEC's website: <http://www.cysec.gov.cy/en-GB/entities/>



During the assessment period (January 2013-June 2016) no money laundering cases were detected in the securities sector.

The possible abuse of the securities sector for money laundering lies mostly in the layering and integration stages. While the use of cash is not prohibited, it is rarely used or accepted by securities firms. Since the funds are mainly transferred through accounts from credit institutions, the risk of money laundering in the placement process is significantly reduced.

One of the main threats to the securities sector, as observed in the October 2009 FATF report⁷⁵, is that it can be used to both launder illicit assets generated outside the securities sector and to generate illicit assets from fraudulent activities such as insider trading, market manipulation and securities-related fraud.

Sector analysis and vulnerabilities

Firms in the securities sector operate in a highly regulated environment, with laws and regulations that conform to the international standards. Apart from the AML/CFT Law, CySEC has its own AML/CFT Directive ('CySECs Directive')⁷⁶, which is in line with the EU related directives and FATF guidelines and provides specific guidance and requirements for the regulated entities' compliance with their AML/CFT obligations.

In addition, CySEC has a strong and comprehensive framework for licensing and registration requirements for the securities firms. All firms in the securities sector are obliged to apply adequate and appropriate systems and procedures for the prevention of ML/TF and are required to submit their AML/CFT procedures manual as part of their license application. The framework also includes a "fit and proper test" for the persons who effectively direct the business and the beneficial owners.

The main vulnerabilities identified, as regards the general AML controls relate to the effectiveness of the sector's supervision, the effectiveness of securities firms' compliance function, AML knowledge of staff in securities firms and the effectiveness suspicious activity monitoring and reporting.

During the assessment, CySEC's AML/CFT related inspections were limited mainly due to the regulator's lack of human resources. The increasing size of the sector requires a more effective supervision and intensification of AML/CFT on-site and off-site inspections. As part of the efforts to enhance and reinforce AML/CFT supervision, CySEC established, in 2015, a new separate department specifically focused on AML/CFT supervision, which was previously performed by the CySEC's Supervision Department. Moreover, during the same year, CySEC implemented its Risk Based Supervision Framework ('RBSF') to perform a risk-based supervision as per the FATF guidelines and the requirements

⁷⁵<http://www.fatfgafi.org/media/fatf/documents/reports/ML%20and%20TF%20in%20the%20Securities%20Sector.pdf>

⁷⁶ Directive DII144-2007-08 of the CySEC for the Prevention of Money Laundering and Terrorist Financing
<http://www.cysec.gov.cy/en-GB/legislation/financial-crimes/AML/>



of the 4th EU AML/CFT Directive 2015/849, focusing on areas and/or firms that exhibit higher ML/FT risk and to allocate its resources more efficiently.

The on-site inspections performed during the assessment period revealed the need for an improved compliance function from securities firms. Some commonly occurring weaknesses identified relate to the establishment and implementation of adequate risk assessment procedures, collection of all the relevant data and information required to draw up and update clients' economic profiles and difficulties in understanding/identifying clients' source of wealth and source of funds. In addition, a number of securities firms with a significant number of clients followed a manual transaction monitoring procedure, which raises questions as to their ability to monitor large volume of clients sufficiently, continuously and in a timely manner. Furthermore, the performance of securities firms' compliance functions suggests the necessity for more advanced and rigorous AML training to securities firms' staff. Off-site reviews also revealed that the Compliance Officer's Annual Report was not detailed enough as prescribed by the CySEC's Directive.

CySEC imposed a number of administrative fines and issued several written warnings in relation to AML/CFT compliance breaches during the assessment period. The regulator's policy is to announce all administrative fines imposed on its website⁷⁷.

Finally, securities firms reported 37 Suspicious Activity Reports ('SARs') to MOKAS up to June 2016, compared to 46 in 2015, 5 in 2014 and 8 SARs in 2013. The low numbers of SARs, especially in the 2013 and 2014, are supported by the findings of the on-site inspections and the manual transaction monitoring performed by a number of securities firms. Even-though the figures seem to follow an upward trend, they still seem to be low compared to the overall size of the sector and the nature of the activities it undertakes. Advances in firm's compliance functions and the tendency observed towards the use of automated solutions for transaction monitoring are expected to improve securities firms' ability to identify and report suspicious activity.

Traditional CIFs

Traditional CIFs offer a wide range of investment services in a diversified portfolio of financial products. Their services include mainly brokerage for equities listed in international stock exchanges, bonds, money market instruments and derivatives. Some of these firms may also offer portfolio management, investment advice and investment banking services.

Their client base varies from natural persons to legal entities, from various geographical locations. They offer services mainly to high-net worth individuals and institutional clients and therefore, deal with high amounts of clients' funds and large transactions. In addition, the types of services they offer, such as access to international exchanges, make traditional CIFs vulnerable to potential misuse by individuals aiming to generate illicit assets from fraudulent activities such as insider trading and market manipulation.

⁷⁷ <http://www.cysec.gov.cy/en-GB/public-info/announcements/>



On the other hand, traditional CIFs have typically a direct personal contact with their clients and hence, the risks associated with non-face to face business relationships are significantly low. In addition, investor monies are mainly transferred through large credit institutions.

CIFs acting as online brokers/dealers in CFDs and Binary options ('online CIFs')

The majority of CIFs are online brokers/dealers who offer, through an electronic trading platform, trading of Contracts for Differences ('CFDs') and binary options mainly in currency pairs, commodities and equity indices. These firms offer a narrow range of services, to a broad spectrum of clientele, which includes mainly small retail investors from around the globe. The main risk associated with online brokers derives from the delivery channel that they offer their services as the majority of their business relationships are non-face to face.

Online CIFs accept mostly small deposits from each client and most of the funds are transferred through credit institutions or payment service providers.

Fund Managers

Fund Managers are relatively new institutions, since the relevant legislation applying to UCITS, UCITS managers and more predominantly to AIFMs and AIFs came into force only recently. As at the beginning of 2016, Fund Managers had assets under management of approximately EUR 1,5 billion. Their size is relatively small compared to the other Securities sector institution types assessed, however, it is expected to grow significantly in the foreseeable future, as the number of authorized Fund Managers increases.

Fund Managers invest in various financial and non-financial products that include among others equities, bonds, derivatives and real estate. The final product offered to investors is their units in the collective investment schemes they manage. The liquidity of the units varies upon the type of the investment fund, whether is open-ended or close-ended, exchange traded and the specific rules set out in its instruments of incorporation and/or prospectus. Currently, their client base consists mainly of high-net worth individuals and institutional clients from the EEA.



1.5 INSURANCE SECTOR VULNERABILITY

The insurance industry in Cyprus is well developed and as from 1/1/2016 its supervision is based on revised robust legal framework (Solvency II European Directive) which requires a risk based supervision, stricter capital rules as well as high level of governance and transparency, for the protection of the policyholders and other beneficiaries. Most of the insurance business written is domestic.

The AML/CFT legal framework is based on EU related directives, the FATF recommendations and the Orders issued by the Superintendent of Insurance. It covers the life insurance business including life insurance intermediation, for the conclusion of life insurance contracts.

The country's insurance sector consists of 32 insurance undertakings, of which, 8 life, 2 composite, 20 non-life and 2 reinsurance. Total market premiums for 2016, for all supervised entities, amounted to €814m (preliminary figure), of which approximately 40% relates to life business and 60% to non-life.

According to the latest official statistical information, the insurance sector's contribution to the economy, as a percentage to Gross Domestic Product (GDP), is 0,7%.

Compared to the rest of the financial sector, life and non-life insurance business represents a small portion, and the risks associated with ML are considered low with no systemic impact to the Cyprus market. This is also supported by the most recent Moneyval 4th round evaluation report (27/11/2013) which has stated that “the insurance sector does not constitute a serious threat given the size of this industry, the type of transactions and the overall current financial situation in the country”.

Life Insurance Sector Vulnerabilities

In 2016, total written premiums of the life insurance companies, represent approximately 40% of the insurance sector and show a small decrease compared to last year's premiums.

The main reasons for which individuals are keen on concluding life insurance policies are for savings upon retirement (most of these products have maturities 15 years or more) as well as for obtaining a tax benefit. This benefit is only given if a policyholder keeps his policy in-force for a minimum number of 6 years otherwise a proportionate reduction is imposed.

Life insurance products are offered either directly from insurance companies, through insurance intermediaries and also through financial institutions (bank assurance). Life insurance products are separated into two main categories, unit-linked and non-linked, and according to payment mode to regular



and single. In order to evaluate life insurance sector vulnerabilities, the assessment/analysis was based on the following four categories:

- Regular Premiums - Unit Linked
- Single Premiums - Unit-Linked
- Regular Premiums - Non-Linked
- Single Premiums - Non-Linked

Unit-Linked products, offer the option to the policyholder to choose from a number of investment funds, based on the level of risk the policyholder is willing to undertake (investment risk is born by the policyholder). Even though the vast majority of unit-linked products have a fixed mode of payment (regular premiums), there are some unit-linked products which offer only one single premium payment at the inception of the contract. Regular premiums for unit-linked products represent on average 45% of the total assets and 59% of total premiums whereas single premiums unit-linked products which are more vulnerable to money laundering abuse represent only 15% of total assets and 7% of total premiums. It must be noted that in Cyprus unit-linked products offer simplified investment options to policyholders which reduces the vulnerability to money laundering abuse. The main investment categories consist of UCITS, bank deposits and property.

Non-Linked are products for which the insurance undertaking bears the risk and invest policyholders' premiums based on the company's investment policy. These products offer some type of return to the policyholder in the form of bonus or dividend which accumulates at the contract's anniversary. Most common under this category are the traditional endowments and individual deferred annuities. One additional product type which falls under this category are term policies (individual/group) which offer only a life cover to the policy holder. The vast majority of non-linked products have a regular premium method of payment even though they may offer the option to the policyholder for single premium payment at the inception of the contract. More specifically, regular premiums non-linked represent 35% of total assets and 30% of total premiums and only 4% of total assets and premiums come from non-linked single premiums products.

Furthermore, the assessment for ML vulnerability of the life insurance sector is considered low due to the fact that the level of cash activity for all products, referred to above, is less than 5% of the total written premiums. The majority of the premiums are paid through direct debits (including SEPA payments), therefore, money laundering risk is decreased substantially. Based on the data collected, it has been noted that for each of the above four product categories, the ML risks associated with client base regarding



Politically Exposed Persons (PEPs) to total clients as well as the number of high net worth individuals is low.

Irrespective of the low risk, life insurance companies and life insurance intermediaries are required to comply with the existing comprehensive legal framework on AML. The Insurance Companies Control Service - ICCS (Supervisory Authority) has recently executed, on a risk-based approach, a number of on-site and off-site inspections, covering 70% of life insurance companies.

The ICCS reviews the Policy and Procedures of the regulated entities giving special attention on the KYC procedures as well as the Fit & Properness of the Money Laundering Compliance Officer (MLCO) determining at the same time whether MLCO has no conflict of interest with any other functions of the undertaking. In addition, during on-site inspections, ICCS requests statistical information (e.g. STRs/PEPs, single premium payments, early surrenders etc.), details on training provided to MLCO/Staff/Intermediaries as well as any review points raised on AML/CFT by the internal and external auditors. Upon concluding an on-site inspection, a formal letter with all the findings is issued and communicated to the undertaking's Senior Management/Board of Directors. Administrative fines may be imposed in case of non-compliance with the weaknesses/recommendations identified.

Weaknesses identified under the period of study include shortcomings in the application of CDD with regards to customers with whom there is a long standing working relationship, as well as the limited use of AML/CFT automated systems by insurance undertakings.

The overall majority of life insurance companies have demonstrated good knowledge on AML compliance issues, reporting procedures and obligations.

Non-Life Insurance Sector

Total non-life insurance premiums represent approximately 60% of the total gross written premiums of the insurance sector. Various products sold by non-life insurance companies for natural persons are fairly simple. Major lines of business exist for motor insurance, which is the largest (75% relates to third party liability), property and liability insurance. Overall ML risk for the non-life sector is considered insignificant and is not included in the AML legal framework, therefore it has not been included in the assessment for money laundering vulnerabilities.



1.6 OTHER FINANCIAL INSTITUTIONS' VULNERABILITY

The Other Financial Institutions category (the “other FIs sector”) comprises the provision of Money Remittance (money transfer businesses), Issuing and Acquiring of cards and card transactions, the operation of Payment accounts, electronic money services (E-money) and the buying/selling foreign currency for immediate delivery (“the Bureau de Change offices”).

In general, the use of the Other FI sector and especially prepaid cards has received attention in the recent past due to its use for terrorist financing, since the traditional banking systems present larger obstacles for this kind of criminal activity to take place. Also, it is used by persons who find it difficult to obtain access to banking services (e.g. because of the absence of credit history, their special status such as immigrant workers etc.). Finally, card scheme frauds have been seeing the light of publicity more prominently.

Payment services in Cyprus may only be provided by a payment institution which has been granted an authorization by the Central Bank of Cyprus (‘CBC’) and is regulated under the Payment Services Laws of 2009 and 2010 (PSL) transposing Directive 2007/64/EC of the European Parliament and of the European Council of 13 November 2007 on payment services in the internal market (the ‘PSD’) and by the Payment Institutions and Access to Payment Systems Directive of 2009 issued by the CBC pursuant to the powers bestowed by the PSL. The sector is not considered as a significant contributor to the economy as its contribution is estimated around 0,02% of the GDP.

The provision of payment services can be extended either through institutions authorised for such business by the competent authority, namely the CBC, or by institutions established in other EU member states exercising their ‘passporting’ rights. Permissible payment services are defined in PSL and derive from the PSD. PSL specifies the type of services that need to be licensed and includes all the activities assessed in this section.

Each of the activities has been viewed separately in the analysis that follows, however aspects such as supervision, legal framework, knowledge and awareness of staff have been considered for the sector as a whole because of the commonalities identified. Bureaux de change is a new activity with extremely limited usage and for this purpose it has been excluded from the assessment. Payment accounts is also offered mainly by only one market participant with low volumes and has also been excluded from the assessment which has been focused around MTBs, EMIs and Issuing and acquiring of card transactions. However, a brief consideration to the two types of activity excluded from review is given in this section of the report.



Overall threat and vulnerability of the other FI sector

The overall ML risk arising from the sector is assessed as medium low mainly due to its size. The vulnerability of the three types of activity reviewed is assessed as medium.

Table 2 gives a snapshot of the sector's composition:

Table 2 - Other financial institutions' sector composition

	Vulnerability	Number of OFIs	Market share 2015	Market share 2014	Market share 2013
Money Remittance Business	Medium	8	3.9%	4.8%	5.3%
Issuing and Acquiring	Medium	4	89.9%	86.5%	86.2%
E - money service	Medium High	5	0.3%	0.4%	0.4%
Payment Accounts	Medium Low	1	6.1%	8.3%	8.1%
Bureaux de change	Emerging service	4*	n/a	n/a	n/a

Source: CBC

* this is the number of licenses granted by the Central Bank of Cyprus in late 2015. Only two such institution have commenced operations with 7 agents all in all.

Analysis of selected variables

The analysis conducted of the vulnerability factors of the sector has revealed that the applicable AML legal framework provides a strong defense against the ML threat. A specialised directive was issued by the CBC for MTBs in 2009 specifying a variety of matters. It is noted that a



directive for EMIs and card acquiring services is yet to be issued and is expected upon the enactment of the provisions of the 4th EU AML Directive into domestic legislation.

The procedures applied by the licensing authority (CBC) at the point of entry in the sector, for granting a license to payment and E-money institutions are comprehensive and analytical thus contributing positively to the strength of the AML regime. As part of this control environment, the CBC requires to be satisfied that the applicant proposes to install an appropriate and adequate organizational framework for its business which will ensure that the entity fortifies itself against possible ML threats. Therefore, applicants need to ensure that the arrangements, procedures and mechanisms described in their business plan are comprehensive and proportionate to the nature, scale and complexity of the services applied for.

Regarding the effectiveness of AML/CFT supervision of the Other FI Category by the competent authority, namely the CBC, it has been observed that, due the financial crisis of 2013 and its profound impact on the banking sector, CBC's attention was diverted to the supervision of credit institutions primarily and to a lesser extent to that of payment and E-money institutions. Notwithstanding this, 13 onsite inspections were performed systematically during the period from 2011 to 2012. More precisely, seven payment Institutions onsite inspections were conducted in 2011 and six during 2012. The situation has been changed since 2015 with the fortification of the CBC's AML/CFT Section which came in position to arrange an intensified on-site inspection schedule for payment and E-money institutions as well. Onsite inspection was carried out in one e-money and four payment institutions in operation, during 2015 and three onsite inspections were carried out up to 30 June 2016. Regarding administrative sanctions, examination reports have been issued in almost all cases, while the results of the onsite inspections have already been communicated to the institutions concerned during the exit meetings after the finalization of the onsite visits.

The compliance function within the sector in most cases is carried out by an appointed MLCO and in certain cases with the assistance of an alternate MLCO. The quality and effectiveness of this control was assessed as of medium level based on the findings of onsite inspections by the CBC. AML knowledge of staff of the sector was assessed as medium as scope for enhanced training activities was identified. Additionally, the analysis of statistics of the suspicious transactions reports filed with the FIU in 2013-2016 (Table 3 below) shows a jump in 2013. This is considered to be as abnormal and not representative since the banking crisis that erupted in March 2013 had a psychological effect on the employees of the financial sector and that led to an overly cautious approach. The trend from 2014 onwards (the post crisis era) is a safer indicator of the enhanced knowledge of ML issues and better evaluations of internal reports by the MLCOs. Also, the introduction of an electronic platform by the FIU for the submission of



STRs/SARs has provided a structured tool to users and has enhanced, as per the FIU itself, the quality of the reports filed. For the card payment agencies, the focus is on fraud as opposed to ML. Statistics on STRs submitted by firms in the other financial institutions' sector are listed in Table 3 below:

Table 3 - Other financial institutions - STRs submitted to the FIU

	2013	2014	2015	2016	TOTAL
Money Remitters	76	12	15	11	114
Issuing & Acquiring	1	3	6	5	15
E-money Institution	0	0	1	0	1
Payment accounts	1	0	2	0	3
TOTAL	78	15	24	16	133

Source: FIU

Staff and management employed by Other Financial Institutions adhere to professional integrity standards which act as a safeguard against criminal use of their organisations. In a survey conducted for the purposes of the NRA, the participants were prompted to define the applied standards for hiring staff and management and in which level the culture, the code of conduct and the AML awareness are dissuasive factors for breaches of integrity. Their responses revealed that the aforementioned are at a high/ satisfactory level within the sector whereas only one incident of breach of integrity was reported to police during the years 2013 – 2016. In addition, 14 internal investigations were carried out within the institutions, during the same period, where 9 out of the 14 investigations has no outcome whereas 5 incidents led to dismissal of the involved staff, indicating thus that such incidents are limited within the sector. Additionally, based on data collected for the 2013-2015, it was observed that the payment institutions proceeded with termination of their relations with agents to a high degree ranging approximately 20% to 24% of the total number of agents. Although the reasons of the termination were not always disclosed, it is taken as an indication of the cleansing process that is exercised by payment institutions amongst agents who do not prove to be up to standard with company procedures.



Money Transfer Business ('MTBs')

The competent supervisory authority maintains a public register which includes (i) the licensed payment institutions (ii) the names and addresses of their agents and their branches' addresses and (iii) the payment institutions which have been authorised in other EU member states and which have exercised the right of establishment or the right of freedom to provide services in the Republic of Cyprus. As at 30 June 2016, 6 payment institutions with 330 agents were operating within the sector as money remitters and 3 agents as passported with physical presence with 62 subagents. As of the same date, there were also approximately 250 passported institutions, with no physical presence. The bulk of money transfer business is carried out by two international household names. No indigenous scheme is operating in Cyprus.

The misuse of MTB services for terrorism financing is globally considered as the biggest threat although there are no available local typologies. No official statistics on investigations, prosecutions or convictions were available for MTBs. Statistics revealed that the value of outward transfers is significantly higher than the inward transfers in MTB sector. This falls in line with predictions as Cyprus relies on legal immigration to fill labour positions, mainly unskilled, and is home for workers from third countries who despite having access to banking services (obligation for the issuance of working visa) still prefer to use MTBs for the remittance of financial aid to their families due to the significantly lower costs of transmission and the convenience emanating from the infrastructures available in their country of origin.

The consolidated turnover of all the money remitters was used to calculate the size of the product within the sector. The service enables individuals to send or receive money up to €3 thousand per customer per transaction in accordance with the limits prescribed in their license.

The examination demonstrated that the main factors, among others examined, that make the product more vulnerable to money laundering are the customers using the service, the use of agents, the international transactions and the material level of cash activity. The analysis of customer base revealed that the service was mainly used from immigrants working in Cyprus usually with a low level of income and a small proportion of non-immigrants who probably were not able or elected not to use the banking sector to send money overseas. The use of the service from immigrants with low level of income, is apparently a feature which is highly correlated with the small average amount per transaction. The average value of outward and inward transactions during 2015 was approximately equivalent to €323 (2014: €305) and €452 (2014: €421) respectively. Payment institutions participating in this sector, appraised that the service was not misused by customers with this profile.



Based on CBC's experience from previous years onsite inspections and monthly reporting submitted from MTBs, it is identified that the latter, classify as high risk customers only those that are blocked by their automated systems (e.g. when the turnover/activity exceeds the internal limits).

MTBs operate through a network of agents. A register of these is made available on the CBC website. Paragraph 3 of the Payment Institutions and Access to the Payment Systems Directive of 2009 (P.I.395/2009) issued by the CBC defines, inter alia, the criteria which an agent of a payment institution must fulfil in order to be listed in the public register maintained by the CBC. Natural and legal persons who/which have been appointed to operate as agents in Cyprus of payment institutions licensed in other EU member states, must complete a specific questionnaire.

MTBs that act as super-agent is responsible and accountable for the conduct of its agents and to this effect they enter into contractual arrangements between principal (the super-agent) and agent in order to set out their respective roles and responsibilities. It must inform the supervised entity of the appointment or removal of every agent.

On the basis of the information obtained by means of both the offsite and on site examinations it was found that agents should be receiving more training regarding AML/CFT issues, tailored made to their situation and custom. However, the use of IT systems either from the brand operator or locally developed acts as an alert system for possible attempts, in most cases, to send more funds abroad than allowed. It is revealed that foreign workers bundle up their outward transfers in an attempt to save on fees and charges. Some payment institutions have established internal control and monitoring mechanisms for their agents which provide the following:

- Confirmation on whether the agents are known or suspected to be associated with criminal conduct or terrorism;
- Evaluation on a regular basis of the operations of agent, the nature and volume of agents' activities based among others on his location and ensure the proper management of cash by the agent;
- Evaluation of the agents' implementation of policies, procedures, controls and systems;
- Independent reviews: these assist an MSB to identify weaknesses or deficiencies in its agents. It was established that independent reviews included checking on daily transactions that appeared to lack justification, or otherwise not supported by verifiable documentation. Personal reviews are also conducted focusing on the agent's AML/CFT knowledge and establishing consistency with the payment institution's existing procedures and the AML/CFT Law. In some cases the findings pointed out the need for further or targeted training as well as to the implementation of corrective actions;



- Agents are usually trained once a year for AML/CFT matters;
- Risk based procedures are applied. It was found that some payment institutions have established a risk classification system for their agents into high, medium and low based on the sub agents' activity level, number of internal suspicious transactions filed, due diligence procedures and compliance with the AML/CFT Law and the institution's internal policies. Some payment institutions have established as a policy for a fresh subagent to be placed under a probation program for a period of 6 months. Some other have established the agents' profile based on the daily and monthly transactions.

The value of outward transfers was considerably higher than the value of inward transfers, concluding thus, that the MTB service is mainly used for outward transfers. The total outward value of transactions was €221mio during 2015 and €216mio during 2014. Based on the monthly statistics submitted to the CBC, 69% (2014: 67%) of the international outward transfers corresponds to the outward transfers to third countries (Asia, Africa, America and Australia).

Transactions with MTBs are paid for in cash. Transactions below €1,000 do not carry the requirement for MTBs to maintain information on the customers' identity although identification of the customer is required at all levels. Due to the absence of durable relationships with customers and the nature of transactions, some money remitters find it particularly challenging to perform ongoing monitoring with a view to detect inconsistencies of transactions in comparison to customers risk profiles.

Bearing in mind the heightened TF risks associated with this activity, it was not possible to identify any trends corresponding to activity from or towards specific jurisdictions because of the manner in which the statistics are collected. Detailed analysis of destination would be needed in order to allow for further analysis to be carried out.

A summary of the inward and outward transfers is included in table 4 below derived from CBC database:



Issuing/ Acquiring service

As at 30 June 2016, three payment institutions were providing payment card issuing and/or acquiring services and one payment institution was granted a license but approval for commencement of operations is still pending. As of the same date, there were also approximately 95 passported institutions. As demonstrated in table 4 above, this service has the biggest share within the sector. During 2014, the license of one out of the four payment institutions, which have been authorised by the CBC to offer issuing and/or acquiring services, was suspended.

The issuing and acquiring service is exposed more to card fraud as opposed to ML. The use of false or stolen identity are common threats for the product. The participants within the sector are aware of the aforementioned typologies in order to identify unusual behaviors, trends and take the necessary measures to mitigate the risk emanating from the threat of the product misuse. International card schemes are also contributing to minimizing the occurrence.

Cash withdrawals by card holders and cross border payments from different geographical areas can be identified as additional trend indicators. Fraud cases were identified during the period 2013-June 2016 according to data obtained from the participants.

The overall risk to which the issuing and acquiring product is exposed to has been evaluated as medium risk. The main clients of such services are merchants who possess bank accounts to enable the payment clearing. The sector classifies as high risk customers only those who were blocked by the systems of the group, (e.g. when the turnover/activity exceeds the internal limits) and some PI's customer risk classification was based on customers' acceptance criteria set by international card schemes. International transactions was another factor considered. The analysis of the data showed that cards issued in Cyprus vs. cards issued abroad were 60% (2014: 79%) and 40% (2014:21%) respectively of the total business value of the sector. Based on this, the international transactions were significantly lower compared to the local transactions. However, as at 31 December 2015 cross border payments from cards issued abroad show an increasing trend, 67% in 2014 and 88% in 2015 posing thus a higher risk in the sector.

The use of cards increases the fraud risk. Most of the payment institutions operating in the sector have established systems on fraud monitoring, as well as various parameters for transactions monitoring. However, a considerable number of fraud cases was identified during 2013-June 2016. The use of false or stolen identity and the multiple cardholders are common threats for the product, unless effective controls are employed to minimise these risks. Additionally, based on statistical data, it was established, that monitoring was performed usually for transactions over the threshold limit of €15,000 thus exposing the sector for transactions below the aforementioned threshold to such risks.



E-money Institutions

E-money is currently a popular means of payment via plastic cards and the internet, offering enhanced accessibility, mobility, simplicity, speed and low transaction cost. These features have led to the wide spread of cards and internet payment channels but at the same time they allow the performing of an easy and fast large sum transfer worldwide. The non-face-to-face element of the client relationship is a particular challenge for EMIs.

Electronic money services in Cyprus may only be provided by an electronic money institution which has been granted an authorization by the CBC, in accordance with the provisions of the Electronic Money Law, 2012 («EML») which was enacted for the purposes of harmonization with the act of the European Community. An authorization for the operation of an electronic money institution is only granted to a legal person which has been incorporated and has its head office in Cyprus. CBC, the designated supervisory authority of the Other FI category, has granted license to six e- money institutions until 30 June 2016, however, only one operates as an E-money institution. The e-money service offers prepaid cards, reloadable via different payment methods (i.e. MTBs, merchants etc.) or not loadable. The use of e-money has been identified in the recent terrorist attacks on European ground as a means to finance the terrorist activity. No typologies have been found for the use of e-money products in Cyprus for ML/TF financing or the use of e-money issued in Cyprus abroad for such acts.

The e-money sector in Cyprus is currently insignificant in the market, due to its size, calculated as 0,3% during 2015 (2014: 0,4%) of the total turnover of the Other FIs' sector. Notwithstanding this, it is recognised that the licensing of four E-money institutions during 2015 and up to 30 June 2016 indicates that the sector is growing. In the light of the above, the regulator remains committed to following through the ongoing of developments. Nevertheless, five out of the six authorised e-money institutions have not yet started or only recently have started operations in order to prompt for an intensified onsite and offsite supervision by the regulator.

Payment accounts (cash placement & cash withdrawal, execution of payment transactions-credit transfers)

The regulator has granted license only to two payments institutions for providing services such as enabling cash to be placed and cash withdrawals on a payment account as well as operating a payment account and execution of payment transactions such as credit transfers, from which one is inactive. This product represents an immaterial percentage within the sector. Approximately 19 providers have been passported to provide these services in Cyprus



on a cross border basis (passporting) however the collection of data on their activities from Cyprus is not applied for the time being. The features of the product which make it less attractive for money laundering. To this end, the product is designated as the less vulnerable product within the sector and was excluded from a detailed review. Customers of the providers in Cyprus have been identified from onsite examinations carried out as legal entities properly vetted by CDD measures who use these services for cost reasons and more personal service offered than traditional banking providers.

Bureaux de Change – Exchange offices

Bureaux de Change services in Cyprus may only be provided by a Bureau de Change business which has been granted a license by the CBC, in accordance with the provisions of the Bureau de Change Business Directive of 2014. This Directive introduces a clear and comprehensive framework for the licensing and registration requirements of the product including the obligation to have appropriate AML/CFT compliance controls in place.

The said product is currently in its infancy. Up to 30 June 2016, the CBC granted four such licenses and these concern companies which have been incorporated and have their head office in Cyprus. One out of these four businesses offices has not yet been granted an approval from the CBC to start operations while only two have started operations via 7 branches in total, aiming at the tourist industry. The regulator will apply offsite and onsite inspections according to the business development in due course.

Known typologies on such product are the use of cash (which can be abused for disguising illegal funds by the way of exchange of one currency to another) and the simpler customer identification practices applied. It is expected that a specialised directive will be issued by CBC for this product and collection of statistics will commence in due course.

Digital currencies

Cyprus law draws a blank, with regard to virtual currencies for the time being. The CBC has drawn the attention of the public to the risks associated with the purchase, holding or trading of virtual currencies (such as Bitcoin), which is not a legal tender. The CBC has twice issued statements about virtual currency risks. According to CBC, Bitcoin is classed neither as a currency in the conventional sense (conforming and adhering to accepted standards), nor as a financial instrument (are monetary contracts between parties) and is hence beyond the realm of regulation.

Transactions in virtual currencies are more liable to be misused for illegal activities, they are public, but the owners and recipients of these transactions are not. Transactions are largely



untraceable and provide virtual currency consumers with a high degree of anonymity. It is, therefore, possible that the virtual currency network will be used for transactions associated with criminal activities, including money laundering.

Currently, a university in Cyprus has announced that it accepts Bitcoin for payment of tuition and other fees. No other use of cryptocurrencies has been documented yet.



1.7 DNFBPs' VULNERABILITY

The Designated Non-Financial Businesses and Professions ('DNFBPs') sector considered for the purposes of the national risk assessment encompasses a wide spectrum of businesses. Specific reference to each activity is made in the following paragraphs

Auditing Firms

The Audit profession in Cyprus is governed by the Auditors and Statutory Audits of Annual and Consolidated Accounts Law, L53(I)/2017.

The Law designates the Cyprus Public Audit Oversight Board (CyPAOB) as the ultimate competent authority for the audit profession on the island, whilst recognises ICPAC as a Recognised Body of Auditors (RBA).

Audit firms may be in the form of a limited company, a partnership or of a sole practitioner and in order to practice the profession, they have to obtain an auditing license by a Recognised Body of Auditors (RBA).

Audit firms perform an external audit on their clients in order to assess whether the financial statements give a true and fair view. Audit work is based on the International Standards on Auditing as issued by IAASB, as well as on the above Law. It involves, inter alia, a specific methodology for carrying out the audit in accordance to the risk analysis of the client, as well as an assessment of the risk of material misstatements in the financial statements. The audit firms, being independent from any operational or other executive activity with the client, are not involved in any sort of handling customers' funds and clients' money. The monitoring of quality assurance system of audit firms is performed by the CyPAOB and ICPAC to confirm compliance with the Auditors Law 2017 via on-site visits and file reviews.

All audit firms and auditors are also subject to the AML/CFT Law, which imposes strict ongoing customer identification and due diligence procedures and requires reporting of money laundering suspicious transactions. ICPAC, as the relevant competent authority under the AML/CFT Law, monitors the compliance of the audit firms with the provisions of the Law. This is achieved through separate on-site visits and customer file reviews, known as the AML/Rules and Regulations review. In order to maximise independence, objectivity and competence, ICPAC outsourced the on-site audit monitoring and AML/Rules and Regulation reviews to the Association of Chartered Certified Accountants (ACCA) of UK.

ICPAC fully endorsed the Code of Ethics for Professional Accountants ("the Code") issued by the International Ethics Standards Board for Accountants (IESBA). As a result, all auditors are subject to the provisions of the Code in relation to ethics and integrity. This forces them to decline or discontinue a specific professional activity or service when they



detect a significant threat for non-compliance with the principles of the Code. Hence, pure audit firms (i.e. those not providing administrative services) are of a much lower risk regarding in terms of aiding customer money laundering activities.

Legal Profession

The CBA is the professional body for over 3.000 advocates and is the competent authority for the professional activities, including trusts and administrative services, of lawyers, a company of lawyers (LLC), partnerships and limited liability companies owned 100 % directly or indirectly by lawyers (ASPs).

CBA performs on-site and off-site inspections to its regulated entities providing administrative and other services as defined in Law (188(I)/2007) based on a risk-based approach in order to ensure compliance of its supervised entities with the provision of the AML/CFT Law and regulations.

Exception to the supervision of the CBA for AML/CFT purposes are lawyers providing litigation services only since they are considered to be of minimal risk regarding AML/CFT matters. To this end litigation services only, have been excluded from the National Risk Assessment. Regulated entities which provide litigation services in conjunction with other services fall within the scope of the National Risk Assessment and as such have been included in the assessment under the Trust and Company Service Providers Section.

Trust and Company Service Providers (TCSPs)

Non-financial sector – TCSPs

A. Introduction

This section focuses on professionals and firms that provide trust and company services. According to the Law 196(I)/2012 regulating companies providing administrative services and related matters of 2012, the provision of trust and company services are supervised and regulated by the three supervisory bodies CySEC, the CBA and ICPAC.

The main activities of the TCSPs comprise of the provision of Fiduciary services, Corporate Secretarial and Administration services, Accounting and Trust services as well as some other auxiliary services to the above such as HR/payroll and domiciliation services.

Professionals - accountants and lawyers- under the supervision of ICPAC and CBA respectively, are also regulated and supervised for AML/CFT purposes by the respective bodies when providing trust and company services. Firms and individuals that are not supervised by any of the above professional bodies are licensed and supervised by CySEC.



Each supervising authority, has issued an AML Directive to its members providing specific guidance and requirements for the TCSP's compliance with AML/CFT obligations. Relevant circulars were also prepared and released between 2014 to 2016, informing the members on new developments and clarifying specific issues.

B. CBA -regulated TCSPs

Under the AML/CFT Law, the CBA is the supervisory authority for the professional activities, including trusts and company services, of –

- I. a lawyer as defined in the Advocates Law, Cap.2, or
- II. a company of lawyers (“LLC”) or a general partnership or a limited partnership whose general partners are lawyers, as defined in the Advocates Law, Cap.2, or
- III. a limited liability company owned 100% directly or indirectly by the above, as well as a subsidiary company of such companies.

Between 2014 and 2016, CBA has organised a number of training seminars relating to AML matters, new aspects of the AML/CFT law and regulations and compliance matters for example the duties of CO, the Risk based approach system, clients identification and transactions monitoring.

CBA has developed and adopted a risk-based methodology and tools for offsite monitoring activities and onsite visits.

CBA has been conducting onsite visits to regulated entities since 2010. Since 2013 the AML/CFT Supervision Department has adopted the risk- based methodology. Onsite visits performed to each regulated entity according to the risk that they are classified. High risk regulated entities are visited annually or every two years, medium risk every 3 years and low risk every 4-5 years.

The overall process of the onsite visits has identified the following common deficiencies:

- a) the reliability of client data
- b) Shortcomings in developing an effective risk-based approach procedure for clients' risk classification.
- c) Shortcomings in staff and profession training for monitoring transactions in order to compare transactions with client profile and therefore effectively identify and record unusual transactions.

Depending on the level of compliance, CBA has issued several written warnings in relation to its findings.



Areas of concern as regards the CBA include, the effectiveness, proportionality and dissuasiveness of the sanctions imposed in cases of non-compliance and the improvement of intensive and targeted training.

CBA taking into account the new AML/CFT matters arising (updates on Cyprus Legislation, EU directives, regulations etc.) plans to organise more specialised seminars/ workshops in order to offer targeted training and education to its members.

The overall ML risk for TCSPs regulated by the CBA was assessed Medium-High.

C. CySEC-regulated TCSPs

As at the beginning of 2016, 148 TCSPs were authorized by the CySEC.

CySEC's AML/CFT Directive provides specific guidance and requirements for TCSPs' compliance with AML/CFT obligations. In addition, CySEC has a strong and comprehensive framework for licensing and registration requirements for TCSPs. All TCSPs are obliged to apply adequate and appropriate systems and procedures for the prevention of ML/TF and are required to submit their AML/CFT procedures manual as part of their TCSP license application. The framework also includes a "fit and proper test" for the persons who effectively direct the business of the TCSP and their beneficial owners, and requirements for the skills, knowledge and expertise of the person to be appointed as the AML/CFT compliance officer. CySEC's supervision entails on-site inspections and off-site inspections of TCSPs AML reporting obligations.

One of the main vulnerabilities identified during the assessment is the effectiveness of supervision. CySEC's lack of human resources resulted to a relatively low number of on-site inspections during the assessment period (January 2013 – June 2016). While the problem was partially tackled in 2015 with the assistance of external providers, the large and increasing number of CySEC's regulated entities requires that CySEC is adequately staffed in order to be able to perform its supervisory duties more effectively and in line with its Risk Based Supervision Framework ('RBSF').

A further vulnerability identified, concerns the performance of TCSP's compliance function. The findings from CySEC's onsite inspections indicate weaknesses in the measures and procedures adopted by a number of regulated entities for compliance with their AML/CFT obligations. During the assessment period, CySEC issued several written warnings in relation to ML/TF compliance weaknesses/deficiencies. Some of the weaknesses identified include the collection of all the relevant data/information required for the construction and updating of a client's economic profile as per CySEC's Directive's requirements, and weaknesses in the procedures followed for the monitoring of clients' accounts and transactions. In some occasions firms failed to take into account all risk factors, apart from the situations which are prescribed in CySEC's Directive as high risk, such as clients' specific characteristics, services provided, clients' geographical location, clients' business activities etc. TCSPs corporate governance is also an area that requires improvement. Off-site reviews also revealed that the Compliance Officer's Annual Report was not detailed enough as prescribed by the CySEC's Directive.



The weaknesses identified above suggest that the AML knowledge of staff and the quality of the training provided needs to be improved. Finally, the low number of SARs submitted to MOKAS is an additional area of concern.

A mitigating factor to the above is the fact that TCSPs covered in Law 196(I)/2016⁷⁸ were only recently authorized and supervised by the CySEC, and as such, TCSPs' compliance functions were not able yet to fully understand and apply the AML/CFT legislation requirements. It is therefore anticipated that, with CySEC's increased monitoring and guidance, TCSPs compliance functions will eventually mature and perform more effectively their AML/CFT obligations.

The overall ML risk of the CySEC-regulated TCSPs was assessed as Medium High.

D. ICPAC-regulated TCSPs

ICPAC licenses only existing members and firms belonging to its members, in accordance with the Regulations of the Institute.

More specifically ICPAC licenses and regulates:

- i. A sole practitioner who is a member that fulfills the criteria of obtaining a practicing certificate
- ii. A partnership with at least 50% of the partners being members and holding a practicing certificate and control the majority of the voting rights under the partnership agreement
- iii. A limited company with at least 50% of the directors being members and holding a practicing certificate and control the majority of the voting rights under the articles of association

At the end of the assessment period (January 2013 – June 2016), ICPAC licensed and monitors 679 licensed firms of which 307 are TCSPs.

During the last 3 years, ICPAC organised a significant number of training activities for its members focusing on AML matters, new Laws and Regulations regarding monitoring and licensing, as well as other compliance related matters.

ICPAC exercises its monitoring function on its practicing members and firms via two specialised monitoring programs, namely, the Audit Monitoring review, and the AML/Rules & Regulations review.

The monitoring procedures consist of the off-site surveillance stage, which involves the gathering of information via a designated questionnaire and the processing of the results to

⁷⁸ <http://www.cysec.gov.cy/en-GB/legislation/services-markets/asp/#>



calculate a risk score for every licensed entity and the on-site inspection stage, whereby ICPAC performs field audits to the firms, based on the results of the off-site surveillance.

ICPAC has been performing the audit monitoring program since 2005. Up to 2015, when the specific monitoring program was adjusted, the audit monitoring review encompassed a section for AML awareness. In 2015, the AML/Rules & Regulations Review was introduced, which includes a thorough review of all AML aspects, constituting a stand-alone comprehensive monitoring procedure.

Both of these monitoring procedures have been outsourced to the Association of Chartered Certified Accountants of UK, (ACCA), where, according to the Regulations of the Institute, all licensed firms will follow a 6-year cycle for AML monitoring purposes.

The experience from the on-site inspection visits reveals that there is an overall awareness by members regarding their responsibilities with respect to AML and no serious breach of the AML/CFT Law or Regulations was detected. However, general observations include:

- Although member firms have an AML procedures manual, they haven't yet been able to fully implement it.
- Shortcomings in establishing a risk based approach for assessing the risk of their clients and assigning a risk profile.
- Shortcomings in proper record keeping from third parties, something which is brought to their attention and subject to review on the specific matter on the next on-site inspection.
- Shortcomings in thorough Customer Due Diligence and Enhanced Due Diligence procedures, which has been dealt with by the services provided by ICPAC.

Warning letters have been issued after the monitoring visits where required.

ICPAC recognises the necessity for improvement hence, it is committed to the continual training and education of its members and licensed firms. Further to the training and education, ICPAC plans to improve the firms overall understanding of the compliance function through improving effectiveness of the AML review process and enhancing the quality of the review points/feedback of the reports issued.

The improvement in the reporting process and final report will also assist to tackle the weakness with regards to the lack of significant administrative sanctions. ICPAC is examining the need and extend of administrative sanctions as well as the most efficient way to evaluate the sanctioning process.



Lastly, ICPAC place emphasis on the low level of suspicious activity reporting and is planning to offer workshops/presentations illustrating examples of reportable scenario and guidance on how to identify reportable suspicion and asses the quality of each suspicion report.

The overall ML risk for ICPAC-regulated TCSPs was assessed as Medium High.

E. Conclusion

All TCSPs are fully monitored by the three supervising bodies. Improvement measures as regards to procedures related to AML/CFT matters include strengthening the supervisory framework and further harmonizing the monitoring process and policies as to ensure consistency of the three regulators.

Finally, all three supervisory bodies should put in place a common communication platform whereby they can exchange information on sanctioned, stricken-off and rejected/declined firms to secure access to the profession and prevent the firms from continuing their activities by registering under another body once they were banned from one of the three bodies.

Real Estate Agents

The current AML/CFT legal provisions expressly designates the FIU as the Supervisory Authority for the real estate agents sector following a decision adopted by the Council of Ministers in 2006. Additionally, the AML/CFT Law expressly designates the FIU as the supervisory authority for real estate agents.

The composition of the sector is made up of individuals and legal entities.

Real estate agents are obliged entities, designated as such by the AML/CFT Legal Framework. In 2007, the FIU issued a Directive to the members of the Cyprus Estate Agents Registration Council (Registration Council), which underlined their obligations on the designation of a compliance officer, KYC procedures, STR submission to the FIU regarding suspicious activities by their clients, and at the same time stressing their obligation for confidentiality and the seriousness of any tipping off and/or failure to report, which are criminal offences. The Directive was revised in 2013.

Information and statistics of the sector is held by the Cyprus Estate Agents Registration Council. Additional information on the value and type of transaction of the sector are kept by the Land and Surveys Department.

The FIU has designated two of its members with the task of supervising the sector, who are in contact with the Cyprus Estate Agents Registration Council, for any updates/developments/changes in the real estate sector. The supervisory authority organised a number of seminars and explained to the members of the Council the importance of the



Directives and their obligations. Onsite visits were performed to a number of estate agencies in 2013, to check that they comply with KYC procedures and no sanctions were imposed. However, the FIU informed the members of the Council that it will perform unexpected onsite visits to various estate agents in Cyprus.

In November 2015, the FIU organised a Conference to present its data system goAML. Representatives from the Cyprus Estate Agents Registration Council and the Cyprus Estate Agents Association attended the conference and were informed about the new system.

It must be noted that the FIU has received a small number of SARs from banks regarding real estate agents and none by the sector itself. This raises concerns in the sense that money laundering may occur but is left unidentified and unreported by the obliged entities.

Consideration should also be placed as to whether Property Developers should be governed by AML/CFT obligations since they also perform sales of immovable property.

Dealers in Precious metals and stones/jewelers

The sector is characterised by small boutique shops, the turnover of which has decreased dramatically in the past few years due to the economic crisis.

All jewelers and traders in precious stones and metals are obliged by Law to apply to the Cyprus Assay Office, which is under the umbrella of the Ministry of Commerce, Industry and Tourism, in order to receive licensing and be recorded in the Registry of the Office to be eligible to conduct business lawfully as per the 2012 legislation.

The sector was assessed as low threat due to the fact that, the Cyprus jewel market has long been composed of small boutique shops, the raw material for the make of various jewel designs is imported since Cyprus and the local jewel shops have lots of low value transactions. In fact, these are small local shops.

At the end of the assessment period, the number of traders in precious metals and stones amount to 154, the number of jewelers licensed to sell jewels and other precious stones and metals amounted to 723 and the number of jewelers licensed to buy second hand jewels amounted to 188.

The FIU is the Supervisory Authority for the dealers in precious metals and stones, following a decision adopted by the Council of Ministers in 2006. Additionally, the AML/CFT law expressly designates the FIU as the Supervisory Authority for dealers in precious metals and stones. The FIU issued a Directive to these professionals regarding the obligations prescribed in the AML/CFT Law.

The FIU has designated in 2006 two of its members to supervise and train professionals in this sector. Seminars were conducted in 2010 regarding the content of the Directives. Onsite



visits were performed on a random basis, to check KYC procedures. No penalties were imposed but a warning letter was issued by the Unit.

In November 2015, representatives of the Cyprus Jewelers Association attended the conference regarding the presentation of the new electronic system of the FIU, goAML.

The FIU received a limited number of SARs from banks relating to traders in precious stones and metals. Upon further investigations, a warning letter was issued by the Unit but no sanctions were imposed. The limited number of SAR's may indicate that suspicious activities may, even on a small scale, take place but are left unidentified and unreported by the obliged entities.

Additionally, a large number of thefts have taken place in Cyprus in the last four years, against jewel shops and individuals, and one cannot exclude the possibility that these items maybe traded in the black market or even transported to the occupied areas of Cyprus for further use.

Betting activity

The National Betting Authority (the "NBA") is an independent authority established on 11th July 2012, in accordance with the provisions of The Betting Law 106(I)/2012⁷⁹. The NBA is the competent authority responsible for the licensing, regulation and supervision of the betting sector, as well as tax collection for sports betting, excluding horse racing bets, with annual turnover of the preceding fiscal year totaling approximately EUR135.738.000.

The Betting Law defines betting in Cyprus as any type of bet on sporting events or other events in which a number of physical persons participate, and which are carried out offline and online. The conduct of slot machine gaming, online casino, games of chance, betting exchange, spread bets and betting services on dog racing are strictly prohibited by the Law.

Currently in Cyprus there are 11 Class A licensed bookmakers, 600 licensed betting shops, and 500 authorised representatives. Betting activity has been set out in accordance with the regulatory framework for preventing and combating illegal gambling, which is being coordinated by both the NBA and the Cyprus Police. According to the Betting Law, the NBA has the power to issue Directives to Class A and B licensed bookmakers, authorised representatives and holders of licenses for premises as well as apply measures for preventing and combating money laundering, in accordance with the provisions of the AML/CFT Law and in cooperation with the Advisory Authority.

The directives issued by the NBA are based on and in line with all AML preventive measures and legislation, as well as with the EU *acquis communautaire* and the international

⁷⁹ http://www.nba.com.cy/eas/eas.nsf/page01_gr/page01_gr?OpenDocument



typologies. The application of the said directives is binding and compulsory by the persons to whom they address and the NBA supervises their compliance through licensed Class A and/or B bookmakers and the authorised representatives. It is underlined that the directives include conditions for the issuance or renewal of licenses. It is noted that no penalties have been imposed, and no license has been revoked yet due to AML deficiencies, since the implementation of the Betting Law.

The NBA is currently in the process of issuing a Guide on AML, which will be completed by the end of 2017. The overall performance of the activities of the NBA is considered satisfactory, given that the Betting Law was introduced only three years ago. In order to adequately perform its functions, it is deemed necessary for the NBA to be reinforced with qualified human resources and implement a continuous training scheme including AML/CFT matters. Moreover, seminars are being programmed for educational purposes that will benefit the NBA personnel, as well as seminars addressed to the licensees.

The technical standards on betting systems will be determined by the Regulations that will be adopted within a two year-period, thus the systems monitoring the betting activity will be standardised in order to become more effective. Also, since the online regime will be licensed within the next year, all the control measures will be applied to establish an online regulated market. For this purpose, the Authority is planning to develop and install a computerised networking system to receive real-time data reporting on the betting activity conducted by the licensed bookmakers. The operations of the regulatory body will become more efficient, having the ability to identify the risks and detect the vulnerabilities of the bookmakers' systems.

Concluding, authorities would be expected to consider whether all betting and gambling related industries should be regulated by a single Authority thus benefiting from knowledge sharing, synergies in regulation and supervision and a common action plan in the industry's fight against ML/TF.

Non-Profit Organizations (NPOs)

There are five main types of NPOs in Cyprus namely Non-profit companies governed by the Companies Law (Cap.113), the Charities governed by the Charities Law and the Foundations/Institutions, Societies/Associations and Clubs governed by the Associations, Foundations and Clubs Law (104(I)/2017).



Non-Profit Companies

The Cyprus Companies Law (Cap. 113) covers non-profit companies (NPCs) equally to for-profit companies and have the same obligations, however, non-profit companies are not allowed to distribute dividends. NPCs are registered to promote one of the following causes: Art, Science, Charity, or any other similar cause/objectives.

At the end of 2016, the number of NPCs, according to the licences issued for the exclusion of the word "Limited" at the end of the company's name, was 382.

Charities

Charities for educational, literary, scientific or public purposes are licensed and registered by virtue of the provisions of the Charities Law (Cap.41) and a certificate of incorporation is thereby granted. Registered charities are obliged to prepare and file audited accounts for all receipts and all payments.

At the end of 2016, the number of registered Charities was 58.

Foundations/Institutions, Societies and Associations and Clubs

Foundations/Institutions, Societies and Associations and Clubs are governed by the Associations, Foundations and Clubs Law (104(I)/2017). Under the new law enforced in 2017, all entities are under the supervision of the Ministry of Interior, they have an obligation to keep accounts and appoint an auditor for their financial affairs and submit financial statements to the Registration Authority. In case of non-compliance, the Registrar can request a court order for dissolution of the organisation concerned.

At the end of 2016, the number of registered Foundations/Institutions was 379, the number of registered Societies/Associations was 4,568 and the number of registered Clubs was 675.

Conclusion

It is noted that the overall ML/TF risk of the NPO sector is assessed as Medium-Low since there is no evidence or case law for its abuse for ML and TF.

The CBC has issued guidance to the credit institutions regarding the vulnerabilities of the NPO sector with respect in particular to terrorist financing. However, with the enactment of the new Legislation the NPO sector will be more effectively regulated and monitored and sanctions can be implemented in the future. Moreover, further analysis will be conducted regarding the risks faced by NPO sector with a view to raising awareness as to the potential threats and vulnerabilities of the sector.



Tourist Sector, Restaurants and Bars

It is clear that the responsibilities of CTO are restricted to supervising the regulations of the establishment (building licenses, fulfilment of special provisions and other), the pricing (technical aspect) and the staffing (training, social insurance contributions and other).

The risk for ML and TF abuse of the sector was assessed as low due to the nature of the operations and, as a result, this sector was excluded from the scope of the NRA.

Car Dealers

Car dealers sector (importers of new and second hand cars) was assessed as a relatively low risk sector and as a result it was decided to exclude it from the scope of our NRA. The car dealers sector in Cyprus is divided between a) Importers of new cars and b) Importers of second hand cars (mainly from the United Kingdom, Japan and Singapore). During the period between 2010 and 2016 the market share of the new cars was 54% (compared to 46% for second hand cars).

The financial crisis in Cyprus had a huge effect in the car dealers sector in Cyprus. During the period 2010 to 2016 the sector (number of cars sold) decreased by 20% (during 2013 the decrease was 56%). The total value of cars sold was €521 million in 2010 compared to €428 million in 2016, decreased by 18% (during 2013 the decrease was 52%). The percentage of high value luxury cars to total registration of cars is almost 2%.

The risk identified in the second hand cars dealers is judged as higher than the new car dealers (based on tax controls performed by the tax authorities).

It is recommended that the sale of luxury cars is monitored by the tax authorities on a regular basis. Currently those checks are done on an ad hoc basis therefore an establishment of a standard periodic review of all car dealers may have some significant results.

On a different note it could be considered whether all car dealers should be licensed and perhaps provide some information of their operations on an annual basis.

Sport Clubs

The most popular sport in Cyprus is football, which falls under the supervision of the Cyprus Football Association. All other sports have very low publicity and consequently have limited budgets.

The estimated total budgets of football clubs participating in the First Division were €27.663.000 in 2016 (June), €38.549.000 in 2015 and €30.843.000 in 2014. The main source



of income for football clubs comes from the UEFA competitions (if the club manages to qualify in European Group stages), TV rights, sponsorships and tickets. Total tickets sold during the period 2015-2016 were 460.105.

During the last three years, clubs have tightened their budgets mainly because of the financial crisis, and the Financial Fair Play rules imposed by UEFA. Most transfers performed are free and only in rare occasions clubs are willing and financially able to pay transfer fees for players.

In view of the above, and taking into account the small size of sport clubs compared to economy as a whole, it is considered that sport clubs pose minimal risk as far as ML/TF is concerned.

Certifying Officers

It is considered that certifying officers do not pose any ML/TF risk and are therefore excluded from in-depth analysis for the scope of the NRA. This conclusion was based on the fact that their duties and responsibilities are very limited, mainly being to certify that the signature or seal subscribed or affixed to any document is the signature or seal of the person whose signature or seal it purports to be. The certifying officer does not certify the contents of the document and is not involved in any financial transaction, consequently charging very low fees. Furthermore, supervisors such as the CBC do not allow supervised institutions to discharge their duties for certification of identification documents by a mere acceptance of copies of documents from certifying officers.

Art Auction Houses

The sector is very small and not regulated in any way and due to the absence of official information it was excluded from an in-depth analysis. There is no requirement for art auctioneers to be licensed and therefore there is no association to issue guidelines and govern this sector. Due to this factor, it has not been possible to assess the sector's vulnerability, yet it is known that very few auction houses operate in Cyprus. Also, marketability of Cypriot artists is very limited and it is unlikely that Cypriot art can be misused for storing illicitly obtained wealth.



SECTION 2 – TERRORIST FINANCING RISK

2.1. Terrorism and terrorist financing ('TF')

Cyprus has not been confronted with any violent terrorist incidents in the last 27 years. Nevertheless, the Government has demonstrated over the years a strong political commitment in joining forces with other countries in the fight against terrorism and terrorism financing. National legislation was enacted criminalizing terrorism and terrorism financing, imposing a number of preventing and suppressive measures and aligning national legislation with the international and EU relevant legislation. A number of administrative and other measures were also taken as part of a strong, integrated strategy to fight terrorism and terrorist financing. In 2014, the national Counter Terrorism Strategy was adopted by the Council of Ministers in line with the EU Counter Terrorism Strategy and is focused on four Pillars: protect, prevent, pursue and respond. Under the Pillars Protect and Pursue priority is given to the implementation of actions relating to the prevention and combating of terrorist financing.

The terrorism incidents that occurred in various countries in the recent years and the security situation in other countries in the region, have raised concerns regarding the level of terrorism threat for the country. Cyprus's proximity to Syria and other Middle East countries has prompted the Cyprus authorities to increase the security measure and raise the terrorism threat level to medium.

Cyprus has recognised the importance of countering terrorist financing in the fight against terrorism and has adopted and implemented all international instruments in this area. Moreover, domestic legislation was enacted as it will be explained under section 2.3. The comprehensive legal framework developed and the wide range of legislative and administrative measures taken have assisted in mitigating the risk of the misuse of the country's financial system by terrorists.

The recent terrorist incidents and their effect on the level of terrorism and terrorist financing were taken into consideration when assessing TF threat, and the level is assessed as medium. Statistical information gathered indicate a low number of reported suspicious activities and international requests received by the FIU and zero number of international requests for mutual legal assistance in criminal matters received in relation to TF. Further, up to date, no persons or entities from the lists issued by the UN and EU have been identified to have assets in Cyprus.



2.2. TF Threat Analysis

Introduction

The relevant authorities involved in the countering of Terrorism and Terrorist Financing are the Ministry of Foreign Affairs, the Ministry of Justice and Public Order, the Police, The Law Office of the Republic, the FIU, the Department of Customs and Excise (DCE) and the Cyprus Intelligence Service.

For the purposes of the national risk assessment project, a team was formed comprising of representatives of the FIU, the Cyprus Intelligence Service and the Counter Terrorism Office of the Police.

The FIU was designated under section 9 of the Law Ratifying the International Convention for the Suppression of the Financing of Terrorism (Ratification Law No. 29(III)/2001 as amended by Law No. 18(III)/2005, to be the national competent authority with regard to financing of terrorism and as such is responsible for receiving and analyzing suspicious activity reports relating to financing of terrorism. Under section 55(I)b, is empowered to disseminate to the police and other State agencies, information and material for the purposes of conducting investigations where there are reasonable grounds for believing that a FT offence has been committed or for intelligence purposes.

The Cyprus Intelligence Service (CIS) is an independent Government Authority reporting to the President of the Republic and its main task is to safeguard the National Security of the State. CIS is responsible for collection, evaluation, analysis and utilization of intelligence that relates to the security of the State, including intelligence on Terrorism and Terrorist Financing.

The Counter Terrorism Office of the Police operates under the Criminal Investigation Office of the Cyprus Police Headquarters with the purpose of coordinating all actions/policies of the Cyprus Police taking into consideration the obligations deriving from the relevant International Conventions, UN Resolutions and EU legislation. It acts as the contact point for the exchange of information and requests concerning terrorism with the respective authorities of European and third Countries. It works closely with the CIS as well as with the FIU.

In assessing the terrorist financing threat the following were taken into consideration: the current level of terrorism threat and its expected future trend as analysed and evaluated by the relevant competent authorities, statistical information from the FIU, Police, CIS, Ministry of Justice and Public Order, DCE, as well as, data from specific cases.



2.2.1 Terrorism Threat

As for many other countries, and considering the country's proximity to the conflict areas, the terrorist threat for Cyprus could emanate from neighboring countries. It is noted that in 2012 and 2015, two persons were prosecuted and convicted in two different cases. In the first case, the accused was convicted for participation in a criminal organization. In the second case, the accused was convicted for several charges including provision of support to a terrorist group, under section 8(1)(a) of the Counter Terrorist Law No 110(I)/10 as well as money laundering and a confiscation order was issued.

2.2.2. Terrorist Financing Threat

In Cyprus there are no native groups designated as terrorists.

It is assumed that TF threat emerging from external funding is higher than the threat emerging from domestic funding. Although, there is little evidence for TF, and despite the low number of operations relating to terrorism activities up to date, the risk of terrorist funding cannot be excluded.

Cyprus, being a financial center, offering international business facilities, can be abused for TF. Therefore, the threat level is assessed as medium.

2.3. National Vulnerability to TF

2.3.1. Criminalization of TF and other laws

Terrorist financing is criminalised consistent with section 2 of the International Convention for the Suppression of the Financing of Terrorism, through a direct reference in section 4 of the Law Ratifying the International Convention for the Suppression of the Financing of Terrorism (Ratification Law No. 29(III)/2001 as amended by Law No. 18(III)/2005) which was enacted in October 2001.

In addition, the Combating of Terrorism Law of 2010 (No. 110(I)/2010) was enacted and came into force on 22 November 2010, to provide a comprehensive legal framework in the area of terrorism. This law aligns national law with the EU acquis in this respect and in particular "Council Framework Decision 2002/475/JHA of 13 June 2002 on combating terrorism" as amended by "Framework Decision 2008/919/JHA". This law criminalises the provision of support in any manner to terrorist groups or persons, including financing.

Moreover under section 5(b) of the AML/CFT Law, financing of terrorism offences as these are specified in Section 4 of the International Convention for the Suppression of the Financing of Terrorism (Ratification Law No. 29(III)/2001 as amended by Law No.



18(III)/2005), as well as the collection of funds for the financing of persons or organizations associated with terrorism are considered as predicate offences.

The criminalization of terrorist financing is considered comprehensive and it is in line with the aforementioned international instruments. The enactment of the Combating of Terrorism Law of 2010 (No. 110(I)/2010) addressed the deficiencies identified in the 4th Moneyval MER in relation to the criminalization of TF. The AML/CFT Law includes provisions for freezing and confiscation which apply to funds/assets related to terrorist financing. It is noted that the effectiveness of legislation was difficult to be assessed as it has not been adequately tested in Courts since, up to date only two cases in relation to terrorism were prosecuted. The assessment was therefore mainly based on reviewing the existing legislation for grounds of improvement and in comparison with the international and EU relevant legislation and recommendations.

In this context, the Combating of Terrorism Law of 2010 (No. 110(I)/2010) could be amended for the sake of clarity to include a definition of terrorist financing. Furthermore, the AML/CTF law is under amendment to incorporate the definition of terrorist financing as provided by the 4th EU AML Directive.

2.3.2. NPO sector

Regarding the NPO sector and as mentioned in section 1.8 of the report a new law was enacted on 14 July 2017, N. 104(I)/2017, amending the law on Societies and Foundations Law and abolishing the Club Registration Law. This law is comprehensive and includes among others, provisions on the registration and supervision of such entities as well as the obligation to submit audited financial statements. It should be also mentioned that supervisory authorities have already addressed the issue of possible abuse of the NPO sector for TF in their Directives.

In the course of the development of the NRA, the FATF Recommendation 8 on non-profit organisations, as well as the relevant recommendations made in the EU Supranational Risk Assessment published in July 2017, were taken into consideration. Most of the elements under the interpretive note of Recommendation 8 are included in the new law enacted in July 2017, as mentioned above.

However, more measures are considered necessary in order to identify potential vulnerabilities of the sector aiming in identifying which type of NPOs pose higher risk for possible abuse for TF purposes. Such measures will be based on a risk based approach with first priority the outreach to the sector by the relevant Authority responsible for the registration and supervision of the NPOs.



The Advisory Authority is considered to be the appropriate forum to raise these issues, by inviting the Ministry of Interior and address recommendations and suggestions aiming at the development of further measures, on a risk based approach, so as to fully meet the requirements of the FATF Recommendation 8. Such measures should undoubtedly include training of all parties involved in this area such as the Authority and the NPOs.

2.3.3. Financial sanctions relating to TF

The Combating of Terrorism Law of 2010 (No.110(I)/2010), also entails implementing provisions regarding "Council Regulation (EC) No 2580/2001 of 27 December 2001 on specific restrictive measures directed against certain persons and entities with a view to combating terrorism", as well as "Council Regulation (EC) No 881/2002 of 27 May 2002 imposing certain specific restrictive measures directed against certain persons and entities associated with Usama Bin Laden, the Al-Qaida network and the Taliban, and repealing Council Regulation (EC) No 467/2001 prohibiting the export of certain goods and services to Afghanistan, strengthening the flight ban and extending the freeze of funds and other financial resources in respect of the Taliban of Afghanistan" which are considered comprehensive and adequate. This law covers also clearly the relevant UN resolutions 1373 and 1267 with a reference in section 2 under the definition of catalogues and section 17. Sections 8, 15, 16 and 17 of the Combating of Terrorism Law of 2010 (No. 110(I)/2010) establish in essence an obligation to all competent authorities and persons in the Republic to proceed with the necessary enquiries in order to identify whether persons and/or entities included in the UN and EU lists have any assets in the Republic and if such assets are identified, these are frozen immediately.

In addition and irrespective of the procedure provided for in the Combating of Terrorism Law of 2010 (No.110(I)/2010), the Ministry of Foreign Affairs circulates without delay the updates of the UN and EU lists received from the Permanent Representations of the Republic of Cyprus to the United Nations and the European Union to the competent authorities i.e. the FIU, the Governor of the Central Bank of Cyprus, the Chief of Police, the Permanent Secretary of the Ministry of Justice and Public Order, the Ministry of Finance, the Ministry of Interior, the Ministry of Defense, the Ministry of Communications and Works, the Ministry of Energy, Commerce, Industry and Tourism, the Commander of the Central Intelligence Service, the Director of the Cyprus Ports Authority, the Chairwoman of the Cyprus Securities and Exchange Commission, the President of the CBA and the President of the Institute of Certified Public Accountants of Cyprus. Relevant notification to all the above mentioned authorities takes place regarding also the de-listing of certain persons/entities from the UN and EU lists.



It should also be noted that an amendment to the Combating of Terrorist Law of 2010 has been enacted on 14/7/2017 which explicitly provides for the obligation to freeze all funds, other financial assets and economic resources owned or controlled wholly or jointly, directly or indirectly by a designated person or persons and entities acting on their behalf or under their direction. For this purpose designated person or entity means a natural or legal person, group or entity included in the catalogues, including the natural or legal persons, groups or entities in respect of which article 4 of the Council Common Position 2001/931/CFSP of 27 December 2001 on the application of specific measures to combat terrorism applies, as this is subsequently amended or substituted. It also provides for the obligation of persons carrying out financial or other business activities to report to the Ministry of Foreign Affairs any assets frozen or actions taken in compliance with the prohibition requirements of the European Union and United Nations Security Council Instruments. The amending law further provides for penal sanctions in case of Infringements of the United Nations Security Council as well as equal penalties for those provided for in the case of infringements of EU regulations, despite the fact that this issue is already covered in a separate legislation which criminalises infringements of all EU and UN instruments imposing sanctions. With this law a clear provision is included with which EU nationals are covered based on a relevant recommendation of the FATF and the Moneyval Committee. The amendment of the Combating of Terrorist Law of 2010 provides explicitly for the obligation to freeze the assets of EU internals thus providing legislative clarity in this respect even though the current procedures are considered as adequate.

The AML/CFT Directives of the supervisory authorities of the financial sector and DNFBPs, in exercise of their powers pursuant to section 59 of the AML/CFT Law, illustrate also the obligations of reporting entities to consult the corresponding lists of the UN and the EU since these are publicly available, in the framework of conducting their customer due diligence obligations and also their reporting obligations to the FIU with respect to suspicious transactions and activities. It is noted that the European Commission keeps an updated Financial Sanctions Database and the financial sector and DNFBPs can subscribe to this database with the latest updates. Credit institutions can also download the consolidated lists through online access. The updated UN lists are also available on the internet and the competent authorities as well as obliged entities have the responsibility to check regularly the lists. Further, it should be noted that the Ministry of Foreign Affairs has set up a dedicated website on sanctions and restrictive measures⁸⁰.

Most of the supervisory authorities circulate the updated lists received by the Ministry of Foreign Affairs to their members as soon as they receive it, but the obligation for their members to check their clientele against the updated lists is pointed out in the

⁸⁰ http://www.mfa.gov.cy/mfa/mfa2006.nsf/eu10_en/eu10_en?OpenDocument



directives/guidelines issued by the supervisory authorities in relation to AML/CFT. As part of the AML/CFT onsite audits, the supervisory authorities assess the effective implementation of EU Regulations and UN Resolutions by the supervised entities. There were some cases identified where reporting entities, other than financial institutions which are considered as most exposed to TF, did not seem to perform checks to identify any connection with the persons/entities on the lists. Additional training and increased and more targeted audits by the Supervisory authorities should be considered. Additionally it should be mentioned that the use of IT customer screening systems is encouraged and supported by supervisory authorities.

With regard to the implementation of certain provisions of the EU and UN sanctions instruments, an Advisory Committee was established upon the Council of Ministers Decision No. 72.222A, dated 17/6/2011, with competency to grant specific authorizations for a) use of frozen funds for essential human needs, b) payments from frozen funds for specific purposes or c) release funds, other financial assets or other economic resources. This is consistent with S/Res/1452 (2002). This Committee is chaired by a representative of the Minister of Finance and is composed of representatives from the Ministry of Finance, the Ministry of Energy, Commerce, Industry and Tourism, the Ministry of Justice and Public Order, the Ministry of Foreign Affairs, the CBC, CySEC and the FIU.

Cyprus, as a Member State of the European Union, implements designations pursuant to UNSCR 1373 through the EU mechanism.

2.3.5. Domestic Cooperation

The FIU can share information with the police and Customs based on the general principles of Law Enforcement cooperation as well as based on existing provisions of AML/CFT law. The Counter Terrorism Office cooperates closely with other members of the Police designated by the Chief of the Police as associates of the Office and includes members of the Crime Investigation Department, Aliens and Immigration Unit, Special Antiterrorism Squad, Crime Intelligence Bureau and others. It also cooperates with the FIU and the CIS.

Recently, legislation has been enacted in relation to the regulation of CIS functioning which further improves cooperation between CIS and other authorities.

Further, a contact person for TF matters was designated within the FIU to enhance the cooperation between the FIU and the police as well as CIS.

The members of the CTO receive counter terrorism training both domestically and abroad. With respect to the FIU training is provided, nevertheless additional training should be considered.



It is also noted that the FIU frequently provides training to reporting entities and to the police on both ML and FT. Courses provided at the police academy include training by a representative of the FIU on both ML and TF matters. Nevertheless, additional training on TF matters and specialised training for TF investigations should be considered both for the FIU and LEAs.

Apart from existing operational cooperation in the process of collection and analysis of data relating to TF and the investigation of TF offences, domestic cooperation is in place at the strategic level as well through the Advisory Authority for the Suppression of ML and TF. As already mentioned, the Advisory Authority for Combating Money Laundering and Terrorist Financing examines policy issues on CTF including possible needs for further legislative and practical measures.

In 2010 a National Counter-Terrorism Coordinator was appointed to improve coordination between all the competent authorities and to increase the effectiveness of the Government's efforts to prevent and combat terrorism. The National Counter-Terrorism Coordinator, who is also the permanent secretary of the Ministry of Justice and Public Order, is responsible for:

- Advising the Government on policymaking with regard to the prevention/combating of international terrorism.
- Coordinating and supervising the implementation of the international and European obligations of the Republic on issues of Terrorism, including EU Action Plans related to terrorism.

Representing the Government at the meetings convened by the European Counter-terrorism Coordinator, as well as at other European and International meetings and concern terrorism.

2.3.6. International Cooperation

International Cooperation related to terrorism financing is based on national law, multilateral treaties and bilateral agreements.

The Law on Combating Terrorism, No 110(I)/2010, provides the necessary framework for the implementation of multilateral Conventions on Terrorism mentioned in Annex 2 of the Law. Sections 23, 24 and 25 of the Law regulate international cooperation. In particular, sections 23 and 24 provide for the exchange of information between the competent authorities of the Republic of Cyprus and the competent authorities of other countries as well as the exchange of information with Europol and Eurojust. Section 25 provides for the establishment of joint investigation teams with other state parties.

The FIU co-operates with foreign counterpart FIUs and can exchange information with any type of FIU (administrative, police, judicial) without the need of a Memorandum of



Understanding ('MoU'). However, MoU's were signed with a number of foreign FIUs. The legal basis for this exchange of information is section 55(c) of the AML/CFT law. International cooperation in this respect is facilitated through Egmont Secured Web, the FIU-Net for cooperation within the EU, as well as Interpol and Europol Channels.

Co-operation on international level is also achieved through the cooperation of the Counter Terrorist Office and CIS with their counterparts.

2.3.8. Political commitment in fighting TF

In 2014, the National Counter Terrorism Strategy was adopted by the Council of Ministers. The strategy complies with EU Counter Terrorism Strategy and is focused on four pillars: protection, prevent, pursue and respond.

Under the four pillars actions are included in relation to exchange of information between competent national authorities, reviewing and increasing of the security measures, training of first line officers, and preparation of contingency plans in the case of attacks etc.

Among the priorities set under pillars 'protect' and 'pursue' of the national counter terrorism strategy, is the implementation of actions relating to the prevention and combating of terrorist financing.

Further, the appointment of a National Counter Terrorism Coordinator during 2010 aimed at improving coordination between all relevant national agencies and increasing effectiveness of the Government's efforts to prevent and combat terrorism.

Under the Counter Terrorism Strategy, the Fusion Center was established. The aim was to create a forum for regular meetings between competent authorities to ensure operational efficiency. Law enforcement and intelligence Services as well as representatives from competent Ministries take part in regular meetings to ensure the timely transmission of information related to terrorism. A national risk assessment is prepared by the Fusion Center every three months. Afterwards a common review and assessment of the situation takes place in the presence also of the CT Coordinator and if necessary initiatives are undertaken for amendments in policy. Finally, it is noted that the Government of the Republic of Cyprus demonstrates a strong commitment to cooperate with international community in all efforts to combat terrorism and terrorist financing and take any additional measures.



INDEX OF TABLES

Table no.	Table heading	Page
Table 1	Resident and non-resident deposits	66
Table 2	Other financial institutions' sector composition	85
Table 3	Other financial institutions - STRs submitted to the FIU	87
Table 4	MTBs inward and outward transfers	91