

ANNUAL REPORT 2002

## CONTENTS

DIRECTORS - MANAGEMENT	4
FINANCIAL HIGHLIGHTS	5
CHAIRMAN'S STATEMENT FOR THE YEAR 2002	6
FINANCIAL REVIEW	22
CORPORATE GOVERNANCE CODE	27
FINANCIAL STATEMENTS 2002:	
Directors' Report	32
Auditors' Report	34
Consolidated Profit and Loss Account	35
Consolidated Balance Sheet	36
Balance Sheet	37
Consolidated Statement of Total Recognised Gains and Losses	38
Consolidated Cash Flow Statement	39
Notes to the Financial Statements	40
IMPORTANT ADDRESSES:	
Cyprus	86
Overseas	87

## BOARD OF DIRECTORS

Kikis N. Lazarides Chairman  
Jacovos Dimitriou  
Michael R. Erotokritos  
Nicos A. Hadjinicolaou  
John A. P. Hill  
Marios E. Lanitis  
Platon E. Lanitis  
Andys Loutsios  
Rena Rouvitha Panou  
Andreas Papaellinas  
Chris Pavlou  
Anthony Townsend

## SENIOR MANAGEMENT

Kikis N. Lazarides Executive Chairman  
Michael R. Erotokritos Executive Director  
Charalambos Schizas General Manager  
Neoklis Lysandrou General Manager  
Petros Petrou General Manager

## SECRETARY

Stelios Hadjijoseph

## MANAGER

## GROUP FINANCIAL CONTROL

Annita Philippidou

## AUDITORS

PricewaterhouseCoopers

## LEGAL ADVISERS

Tassos Papadopoulos & Co

## REGISTERED OFFICE

154, Limassol Avenue, 2025 Nicosia

## NOTE

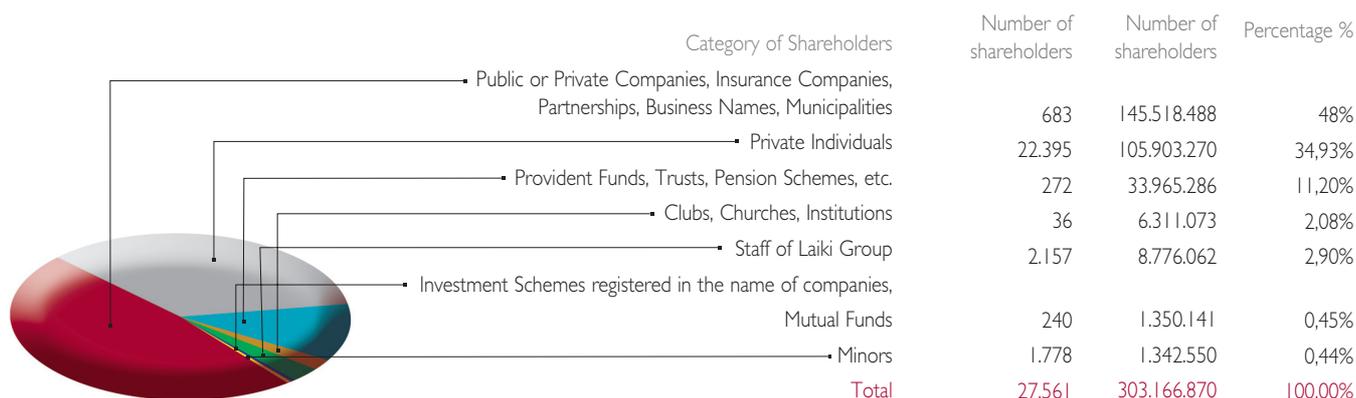
The Annual General Meeting will be held on May 21, 2003 at 6:00 p.m. at the Hilton Park Hotel, Nicosia.

## FINANCIAL HIGHLIGHTS

	2002	2001	2000	1999	1998
	£ '000	£ '000	£ '000	£ '000	£ '000
Group operating profit	52.886	19.871	82.341	167.157	53.157
(Loss)/profit attributable to the shareholders	(51.833)	(9.263)	46.526	131.324	26.078
<b>Capital resources</b>					
Capital	151.819	149.404	149.107	87.857	76.011
Reserves	123.281	152.895	220.071	280.482	104.706
Loan capital	148.723	149.015	40.141	43.192	14.632
Minority interest	26.039	28.062	33.316	16.102	6.618
	449.862	479.376	442.635	427.633	201.967
Deposits	4.138.302	3.956.361	3.438.539	3.000.091	2.445.760
Advances	2.913.825	2.601.348	2.224.458	1.944.152	1.673.380
Total assets	4.882.098	4.714.635	4.063.387	3.599.453	2.852.930
Total capital resources/Total assets	9,2%	10,2%	10,9%	11,9%	7,1%
Capital adequacy ratio	12,3%	14,5%	13,9%	13,05%	10,1%
Return on average assets	(1,08%)	(0,21%)	1,21%	4,10%	0,94%
<b>Per ordinary share</b>					
Earnings – cents	(17,2)	(3,1)	15,8	51,2	10,4
Gross dividend – cents	-	8	12	15	10
Capital and reserves – £	0,90	1,01	1,24	1,21	0,72

## ANALYSIS OF SHAREHOLDERS

Issued Capital: 303.166.870



## CHAIRMAN'S STATEMENT FOR THE YEAR 2002



### Introduction

In 2002 the broader financial sector operated in a negative environment, mainly characterised by the deceleration of the growth rate of the Cyprus and the international economy and the declining trend of stock markets. Given the negative condition and intensifying competition, the performance of Laiki Group is considered very positive.

Profit from operations of Laiki Group before the loss from the disposal and revaluation of securities was C£64,9 m. compared with C£60,5 m. in 2001, despite the very low interest rates, which prevailed, intense competition and increased operating costs. The loss from the disposal and revaluation of securities reached C£12,1 m. compared with C£40,6 m. in 2001, underlying the fact that the exposure of the Group to the fluctuations of stock markets has been significantly reduced. After taking into account the transfer from the revaluation reserve, due to permanent impairment of investments, the total loss incurred by the Group amounted to C£51,8 m. I wish to emphasise that this transfer has absolutely no impact whatsoever either on the total reserves of the Group or on shareholders funds.

Following a recommendation by the Central Bank, the Board of Directors has decided to recommend at the Annual General Meeting of the shareholders that no dividend be paid for 2002. This is considered necessary for the purpose of strengthening the capital base of the Group, in order to finance the programme of international expansion and create the prerequisites for future profitability, given the difficulties for raising funds from the capital market.

During the year under review, Laiki Group continued with the implementation of its ambitious development programme in Cyprus and abroad with the aim of exploiting opportunities that emerge.

## Institutional, Economic Developments

The legal framework within which the financial system in Cyprus operates is going through a period of important changes, due to the process of harmonisation with the European Union (EU) *acquis communautaire*. The decision taken at the Copenhagen summit for our accession to the European Union on 1st May 2004 is of decisive importance for the political and economic future of Cyprus. We expect that from the harmonisation process the Cyprus economy and the financial system will become more modern and competitive. For this reason we are all called upon to adapt to a renewed spirit and increased flexibility to the new circumstances of the demanding and complex environment.

The most important legislative and institutional changes that took place concerned the institutional independence of the Central Bank, the adoption of legislation relating to the operation of companies providing investment services and the introduction of mutual funds. The gradual abolition of exchange controls continued, which will integrate the local financial system with the single financial market of the EU.

Another important development was the approval of the Code of Corporate Governance in September 2002 by the Council of the Cyprus Stock Exchange. Although its implementation is not compulsory, the Board of Directors of the Group, at its first meeting after the approval of the Code, decided to implement it immediately. It is stressed that Laiki Group has been implementing for years the basic principles of corporate governance, with the aim of maintaining a balanced relationship between the Board of Directors, the Management and the shareholders. Particular emphasis is given to strengthen transparency.

In 2002 the Cyprus economy faced an unfavourable international environment the main characteristics of which were the deceleration of the rate of economic growth and significant losses in the international stock markets for the third consecutive year. Within this unfavourable environment, the Cyprus economy continued to grow at a relatively low pace. The rate of economic expansion was 2,2% as against 4,1% in 2001, mainly as a result of a 10,3% decline in tourist traffic. The main impetus to growth was private consumption, while, as regards the supply side of the economy, the sectors of agriculture, communications and financial services achieved the highest rates of economic growth. The manufacturing sector recorded a decline due to problems of competitiveness.

In the labour market, the unemployment rate increased marginally to 3,3% of the economically active population. At the same time, inflation rose from 2,0% in 2001 to 2,8%. This is attributable to the increase in the VAT rate from 10% to 13% and in certain excise taxes for the purpose of tax harmonisation. The fiscal deficit as a percentage of GDP rose above 3%, while the current account deficit widened as a result of the drop in the income from tourism.

As regards developments in the monetary system, total liquidity increased by 13,1% in 2002 compared with 13,3% in 2001. Lending to the private sector rose by 7,6% compared with 12,7% in 2001. The sluggish demand for loans was mainly due to the deceleration of the economy and the stricter appraisal of applications for loans by the banks. There was also a slowdown in deposits, which increased by 4,6% compared with 14,8% in 2001. The banking market was characterised by excess liquidity, a fact that exerted a negative influence on the profitability of the commercial banks.

The Central Bank, in an effort to boost economic activity, and within the framework of its policy for convergence with interest rates in the Eurozone, cut the base rate from 5,5% to 5,0% in December.

For the third consecutive year, the Cyprus capital market operated in a negative climate. The share price index dropped sharply in the first nine months of the year below the 80-point mark. The negative sentiment of the market was reversed in October and November due to political developments regarding the Cyprus problem and the prospect of Cyprus' accession to the EU, with the result that the share price index rose above 110 units. However, after the Copenhagen summit the trend was again downward and the index closed at the end of 2002 at 94,52 units, with losses for the year amounting to 26,8%. At the same time the interest of investors dwindled significantly, as the average daily volume of transactions dropped to C£1,5 m., recording a reduction of 83,1% compared with 2001.

During the year under review, Laiki Group vigorously continued with the implementation of its strategic plan, which is based on the following pillars:

- internationalisation of activities
- expansion of non-interest income
- strengthening the technological infrastructure and the use of advanced technology
- integrated provision of high quality products and services
- continuous improvement of operational efficiency
- employment of the best human resources.

## DOMESTIC OPERATIONS

### Banking Activities

During 2002 domestic banking operations were conducted in a sluggish economic environment and under conditions of intensified competition. Factors that affected the banking market were the reduced demand for loans and the decline in the level of foreign currency deposits. At the same time the regime of very low interest rates, which prevailed both internationally and in Cyprus throughout the year, had a negative impact on interest rate margins. This trend was further accentuated by the reduction of interest rates in Cyprus at the end of the year. Under these conditions we pursued a balanced and flexible pricing policy for deposit and loan products,

without disregarding the changing trends in the market. This had a favourable effect on creating a positive financial outcome from local banking activities.

A substantial effort was made in all areas of banking activity to upgrade the quality of advances. This effort concentrated on the appraisal of loan applications according to stricter criteria, the drastic reduction of excesses, arrears and the strengthening of securities. The upgrading of the quality of lending aims at the gradual reduction of the provisions for bad and doubtful debts, which will have a positive impact on the profitability of the Group.

In the segment of retail banking efforts were continued to upgrade the quality of customer service. These efforts are based on the customer-oriented approach we follow in all sectors. At the same time, emphasis was given to the development and launching of new products in the market that cover the housing, student, professional and also personal needs of customers. Our aim is to offer flexible products with characteristics adapted to the needs of our customers. In addition, the provision of bancassurance products was systematically pursued, which will contribute to the increase of non-interest sources of revenue. Emphasis was also given to the further promotion of the Personal Banker. The objective is to provide advisory services on matters relating to portfolio management and the maximum utilisation of customers' savings taking into account investment opportunities that arise, in accordance with their needs.

The year under review is characterised by various achievements, especially the implementation of innovations in the field of cards. Cards present a significant potential for development because of their increasing use as a medium of payment. Despite the intense competitive environment, the Card Services maintained a strong market share and played a leading role in the carrying out of payments by card, contributing significantly to the profits of the Group. The turnover increased by 12%.

During 2002 the quality upgrading of products and services related to cards was further pursued in order to meet the needs and different demands of customers. The promotion of cards was focused on the greater utilisation of the branch network and of Laiki eBank. At the same time particular emphasis was given to the promotion of the Laiki Platinum and Laiki Business Cards.

With the aim of adding greater value to the transactions of customers using the cards of Laiki, emphasis was given for the first time on the utilisation of information and data that would help us draw conclusions about the profile and behaviour of customers. In this context, the loyalty scheme "Purchase – Win" was upgraded and the ability of printing gift vouchers at ATMs and the exchange of card points for items of basic necessity, such as fuel and food, was offered. These incentives make the Laiki card scheme one of the most pioneering and successful in the market, since it offers quick and effective solutions to customers' needs.



In the Commercial Business segment efforts were intensified to strengthen relations and increase sales to new and existing customers. At the same time, serious efforts were made to upgrade the level of service through the simplification of procedures and the provision of alternative ways of service.

In 2002 the organisational restructuring and centralisation of the Corporate Banking Division was successfully implemented with the creation of a central office in Nicosia. This move contributed to the provision of an upgraded and specialised level of services, with the increase in productivity and the reduction in operating costs. At the same time, specialisation of account managers in the main sectors of the economy took place in order to take advantage of new opportunities and expand the clientele. The aim of our Group is the provision of specialised services and practical solutions to meet the financial needs of customers.

During the year under review, the programme of restructuring of the branch network of domestic banking operations continued. This programme comes within the framework of our policy of further upgrading the already high quality of services, improving the efficiency of our branch network and promoting the Group corporate image.

With today's technological developments, the role of bank branch changes. A number of procedures are transferred from branches to central processing points, while alternative options are provided to customers for carrying out transactions through the electronic channels as well. The role of the bank branch is being upgraded and transformed to a central point of sale of financial products, customer service and promotion of cross selling.

During the same period, the preparatory work for the implementation of a new system of target setting for branches, which covers profitability, quality of advances, quality of service and business development was completed. On the basis of this new procedure, those directly involved also participate in the process of target setting. The results of each branch are assessed on a monthly basis. The new computerised system of target setting was put into effect at the beginning of 2003.

In 2002 the banking system and the Cyprus economy were characterised by conditions of excess liquidity. The Treasury managed the liquid assets of the bank effectively, with the aim of achieving a satisfactory return and offsetting the risk arising from the fluctuation of interest and exchange rates.

In May of the same year, a new deposit product, ATLAS, was designed and offered to the public at large and customers of Laiki Cyprialife. This product combines features of a deposit and investment. It guarantees the initial capital and links performance to a European stock exchange index, through which risk is spread. In addition, the Service began the trading of derivatives, such as futures, which are instruments for hedging risk.

In April 2002, the International Business Centres in Nicosia and Limassol began operations with the aim to centralise the servicing of international businesses - customers of the Bank. This centralisation and the operation of the accounts by the two centres has facilitated the further growth of operations originating from the international businesses and contributed to the provision of specialised services, in accordance with the requirements of the institutional framework. It is also expected that the new tax system with the low corporate tax rate of 10%, the imminent accession to the EU, the strategic position of Cyprus and the other comparative advantages it offers, will have a positive effect on the sector of international business, which presents prospects for further growth.

### **Laiki eBank**

Laiki eBank has been operating since September 2000 and is today the most comprehensive electronic bank in Cyprus with regard to products and services. During 2002, Laiki eBank enriched the range of its first electronic products, namely the current account Laiki eChecking and the credit card Laiki eCard, with the new savings account Laiki eSavings.

To satisfy the needs of young persons between the age of 13 and 26, Laiki eBank created in cooperation with the Cyprus Youth Organisation the upgraded young persons' card Euro<26 Visa Card, which is a combination of the Visa Electron Card and the discount Young Persons' Card and offers discounts for purchases from thousands of businesses in Cyprus and Europe. Like all electronic products of the Group, the Euro<26 Visa Card and the Laiki eSavings account are characterised by attractive pricing, convenience, speed and quality of service on a 24-hour basis.



Laiki eBank has also extended the capabilities of electronic payments and the service of electronic messages, Laiki eBank Alerts, by offering notification messages about purchases with cards, cash withdrawals and other facilities, which ensure maximum security for customers' transactions. The electronic banking services, through all the channels - Internet, mobile (WAP), Laiki Telebank and ATM - have also been enriched with new capabilities, confirming again the promise made by the Laiki Group to continuously upgrade its services.

In mid 2002, the Group took the lead once again, providing its customers the ability to have easy access to the Internet through their television (Web TV) with an easy-to-use device offered to Laiki eBank subscribers at a very low price.

In July 2002, the major task of upgrading the Group's web page was completed. The new web page, at the address [www.laiki.com](http://www.laiki.com), is in two languages - Greek and English and is simple, flexible and easy to use. It helps the visitor to acquire information about the products and services of the Group worldwide, through a unified and complete presence on the Internet.

2002 was a successful year for Laiki eBank as the number of subscribers rose to 72.000, recording an increase of 29%. The services of electronic banking undeniably constitute today the most modern form of banking service, adding continuously value to the Laiki Group customer.

## **INSURANCE SERVICES**

The insurance industry was negatively affected by the fall of the stock market and the deceleration of the Cyprus economy in general.

### **Laiki Cyprialife**

Under conditions of recession in the insurance market, the efforts of Laiki Cyprialife were focussed on reforming its operations with the aim of future growth.

In 2002 priority was given to the restructuring of the Company's sales network with the creation of five district offices, with the main targets being the reduction of operating costs and increase in productivity. In addition, systematic efforts were made to control expenditure relating to commissions, with positive results.

Emphasis was also given on the creation of new products. The range of products of Laiki Cyprialife was enhanced with the Cypria Extraplan.

Within the framework of the policy to promote of bancassurance, a strong effort was made to increase the products made available through the branch network. At the same time, more than 130 customer relationship officers of the Bank underwent training and obtained a licence to sell insurance products through the branch network.

For the second year the multiple investment funds continued to be offered in the market. These are characterised by transparency and give the insured the ability to choose the allocation of his savings according to his needs and investment preferences. As regards the management of reserves, emphasis was given to flexible management of the composition of the portfolio, on the basis of market conditions and expectations.

A significant development was the completion of the integration of the information system, which led to the enhancement of the reliability and effectiveness of the Company's internal procedures. It is also expected that the unification of the information system will save staff time. An equally important development was the creation of a specialised communication section, the aim of which is to develop customer relations and, by extension, to improve the persistency rate of the Company's portfolio.

## Laiki Insurance

Laiki Insurance maintained in 2002 its leading role in the general insurance industry, offering a complete range of products to individuals and companies. Last year Laiki Insurance returned to profitability, despite the significant increase in reinsurance premiums and staff costs due to the recent collective agreement. This very positive development was achieved as a result of the coordinated implementation of the Company's strategic plan and the adoption of measures that related mainly to:

- revision of the pricing policy and the increase in premiums
- revision of guidelines for insurance underwriting and the selection of risk
- adoption of measures in the area of claims management with emphasis on the prompt settlement of general insurance claims
- close monitoring and carrying out of controls on agents with negative results
- reduction of the commissions relating to earthquakes
- improvement in the management of debtors
- promotion of specialised insurance products
- improvement in the composition of the portfolio
- growth of operations from indirect sales.

## OTHER FINANCIAL SERVICES

### Laiki Finance

Under conditions of intense competition and deceleration of the economy, Laiki Finance maintained its leading role in its field, making a significant contribution to the profitability of the Group. Despite the intensely competitive climate, the Company created the preconditions for the enhancement of its services and the penetration into specific markets with its range of products in order to satisfy the private market and the needs of businesses. The large market share it holds and the enhancement of its technological infrastructure create particularly positive prospects for 2003 for facing directly and dynamically the challenges that arise.

### Laiki Factors

The performance of Laiki Factors is considered to be positive. In a difficult business environment, it managed to maintain a leading role in the provision of factoring services. The activities of the Company were focused mainly on the improvement of the management of the portfolio of advances. Emphasis was also given on the readjustment of the pricing policy. This policy had a positive impact on the profitability of the company, which remained at very satisfactory levels.

### Laiki Investments

The downward trend of the stock exchange, which continued in 2002, combined with the reduced investment interest, had a negative effect on the results of Laiki Investments. In 2002, priority was given to the restructuring the Company's

operating procedures in order to continue to offer services of a high standard with a parallel reduction in operating costs. An important development was the submission of an application by the Company for the acquisition of a licence to operate under the new legislation as a Cypriot company providing investment services.

Laiki Brokerage remained one of the leaders in the stockbroking sector in 2002, in a climate of intense competition and a tendency for small offices to merge into larger units. Activity in the field of investment banking remained sluggish. Priority was given to expanding operations in the area of mergers and acquisitions. At the same time, through organisational changes, a greater specialisation concerning the productive sectors of the economy was pursued. As regards asset management, the efforts of Laiki Asset Management focussed on attracting new customers, private and institutional. A significant development was the passing of legislation regulating the registration and operation of mutual funds in Cyprus, which came into force on 17th March 2003. Laiki Asset Management is ready as concerns infrastructure, systems and staff training to commence operations. Our aim is to offer professional management with high performance to unit holders.

### **Private Banking Service**

During the year, the Private Banking Service proceeded with a reorganisation of its operations with the aim to reduce operating costs and increase productivity. Today, two units are in operation, in Nicosia and in Limassol.

The Service is staffed with officers who serve the banking and investment needs of high-net-worth individuals, with professionalism, confidentiality and dedication, creating a long-lasting relationship of trust with the customer. Customers, in co-operation with the personal investment advisors, can choose suitable placements for their capital according to their personal profile. At the same time, customers are in a position to satisfy their banking needs by means of a range of banking services, which are tailor-made to their requirements.

The policy of the Private Banking Service is to enter into cooperation agreements with investment companies of international repute. Within this framework, the strategic cooperation with HSBC Bank International continued for the promotion of mutual funds and the provision of stock exchange products, with INVESCO Global Investment Fund for the provision of mutual funds, with MAN Group for the provision of products with alternative strategic investments, as well as with CIBC Oppenheimer, through which the international brokerage transactions of the Company's customers are executed.

## INTERNATIONAL OPERATIONS

The main pillar of the strategy of Laiki Group remains the internationalisation of its activities. This strategy aims at enhancing and differentiating the sources of income of the Group, which is necessary due to the limited size of the local market. It is implemented by steady steps, as we are aware of the factors characterising the environment in which the expansion takes place. We have maintained and followed a prudent conservatism, and a proper understanding of balanced decisions. In this way we have managed to avoid hasty actions and we are consistently led to success.

The contribution to the Group's profits by operations abroad in 2002 increased to 23%. The successful promotion of our international operations constitutes a guarantee for further growth of turnover and profits.

### Laiki Bank (Hellas) S.A. and subsidiaries

We place particular emphasis on the expansion into the Greek market and the penetration of markets where there is a significant Cypriot and Greek presence. In 2002 the Laiki Group completed eleven years of dynamic and successful presence in the Greek market. The performance of the Group in Greece was also very satisfactory in 2002, bearing in mind the international economic conditions and the consequences from the drop in stock markets. It is worth noting that the profit was achieved in a period during which high investments for expansion were made, covering the branch network and technology. The penetration programme into the Greek market is based on:

- the creation of a branch network, of appropriate size and structure, in strategically chosen areas in Greece
- the development of the electronic bank and the provision of a full range of financial services.

In the same year the size of the bank increased significantly and, specifically, advances to customers increased by 37%, while deposits increased by 32% compared to 2001. At the end of 2002, the bank network consisted of 36 branches, compared to 28 in 2001. The network will continue to grow during 2003.

During 2002 emphasis was given on the promotion of retail banking and commercial lending. The Bank developed a range of new products and services, such as Laiki Professional Solutions, Laiki X13, Laiki Pro and the payment of cards outstanding balances with cash through ATMs. Furthermore, a new range of products is at the development stage, such as the VISA Electron credit card, the debit card, the co-branded card, as well as other loan products, such as, the housing loan with a grace period.



In the area of electronic banking the growth of Laiki eBank continued at a fast pace, since in the eighteen months of its operation the number of subscribers reached 11.000. We note that Laiki eBank has brought a pioneering element into the Greek market. Laiki eBank gives the customers of Laiki Bank (Hellas) S.A. and its subsidiaries the capability to direct access of the Group's products and services, providing a 24-hour service. The ATMs have also been upgraded with a new pioneering software.

Laiki Leasing S.A. continued its upward course for the fifth consecutive year with operations expanding by more than 35%. This establishes it among the fastest growing companies in its field. It was also a successful year for Laiki Factoring S.A., with loan assignments increasing by 25%.

Laiki AEDAK offered the investing public the possibility to participate in four mutual funds, Laiki Greek Money Market, Laiki Greek Equity, Laiki Domestic Bond and Laiki Blue Chips Equity. These categories of mutual funds cover a wide spectrum of investment choices, providing the possibility of designing the customer's portfolio according to his investment needs.

In the fields of brokerage and investment banking, Laiki Attalos extended its range of services, while at the same time it steadily gained market share. It is currently included among the largest brokerage companies in the Greek market. This achievement is attributed to the high standard of service and the exploitation of synergies with the Bank and the its subsidiaries, especially with regard to the clientele.

In March 2002, Laiki Life S.A. began operations. In the short period of its operation the Company has already offered bancassurance life products through the group insurance of customers, who have obtained consumer, housing and professional loans and of customers who maintain Euro savings deposit accounts. Since July of the same year, Laiki Group has also been active in the field of general insurance, with the operation of a general insurance agency, Laiki Insurance Agents. The Bank's clientele constitutes an important basis for the growth of the Company's business.

### **Laiki United Kingdom**

The results of Laiki in the United Kingdom are considered satisfactory given that an increase in profits was recorded. This is particularly significant in view of the fact that during the year investments were made to upgrade the branch network and technological infrastructure. More specifically, in March the first phase of the installation of a new banking software system was completed while the implementation of the second phase of the project is in progress.

In the year under review, the policy for enhancing and upgrading the range of products and services offered was continued. The operations of the Bank in the factoring sector were also important, as well as the commencement of the plan

to introduce its electronic bank into the United Kingdom. Particular attention was given to extending the clientele of the Bank, with emphasis on the second and third generation of overseas Cypriots and other special groups in the market.

### **Laiki Bank (Australia) Ltd**

Laiki Bank (Australia) had a successful year in 2002. In December 2002 the Bank showed a profit after operating for a period of less than two years and considerably sooner than planned.

Its clear orientation is to strengthen its position in the market, particularly in retail banking, and to establish itself as the leading bank of Greeks in Australia. Within this framework, Laiki Bank (Australia) continued to invest in modern technological infrastructure systems and in the creation of new competitive products and services, which meet the high specifications of the market. The Bank's branch network, which today consists of five branches, two in Sydney, two in Melbourne and one in Adelaide, is expected to expand during 2003.

## **WITH A VIEW TO THE FUTURE**

### **Infrastructure - Technology**

The present era of rapid technological growth and the demands of the liberalised financial environment render imperative the implementation of important infrastructure projects in the field of technology and computerised systems at the Group level. In 2002, the first phase of an ambitious project was completed, which relates to a new strategic system and covers the measurement of profitability and the improvement of risk management. In addition, the Employee Portal project is in the process of development. This includes the electronic movement and storage of forms and data and will contribute to a reduction in the use of paper and to the speeding-up of related procedures.



It is expected that the completion of the technology projects will bring multiple benefits to the Group, especially as regards:

- the offer of comprehensive products that will cover the entire spectrum of customers' financial needs
- the further upgrading of the quality of services
- the more rational management of customer relations
- the promotion of cross-selling
- the assessment of profitability in the relevant sectors
- the increase of productivity and the improvement of operational flexibility
- the improvement of risk management
- the provision of information at all levels of Management
- the more rational management of available resources.

## Human Resources

Human resources are the driving force and the most important factor in the achievement of the targets of the Group.

The basic pillars of action of Human Resource Management (HRM) in 2002 were communication – meritocracy – transparency. HRM aimed at the further promotion of these three principles/values through the development of new procedures and systems throughout the Group. An important project in the year under review was the computerisation of the administrative procedures of HRM using the platform of a new software system. This project is expected to contribute significantly to the effectiveness and efficiency of the administrative processes and to the best possible use of data-information about the Group's human resources with the aim to improve decision-making. Particular emphasis was placed on the improvement of communication and open dialogue within the Group.

With regard to training, there was a marked increase in the needs resulting from the continuous changes in the environment within which of the Group operates, and also internal changes concerning systems, products and procedures. Emphasis was given to the utilisation of technology for effective staff training with the introduction of the eLearning methodology, programmes for management development on the basis of the Group's management criteria, to further utilisation and expansion of methods for personnel development as well as training in the field of banking operations. In addition, the Information and Learning Centre was upgraded and enriched with new material.

A new system of performance appraisal was implemented in accordance with the standards of the HSBC model, which promotes transparency and is based on setting operational and development targets. The implementation of the "360° Feedback" method, which makes a substantial contribution to management development, was also pursued.

In this connection, I feel I should mention the retirement of Mr. Nicos Hadjinicolaou in December. I express my warmest thanks to Mr. Hadjinicolaou as well as the gratitude of all the staff for his invaluable contribution to the building up of what is today Laiki Group.

## Risk Management

Following international trends, Laiki Group proceeded in 2002 with the further upgrading of the system of risk management, with the improvement of procedures and methods implemented. The international financial conditions and the more competitive and complex environment make the continuous improvement of the system essential. Thus, the Group has invested in the human resources of the Risk Management Unit in the form of continuous training with the aim of upgrading its techniques and skills, and improving the assessment and control of the various risks.

## Managing for Value

The Group adopted the philosophy of the "Managing for Value" strategy in 2001. Efforts in 2002 concentrated on the intensive training of managers and staff, as well as on the appraisal of the existing practices and procedures followed throughout the Group. The findings will be implemented in 2003 in accordance with specific action plans. Among the initiatives being promoted are the adoption of the economic profit as the internal measure of performance at the unit level as well as the abolition of procedures and activities that destroy value. The ultimate objective is to align managerial processes such as strategic planning, allocation of resources, performance management, as well as day-to-day activities, with the principles and practices of the "Managing for Value" strategy. With "Managing for Value" the customer is the focal point of our endeavours. Our main mission is to offer customers greater value, namely attractive products at competitive prices and excellent service that exceeds their expectations. The Board of Directors, the Management of the Group and I personally are committed to promote this endeavour, recognising the potentials it provides for maximising the value we create as a Group.

The Group has adopted a procedure providing for the submission and solution of customers' complaints. The aim of this new procedure is to enhance even further the excellent service we offer to our customers and to keep senior management informed of the complaints made by customers and their underlying causes, so that remedial measures are taken, when necessary.



Customers may submit their complaints by telephone through Laiki Telebank and orally, as well as in writing or by telephone, through the branch network. In the case where a problem cannot be solved immediately, the customer is given a date for its solution. From experiences to date, the degree of customer satisfaction is very high.

## SOCIAL POLICY

Apart from its business presence in the economic life of the countries in which it is active, our Group continued in 2002 to have a noteworthy presence in the field of social contribution and involvement in social events, with the promotion of programmes and activities that include charitable, cultural, social and athletic events. The aim of this social policy is to contribute to the enhancement of the quality of life of the Cypriot society. The focus of our initiatives in recent years has been health, mainly that of children, and culture.

As in previous years, the culminating event of the Group's social activity in 2002 was the Radiomathon for children with special needs, organised in cooperation with the Cyprus Broadcasting Corporation. In 2002, the Radiomathon raised

C£1,3 m., a record amount for the thirteen years of its functioning. This amount was deposited, as every year, in the Fund of the Radiomathon Foundation. The total amount raised over the thirteen-year period is C£12,3 m.

With the aim of enhancing public awareness, of propagating the Olympic spirit and generally upgrading sports in our country, our Group sponsored for the third time the Cyprus Olympic Committee, supporting its multi-faceted work financially and in other ways.

The social policy of the Group is complemented by the multifarious activities of our Cultural Centre. I note that in the year under review, the work of renovation and preservation of the neo-classical mansion in Byron Avenue was nearly completed. This building will house the collections of our Cultural Centre; the collection of rare books on Cypriot studies, the photographic archive regarding Cyprus and the collection of works of art by Cypriot artists. The building, which will also house our Cultural Centre Services, is expected to inaugurate soon.

Work is also in progress on upgrading the collections and the premises of the Cultural Centre of Laiki Group - Pierides Museum Trust in Lamaca.

These two projects form the basic pillars of the Group's social policy for the creation of works of infrastructure in the field of culture.

### **STRATEGIC ACTION 2003**

The strategic objective of the Group is to adapt to the new conditions that have emerged with the aim of exploiting opportunities and successfully facing competition. For 2003, the actions of strategic importance of the Group include the following:

- upgrading of existing and the design of new innovative products, in response to prevailing market conditions and the needs of customers, including fixed income products
- maximum utilisation of the data base of the Group to promote cross-selling
- offer of new eProducts and enhancement of existing products and services
- introduction of mutual funds
- further promotion of bancassurance products
- promotion and installation of new information systems in the areas of non-life insurance and finance
- centralisation of procedures with the aim to increase productivity and reduce operating costs
- enhancement of the quality of the loan portfolio in all sectors
- strengthening of the system for a more effective management of credit risk
- expansion of the branch network in Greece
- introduction of new products by Laiki Bank and its subsidiaries in Greece
- growth of the operations of Laiki Life and Laiki Insurance Agents in Greece by using the Bank's clientele
- introduction of the electronic banking in the United Kingdom and Australia.

## CLOSING REMARKS

In summary, despite the negative consequences from the deceleration of the growth of the Cyprus and world economy, the reduction in interest rates, the depressed stock market climate and the difficult competitive environment, the financial results of Laiki Group in 2002 are satisfactory. The operating profit of the Group before the loss from the disposal and revaluation of securities recorded an increase of 7,3% compared with 2001, which indicates a healthy growth at the operational level.

The prospect of Cyprus' accession to the EU creates a more positive framework for the growth and stability of the Cyprus economy in the future. The liberalisation of the financial system creates challenges and also opportunities, which we are called upon to face. A possible solution to the Cyprus problem is expected to have a positive influence on the growth rate of the Cyprus economy and the financial sector.

Our renewed vision is to stand out as the most dynamic, effective and reliable financial organisation, preserving our anthropocentric approach to customer service. The diversifications of the Group's activities in the local market and the rigorous drive for strenuous internationalisation of its operations have created a very strong infrastructure, which guarantees a steady course in the future.

In the new era of globalisation, those who will emerge as winners in the arena of competition in the future will be the organisations that offer innovative products, control costs, extend the sources of their income, have modern systems and make the best use of their human resources. Our Group is determined to be among the winners.

Contributors to our Group's very satisfactory performance in 2002 were the management, staff, shareholders, customers and the Cyprus public in general. I would like to express my sincere thanks to them all for the confidence they show in us.

## FINANCIAL REVIEW

### Profitability of the Group

The results of the Group for the year 2002 are considered satisfactory, especially if one takes into account the economic conditions under which they were achieved. Operating profit reached C£ 64,9 m compared to C£ 60,5 m in 2001 recording an increase of 7,3%.

The Group's operating income reached C£ 186,6 m having risen by 12,7% compared to 2001, despite the negative effects from the significant fall in the interest rates and the prolonged depression in the stock exchanges. The prolonged depression in the stock exchanges negatively affected the commissions arising from stock exchange transactions and the income from insurance operations.

Operating expenses increased by 15,8%. Staff costs and depreciation recorded the most significant increases in that category both in Cyprus and overseas.

Provisions for bad and doubtful debts reached C£ 53,8 m compared to C£ 17,8 m in 2001 having surged by 203%. A very thorough review of all provisions has been carried out and the increase in provisions was considered necessary in view of the prolonged slowdown in growth both in the Cyprus and the world economies, the political instability prevailing in our wider area and the continuing deterioration in the Cyprus Stock Exchange (CSE).

Losses from the sale and revaluation of securities have dropped to C£ 12,1 m compared to C£ 40,6 m in 2001. The portfolio of trading investments now stands at C£ 24 m and this shows that any further fluctuations of the CSE index will have very limited impact on the Group's results.

An amount of C£ 47,1 m has been transferred from the Investment Revaluation Reserve to the Profit and Loss Account. This transfer has absolutely no effect on the total Reserves of the Group and on Shareholders' Funds.

### Net interest income

Net interest income rose by 6,7% compared to 2001 and reached C£ 122,5 m. This was achieved despite the significant interest rate reductions that took place in the second half of 2001. The fall in interest rates squeezed the net interest margin, as a significant part of the Group's deposits bear fixed interest rate for periods up to one year. In addition, the reduction in the base rate and the higher liquidity in the Banking System have caused a significant reduction in the return of the Group's liquid funds.

The reduction in the interest rates of major currencies has also caused a squeezing of the foreign currency interest rate margins.

### **Fees and commissions**

Income from fees and commissions grew in total by 10,7% to C£ 41,4 m, despite the negative impact of the reduction in the Group's capital market operations and the reduced commissions from trading activities. There was a significant contribution from the Group's banking operations in Greece as well as from the banking operations in Cyprus that increased by 16,1% and 15,8% respectively.

### **Profit from dealing in exchange and other income**

Income from foreign exchange transactions reached C£ 12,4 m, recording a satisfactory increase of 18,3%. Other income, which is mostly made up of income from Insurance Operations, surged by 246,7% to C£ 10,4 m. This type of income showed a significant improvement, despite the fact that it is still negatively influenced by the adverse Stock Exchange conditions.

### **Staff costs**

Staff costs represent about 63% of the Group's total operating expenses. Staff costs have risen by 19,5% reaching C£ 76,6 m. This is due to the expansion of the Group's operations abroad as well as to the increase in staff costs in Cyprus following the new collective agreement.

The increase in staff costs overseas is due to the rapid expansion in the number of branches operating in Greece and to the commencement of operations of the Group's new bank in Australia. The 28 branches operating in Greece at 31/12/01 rose to 36 at 31/12/02. In addition, in May 2001 the new Bank in Australia commenced operations with 5 branches and the required staff.

Staff costs in Cyprus (excluding the retrospective retirement benefit charge) grew by 11,4% compared to 2001, despite the Group's policy of freezing new recruitments and the reduction in the number of employees in Cyprus from 2.478 at 31/12/01 to 2.458 at 31/12/02. The increase is mainly due to the agreed yearly increases in salaries and the extra charge as a result of the new collective agreement.

The recent collective agreement in Cyprus provides for substantially improved employee retirement benefits. The recognition of the probationary period and the increase in the retirement benefit rate are considered vested for accounting purposes as they relate to past service. According to International Financial Reporting Standard 19 the Group is obliged to recognize the retrospective cost of the change in retirement benefits in the year 2002. The total cost in accordance with the actuarial valuation carried out by independent actuaries is C£ 4,2 m and is not recurrent.

## Depreciation and amortization

Total depreciation charge for the Group increased to C£ 13,3 m, representing an increase of 19,8% compared to 2001. There was a 48,3% rise in depreciation from Group operations overseas, which is due to the dynamic expansion of the Group mainly in Greece and Australia. The 9,7% increase in depreciation in respect of local operations is due to the continuous investment in new technology.

These investments are considered necessary to enable the Group to cope with the challenges from the liberalization of the financial system and the accession of Cyprus to the European Union. The Group has invested in technology projects that will allow it to design and price new products correctly and manage the available resources and the risks undertaken. In addition, it is expected that investment in technology will enhance the Group's productivity. This is already evident from the fact that the number of the Group's employees in Cyprus has been reduced whereas its operations have increased further.

## Other expenses

The Group's other expenses have risen by 6,4% to C£ 31,8 m compared to 2001. This is mainly due to the expansion of the operations overseas.

It is worth noting that other expenses in Cyprus rose by only 3,1% as against 2001. Taking into account the inflation rate, this is significant evidence that the Group's continuing efforts to control its operating expenses have started to bear fruit.

## Provisions for bad and doubtful debts

The provision for bad and doubtful debts amounted to C£ 53,8 m, or an increase of 203% compared to the corresponding period last year. It should be emphasised that at this stage this amount relates to provisions and not write-offs.

The substantial increase in the provision for bad debts was deemed necessary both as a result of the prolonged slowdown in the growth of the Cyprus economy and the continuing decline of the CSE, as well as a result of the recession in the world economy and the political instability prevalent in our wider area.

The Group has always adopted a very conservative provisioning policy, which is further reinforced by the Central Bank's urges and announcements.

Non-performing advances have increased by 46,4% to C£ 351,5 m in comparison to C£ 240,1 m at 31/12/01. Accumulated provisions included in these advances amount to C£ 177,4 m or 50,5% of non-performing advances, compared to C£ 119,2 m (or 49,7%) in 2001. The difference, which is not provided for, is covered by tangible securities.

### Transfer from the Investments Revaluation Reserve to the Profit and Loss Account

According to International Financial Reporting Standard 39 any profit / loss resulting from the revaluation of available-for-sale investments to their fair value is included in the Group Balance Sheet in the Investment Revaluation Reserve.

The International Financial Reporting Standards Board issued for discussion certain revisions to standard 39. One of these revisions indicates that a significant and prolonged decline in the fair value of available-for-sale investments below the cost of acquisition indicates objective evidence of impairment. Any impairment in the value of investments must be charged to the Profit and Loss Account and therefore be removed from the Investment Revaluation Reserve.

The Group has transferred C£ 47,1 m from the Investment Revaluation Reserve to the Profit and Loss Account due to impairment in the value of available-for-sale investments.

This transfer has no effect either on the Shareholders' Funds or on distributable profits. In addition, the Group's Balance Sheet remains unchanged because the revaluation of these investments has always been at fair value. In effect, the negative Revaluation Reserve of certain investments was transferred to the Revenue Reserves passing through the Profit and Loss Account of the year.

### Total Assets

Group total assets increased by 3,5% compared to 2001, reaching C£ 4,9 bln. The low rate of increase is a result of both the fall in the value of investments as well as the reduction in the exchange rates of the Dollar and the Sterling.

In Greece total assets grew by 24,8% reaching C£ 1,2 bln. This substantial increase confirms the dynamic expansion of the Group's operations in Greece.

### Deposits

Group deposits increased by 6,8% over 2001 reaching C£ 4 bln. This increase is considered satisfactory if one takes into account the prevailing economic conditions and the intense competition regarding depository products.

Deposits in Greece rose by 32,3% compared to 2001 reaching C£ 766 m. The rate of increase of the Group's deposits in Greece is very satisfactory bearing in mind the competition faced. The Group managed to increase deposits without entering into an interest rate "war" thereby maintaining the cost of deposits at a relatively low level.

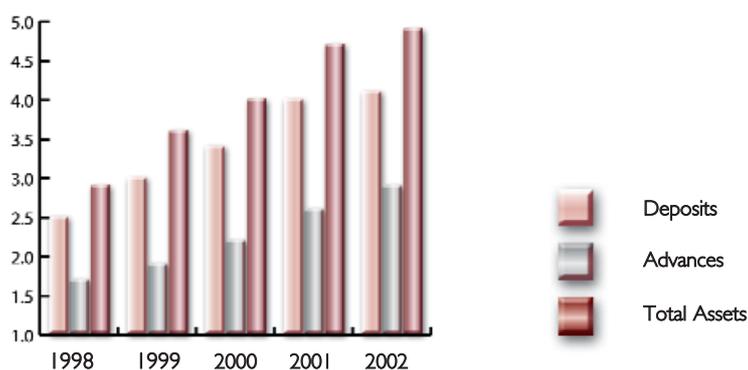
## Advances

Group advances increased by 13,6% over 2001 reaching C£ 3,1 bln. The rate of increase in the Group's advances portfolio is very satisfactory having in mind the subdued demand for loans in the Cyprus market.

Advances in Greece expanded by 37,9% in comparison to 2001 and amounted to C£ 739 m. The Group anticipates that the rapid growth of its operations will be maintained in the coming years as a result of the continuous expansion of its branch network and of the Group's strategic decision to give emphasis on retail and commercial banking.

## FINANCIAL HIGHLIGHTS

in C£ billion



## **CORPORATE GOVERNANCE CODE**

With effect from September 2002, the Cyprus Stock Exchange issued a Corporate Governance Code applicable for all companies listed on the Exchange.

### **Compliance with the Code**

Laiki Group has always followed principles of good governance and the introduction of the Code has helped its further improvement. The Board of Directors has taken the necessary decisions for the full implementation of the Code.

### **Board of Directors**

The Board meets regularly which ensures that the Directors are able to review corporate strategy, the Budget and the results of the Bank and its subsidiaries and major capital and other important transactions.

The Board of Directors includes seven independent non-executive directors, namely: Jacovos Dimitriou, Marios Lanitis, Platon Lanitis, Andys Loutsios, Andreas Papaellinas, John A.P. Hill and Anthony Townsend and maintains a balance between executive, non-executive and independent non-executive directors as required by the Code.

All directors offer themselves for re-election at regular intervals and at least once every three years.

In addition, none of the Directors have a material interest, directly or indirectly in any contract of significance with the Company or any of its subsidiaries.

### **Going Concern**

The Board of Directors is satisfied that Laiki Group has adequate resources to continue in business.

### **Board Committees**

The Board has appointed an Audit Committee and also Nomination and Remuneration Committees.

The Board first appointed an Audit Committee and issued its written terms of reference ten years ago. These terms of reference were recently revised in order to comply with the principles of the Code and the guidelines of the Central Bank of Cyprus.

The Committee comprises exclusively independent non-executive directors, namely: John A.P.Hill (Chairman), Jacovos Dimitriou, Marios Lanitis, Platon Lanitis and Andys Loutsios.

The Committee meets at least four times a year to consider the reports of the Internal Audit Department of the Group, the External Auditors' fees, the financial reports and other matters falling within its terms of reference. The Committee is assisted in the execution of its duties by the audit committees appointed by major group subsidiaries.

The Nomination Committee has the responsibility of making recommendations for the appointment of new Board Members and has written terms of reference. The appointments are made by the Board subject to the approval of the Annual General Meeting.

The Members of the Nomination Committee are Kikis N. Lazarides (Chairman), Jacovos Dimitriou, Marios Lanitis, Chris Pavlou and Anthony Townsend.

The Remuneration Committee considers the remuneration of the executive directors in accordance with written terms of reference which take into account the provisions of the Code.

The Members of the Committee are: John A.P. Hill (Chairman), Andys Loutsios and Andreas Papaellinas.

### **Internal Control System**

The Board of Directors has overall responsibility for maintaining a proper internal control environment, which safeguards, amongst other things, the assets of the Group and its clients, the accuracy and confidentiality of transactions, the reliability of financial information, and compliance with applicable regulations.

To this end, the management of each business entity within the Group are tasked with introducing and operating internal control systems, which are commensurate with the scale and complexity of operations, and comprise, as a minimum, the following:

- clear organisational structure and division of responsibility, including supervision of day-to-day operations
- drafting and monitoring of implementation of strategic and operating plans and budgets for each material line of business
- effective internal communication lines that disseminate information quickly and to the appropriate level
- documented procedures for key areas of activity and frequent briefing of staff through circulars, announcements, and training seminars on prescribed Group policies and practices
- adequate segregation of duties and avoidance of assignment of conflicting responsibilities
- frequent compilation of financial and operational performance statistics
- support of key activities by reliable and secure information systems

- approval of transactions by appropriate and authorised persons
- a well established financial control environment including routine controls, such as reconciliations, audit trail, and spot checks
- existence of business resumption and contingency plans
- adequate insurance arrangements

In addition, at Group level suitable risk management units exist for supporting the Asset and Liability Committee (ALCO) in drafting and monitoring implementation of the overall risk policy and in managing individual risks. For measurable risks, in particular, Group procedures require determination and periodic revision of acceptable exposure limits.

The internal control system aims at mitigating, but not eliminating, the risks faced by the entity, and provides reasonable but not absolute assurance that material loss will not be incurred.

The adequacy and proper operation of internal controls in individual areas of operation are reviewed periodically by an independent internal audit function, and its findings are reported to the Audit Committee. The latter informs the Board regarding important issues, and presents also an annual report on the adequacy and efficiency of the internal control systems of the Group. The report for the year 2002 confirmed the adequacy and effectiveness of the internal control systems of the Group.

### **Relations with Shareholders**

Laiki Group, recognising the importance of communicating correct and timely information, publishes its results on a quarterly basis. The results and other information relating to the activities of the Group are presented at meetings which are attended by analysts, journalists, shareholders and investors.

The Bank encourages shareholders to attend the annual general meetings and in its relations with shareholders complies with the requirements of the Companies Law and the Corporate Governance Code.





