



CENTRAL BANK OF CYPRUS
EUROSYSTEM

MACROPRUDENTIAL POLICY:

**POLICY FOR THE DESIGNATION OF CYPRUS INVESTMENT
FIRMS THAT MEET THE DEFINITION OF OTHER SYSTEMICALLY
IMPORTANT INSTITUTIONS (O-SIIs)
&
METHODOLOGY FOR THE DETERMINATION OF THE O-SII
BUFFER REQUIREMENT OF EACH CYPRUS INVESTMENT FIRM**

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1. Introduction

The Central Bank of Cyprus (“CBC”), as the national macroprudential authority, is responsible for the “macroprudential oversight of the financial system, with the ultimate objective to ensure the stability of the financial system”, as defined in the *Central Bank of Cyprus Laws, 2002 – 2016*. These Laws require the CBC to identify, monitor and evaluate threats to financial stability and implement policies to prevent or mitigate these threats when exercising its macroprudential oversight of the financial sector.

Based on the provisions of the *Macroprudential Oversight of Institutions Law, 2015* (Law 6(I) of 2015), the CBC is the Designated Authority responsible for the application of the macroprudential instruments that derive from Directive 2013/36/EU, the Capital Requirements Directive (“CRD”). One of the responsibilities of the CBC set out in Law 6(I) of 2015, is the identification of institutions (i.e. credit institutions and Cyprus Investment Firms¹ (“CIFs”)) that meet the definition of Other Systemically Important Institutions, hereafter “O-SII institutions”.

According to Law 6(I) of 2015, the CBC, after cooperation and consultation with the Cyprus Securities and Exchange Commission (“CySEC”) as far as CIFs are concerned, may require each O-SII institution on a consolidated, sub-consolidated or individual basis, as applicable, to maintain an O-SII buffer of up to 2% of its total risk exposure amount, taking into account the criteria for the identification of O-SII institutions. The O-SII buffer shall consist of and shall be supplementary to Common Equity Tier 1 capital.

When requiring an O-SII buffer to be maintained, the CBC shall comply with the following:

- 1) the O-SII buffer must not entail disproportionate adverse effects on the whole or parts of the financial system of other Member States or of the European Union as a whole, nor forming or creating an obstacle to the functioning of the internal market,
- 2) after cooperation and consultation with designated authorities, the O-SII buffer is reviewed at least annually.

The O-SII buffer reflects the cost of an institution being systemically important, reduces moral hazard and increases the resilience of the systemically important institutions during periods of stress, when losses are incurred.

The European Banking Authority (“EBA”), published guidelines setting out the criteria that national macroprudential authorities shall use for the designation of systemically important institutions, either at the European level, or at the national level (O-SII institutions). These guidelines were issued as required by the EU Capital Requirements Directive. The CBC has adopted these guidelines.

The CBC designates CIFs that meet the definition of O-SII institutions and determines the O-SII buffer for each O-SII institution, by following the EBA guidelines. Prior to the determination of the O-SII buffer for CIFs by the CBC, the CBC cooperates and consults with the CySEC. The designation of O-SII institutions is reviewed on an annual basis.

¹ The scope of application of Law 6 (I) of 2015, includes CIFs that provide the investment services of dealing on own account or underwriting of financial instruments and / or placing of financial instruments on a firm commitment basis.

2. Designation of Cyprus Investment Firms that meet the definition of Other Systemically Important Institutions

Based on the EBA guidelines, the designation of O-SII institutions comprises two steps. In the first step, the score for each relevant CIF is calculated using the criteria set out in Law 6(I) of 2015, being its size, its importance for the economy of the European Union or Cyprus, the importance of its cross border transactions and its interconnectedness with the financial system.

Based on the same guidelines, each of the four criteria consists of one or more indicators. These indicators have been agreed between the CBC and the CySEC, in order to be more relevant to the operations of CIFs. All criteria are weighted equally at a weight of 25%. The indicators within each criterion are weighted equally relative to the other indicators within the respective criterion as indicated in Table 1. The total score is calculated by:

- (1) dividing the indicator value of each individual relevant CIF by the aggregate amount of the respective indicator values summed across all CIFs,
- (2) multiplying the resulting percentages by 10.000 to express the indicator scores in terms of basis points,
- (3) calculating the category score for each relevant CIF, by taking a simple average of the indicator scores in that category, and
- (4) calculating the overall score for each relevant CIF, by taking a simple average of its four category scores.

Table 1

Criterion	Indicators	Weight
Size	Total assets	12,50%
	Total assets (after the implementation of netting agreements)	12,50%
Importance (including substitutability/financial system infrastructure)	Funds guaranteed under the Investor Compensation Fund Scheme	8,33%
	Private sector deposits from customers in the EU	8,33%
	Private sector loans to customers in the EU	8,33%
Complexity/cross-border activity	Number of active retail customers	8,33%
	Value of trading and available for sale securities	8,33%
	Value of OTC derivatives (notional)	8,33%
Interconnectedness	Intra-financial system liabilities	12,50%
	Intra-financial system assets	12,50%
Total		100,00%

In the second step, the CBC following cooperation with the CySEC, evaluates whether a CIF should be designated as an O-SII institution based on additional quantitative or qualitative indicators of systemic importance that are set out in the EBA guidelines. CIFs with a total score higher than 350 basis points are automatically designated as O-SII institutions.

3. Methodology for the determination of the O-SII Buffer requirement for Cyprus Investment Firms

The methodology for the determination of the O-SII buffer requirement, aims to associate the systemic importance of an O-SII institution, as derived from their total score, with the level of the O-SII buffer requirement. Following this approach, the determination of additional O-SII buffer requirements is achieved. In addition, this methodology may prevent the accumulation of systemic risk in one or more institutions and can positively contribute to the reduction of the concentration of the financial sector of Cyprus. At the same time, qualitative factors are taken into consideration such as the general vulnerability of the Cyprus financial sector.

Since the EU Capital Requirements Directive and Law 6(I) of 2015 provide flexibility for the determination of the O-SII buffer rates between 0% and 2% of the total risk exposure, the CBC with the present methodology, assigned the O-SII institutions into different sub-categories based on their total score. Each sub-category corresponds to a specific O-SII buffer requirement. This approach follows the reasoning of the mandatory methodology set out in the EU Capital Requirements Directive for the determination of the capital buffer that institutions designated as Global Systemically Important Institutions ("G-SIIs") need to maintain.

O-SII institutions with a score between 350 and 1.000 basis points, bear an O-SII buffer rate of 0,5% of their total risk exposure. Institutions with a score greater than 2.500 basis points, are assigned to the sub-category that bears the highest O-SII buffer rate provided in the EU Capital Requirements Directive, i.e. 2,0%. The space between the lowest and the highest sub-categories is divided into two equal sub-categories, with the increase between each sub-category being 750 basis points and each sub-category bearing an O-SII buffer rate of 1,0% and 1,5% respectively. Following the above mapping, a continuous linear increase of the systemic importance of each sub-category is achieved.

The determination of the O-SII buffer rate of the institutions designated as O-SII, follows the mapping presented in Table 2.

Table 2

Total score (Basis points)	O-SII buffer requirement
350 – 1.000	0,5%
1.001 – 1.750	1,0%
1.751 – 2.500	1,5%
Greater than 2.500	2,0%

The O-SII buffer requirement pertinent to each O-SII institution applies from 1 January of the following year, unless a different date is set. The CBC reserves the right to introduce the O-SII buffer requirement gradually, as well as to set the commencement date of the gradual introduction of the buffer requirement, after taking into consideration the financial situation of the institutions, households, businesses and the economy in general.

The level of the O-SII buffer requirement of the CIFs designated as O-SII, together with the percentage of the buffer requirement that will be applied, are published on the CBC website, after they are approved by the Board of Directors of the CBC.

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Before setting or resetting the O-SII buffer, the CBC notifies the European Commission, the European Systemic Risk Board (ESRB), the EBA and the competent and designated authorities of the Member States concerned one month before the publication of its decision. The notification describes in detail:

- 1) the justification why the O-SII buffer is considered to be effective and proportionate to mitigate the risk,
- 2) an assessment of the likely positive or negative impact of the O-SII buffer on the internal market, based on information which is available to the CBC, and
- 3) the O-SII buffer rate that the CBC plans to set.

Where an O-SII institution is a subsidiary of either a G-SII or of an O-SII which is a European Union parent institution and subject to an O-SII buffer requirement on a consolidated basis, the O-SII buffer rate that applies at individual or sub-consolidated level for the O-SII institution shall not exceed the higher of:

- 1) 1% of its total risk exposure amount, and
- 2) the G-SII buffer rate or O-SII buffer rate applicable to the group at consolidated level.

The CBC notifies the names of the O-SII institutions and the respective sub-category each O-SII institution is allocated in, to the European Commission, the ESRB and the EBA, and discloses on the CBC website their names and the sub-category each O-SII institution is allocated in.

The CBC reviews annually the identification of O-SII institutions and the allocation of O-SII institutions into the respective sub-categories and reports the result to each O-SII institution, to the European Commission, the ESRB and the EBA and discloses on its website the updated list of identified O-SII institutions and the sub-category each identified O-SII institution is allocated in.

4. Policy review

The present policy may be reviewed annually, taking into account the data and information that are communicated to the CBC by CySEC.