



CENTRAL BANK OF CYPRUS
EUROSYSTEM

MACROPRUDENTIAL POLICY:

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

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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 - 2017*. These Laws require the CBC to identify, monitor and evaluate threats to financial stability and implement policies to prevent or reduce these threats when exercising its macroprudential oversight of the financial sector.

Based on the provisions of the *Macroprudential Oversight of Institutions Laws, 2015 - 2022* (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 the *Macroprudential Oversight of Institutions Laws*, 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 the *Macroprudential Oversight of Institutions Laws*, the CBC, after requesting and taking into account the views of competent authorities, may require each O-SII institution on a consolidated, sub-consolidated or individual basis, as applicable, to maintain an O-SII capital buffer of up to 3% of its total risk exposure amount, taking into account the criteria for the identification of O-SII institutions. The O-SII capital buffer shall consist of Common Equity Tier 1 capital.

Further to the above, subject to obtaining the European Commission’s authorisation as per paragraph 5A of Article 131 of Directive 2013/36/EU, the CBC may require each O-SII institution, on a consolidated, sub-consolidated or individual basis, as applicable, to maintain an O-SII capital buffer higher than 3% of its total risk exposure amount. The O-SII capital buffer shall consist of 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 capital 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 requesting and taking into account the views of competent authorities, the O-SII capital buffer is reviewed at least annually.

The O-SII capital 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. These guidelines were issued as required by the CRD. The CBC has adopted these guidelines.

The CBC designates credit institutions that meet the definition of O-SII institutions and determines the level of the O-SII capital buffer for each O-SII institution by following the EBA guidelines.

¹ The CBC policy for the designation of CIFs that meet the definition of O-SII institutions is available at: https://www.centralbank.cy/images/media/pdf/O-SII_buffer_policy_CIFs_-_2016_-_EN_.pdf

2. Designation of credit institutions that meet the definition of Other Systemically Important Institutions

Based on the EBA guidelines, the designation of O-SII institutions comprises of two steps. In the first step, the score of systemic importance for each relevant credit institution is calculated using the criteria set out in the *Macroprudential Oversight of Institutions Laws*, being their size, their importance for the economy of the European Union or Cyprus, the importance of their cross border transactions and their interconnectedness with the financial system.

Based on the same guidelines, each of the four criteria consists of one or more mandatory indicators. 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 credit institution by the aggregate amount of the respective indicator values summed across all credit institutions,
- (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 credit institution, by taking a simple average of the indicator scores in that category, and
- (4) calculating the overall score for each relevant credit institution, by taking a simple average of its four category scores.

Table 1

Criterion	Indicators	Weight
Size	Total assets	25,00%
Importance (including substitutability/financial system infrastructure)	Value of domestic payment transactions	8,33%
	Private sector deposits from depositors in the EU	8,33%
	Private sector loans to recipients in the EU	8,33%
Complexity/cross-border activity	Value of OTC derivatives (notional)	8,33%
	Cross-jurisdictional liabilities	8,33%
	Cross-jurisdictional claims	8,33%
Interconnectedness	Intra-financial system liabilities	8,33%
	Intra-financial system assets	8,33%
	Debt securities outstanding	8,33%
Total		100,00%

In the second step, the CBC evaluates whether a credit institution 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. Institutions 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 capital buffer requirement for credit institutions

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 its total score of systemic importance, with the level of its O-SII capital buffer requirement. Following this approach, the determination of additional O-SII capital buffer requirements is achieved. In addition, this methodology may deter the accumulation of systemic risk in one or more credit 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 CRD and the *Macroprudential Oversight of Institutions Laws* provide flexibility for the determination of the O-SII buffer between 0% and 3% of the total risk exposure amount, the CBC with the present methodology, assigns the O-SII institutions into different sub-categories based on their total score of systemic importance. Each sub-category corresponds to a specific O-SII capital buffer requirement. This approach follows the reasoning of the mandatory methodology set out in the CRD for the determination of the capital buffer that institutions designated as Global Systemically Important Institutions (“G-SII institutions”) need to maintain.

The determination of the O-SII capital buffer requirement of the credit institutions designated as O-SII institutions follows the mapping presented in Table 2.

Table 2

Total score (Basis points)	O-SII capital buffer requirement
350 – 749	0,25%
750 – 1.149	0,50%
1.150 - 1.549	0,75%
1.550 - 1.949	1,00%
1.950 - 2.349	1,25%
2.350 - 2.749	1,50%
2.750 - 3.349	1,75%
3.350 - 3.949	2,00%
3.950 - 4.549	2,25%
4.550 - 5.149	3,00%
Over 5.150	Over 3,00% and to be examined on a case by case basis

Following the above mapping, a significant increase in the O-SII capital buffer requirement in higher sub-categories of systemic importance is accomplished, which serves as an additional disincentive against the further increase in the systemic importance of O-SII institutions that have already high scores of systemic importance.

The O-SII capital 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 capital buffer requirement gradually, as well as to set the starting 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 capital buffer requirement of the credit institutions designated as O-SII institutions, together with the percentage of the buffer requirement that will be applied, are published on the CBC’s website, after they are approved by the Board of Directors of the CBC and provided that the Governing Council of the European Central Bank (“ECB”) has not objected to this decision.

Before setting or resetting the O-SII capital buffer, the CBC notifies the European Systemic Risk Board (ESRB) one month before the publication of its decision, in case the O-SII capital buffer requirement does not exceed 3%, or three months before the publication of its decision, in case the O-SII capital buffer requirement exceeds 3%. Such notifications set out in detail:

- (1) the justification why the O-SII capital buffer is considered likely 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 capital buffer rate that the CBC plans to set.

Where an O-SII institution is a subsidiary of either a G-SII or an O-SII which is either an institution or a group headed by an EU parent institution, and subject to an O-SII capital buffer on a consolidated basis, the buffer that applies on an individual or sub-consolidated basis for the O-SII institution shall not exceed the lower of:

- (1) the sum of the higher of the G-SII or the O-SII capital buffer rate applicable to the group on a consolidated basis and 1% of the total risk exposure amount, and
- (2) 3% of the total risk exposure amount, or the rate the European Commission has authorised to be applied to the group on a consolidated basis in accordance with paragraph 5A of Article 131 of Directive 2013/36/EU.

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

The CBC reviews annually the designation of O-SII institutions and the allocation of O-SII institutions into the respective sub-categories and reports the result to the O-SII institution concerned and to the ESRB and discloses the updated list of designated O-SII institutions and the sub-category each designated O-SII institution is allocated in.

4. Policy review

The present policy may be reviewed annually.