



CENTRAL BANK OF CYPRUS

EUROSYSTEM

MACROPRUDENTIAL POLICY:

**POLICY FOR THE DESIGNATION OF OTHER
SYSTEMICALLY IMPORTANT INSTITUTIONS
(O-SIIs)
&
METHODOLOGY FOR THE DETERMINATION
OF THE O-SII BUFFER REQUIREMENT**

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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 - (No. 3) 2014*. 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 Law, 2015* (Law 6(I) of 2015), **that comes into force on 1 January 2016**, 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 Firms (“CIFs”)) that meet the definition of Other Systemically Important Institutions, hereafter “O-SII institutions”.

According to the Law 6(I) of 2015, the CBC, after cooperation and consultation with the Cyprus Securities and Exchange Commission 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 and reduces moral hazard from the support of the institution from the state and the taxpayers.

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 Capital Requirements Directive (CRD). The CBC has adopted these guidelines.

The CBC designates institutions that are considered O-SII institutions and determines the additional capital requirements for each O-SII institution by following the EBA guidelines. For the designation of systemic CIFs, before the determination of the O-SII buffer by the CBC, the CBC cooperates and consults with the Cyprus Securities and Exchange Commission. The designation of O-SII institutions is reviewed on an annual basis.

2. Designation of Other Systemically Important Institutions (O-SIIs)

Based on the EBA guidelines, the designation of O-SII institutions comprises two steps. In the first step, the score for each relevant institution is calculated using the criteria set out in Law 6(I) of 2015, 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 entity by the aggregate amount of the respective indicator values summed across all 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 entity, by taking a simple average of the indicator scores in that category, and
- 4) calculating the overall score for each relevant entity, 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 an 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.

A similar procedure is followed for CIFs and is available at:

https://www.centralbank.cy/images/media/pdf/O-SII_buffer_policy_CIFs_-_2016_-_EN_.pdf

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

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 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 banking sector.

Since the CRD and Law 6(I) of 2015 provide flexibility for the determination of the O-SII buffer 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 CRD for the determination of the capital buffer that institutions designated as Global Systemically Important Institutions (“G-SII institutions”) need to maintain, under which each sub-category corresponds to a specific G-SII buffer requirement between 1,0% and 3,5% of the G-SII institutions’ total risk exposure.

O-SII institutions with a score between 350 and 1.000 basis points, bear an O-SII buffer requirement 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 requirement provided in the CRD, i.e. 2%. 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 requirement 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 requirement 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 institutions 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 and the Governing Council of the European Central Bank (“ECB”) has not objected to this decision.

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 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 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 a European Union parent institution and subject to an O-SII buffer requirement on a consolidated basis, the buffer 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 the 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 the O-SII institution concerned, to the European Commission, the ESRB and the EBA and discloses 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.

This policy, to the extent it concerns CIFs, can be revised after taking into account the data and information that are communicated to the CBC by the Cyprus Securities and Exchange Commission.