FINANCIAL SECTOR IN CYPRUS

MINISTRY OF FINANCE

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Themes

1. Outline of Cyprus
2. Key points of the economic environment
3. Overview – Cypriot Financial System
4. Financial Stability Arrangements
5. Recent developments of financial regulation and infrastructure in Cyprus
1. Outline of Cyprus

- The Republic of Cyprus is a sovereign island nation located in the eastern Mediterranean Sea.

- Cyprus is the third-largest Mediterranean island and one of the most popular tourist destinations, attracting over 2.4 million tourists per year.

- A former British colony, it gained independence from the United Kingdom in 1960 and became a Commonwealth Republic in 1961.

- The Republic of Cyprus is a developed country and has been a member of the European Union since 1 May 2004. It adopted the euro on 1 January 2008.
2. Key points of the economic environment (1)

- A small, robust and fairly flexible economy, able to adjust to rapidly changing conditions.
- A satisfactory rate of growth (average annual rate of growth of around 5% in real terms over the period 1961-2011).
- Unemployment rate 7.7% in 2011 (6.2% in 2010).
- High real and nominal convergence with EU
- GDP (at constant prices) 2011 - €15.153 billion - $21.092 billion
- Per capita income 2011 - €21.898 - $30.482
- GDP growth of 0.5% in 2011 (-1.1% in 2010)- (expected -0.5% in 2012 and around 0.5% in 2013)
- Fiscal deficit 6.4% in 2011 (expected 2.7% in 2012 and 0.5% of GDP in 2013)
- Public Debt 71.6% of GDP 2011 (61.5% in 2010)
- Low inflation levels (3.5% in 2011, core inflation 2-2.5 %)
2. Key points of the economic environment
Structure of the Economy
(2)
3. Overview – Cypriot Financial Sector (1)

- The financial system has exhibited steady growth over time till recently.

- Cypriot banks conduct mainstream banking (mostly deposit taking and loan granting)

- Well regulated banking and financial system.

- However, at the current phase, it faces challenges
  - Excessive lending following Euro adoption, led to increased exposure to the real estate market.
  - World financial and economic crisis + prudential regulation led to a containment of credit expansion.
3. Overview – Cypriot Financial Sector
Banking Sector
(2)

- There are 41 banks operating in Cyprus of which only 6 have Cyprus as their home country, 11 are branches of EU banks, 16 are branches of third country banks, 5 are subsidiaries of EU banks and 3 are subsidiaries of third country banks. Moreover, there are 100 Co-Operative Societies operating in Cyprus, of which all but one, have signed an affiliation agreement with the Co-Operative Central Bank which, through this affiliation, guarantees all their liabilities.

- Total assets of all banks (including overseas operations of the three Cypriot banks activated abroad), as at 31 December 2011, amounted to €146.2 bln or around 800% of GDP.
  - Total banking system assets of local banks amounted to 56.3%.
  - Total banking system assets controlled by foreign banks (subsidiaries and branches) amounted to 32% of the total.
  - Total banking system assets controlled by Co – Op Societies amounted to 11.7%.
3. Overview – Cypriot Financial Sector
Banking Sector
(3)

The ratio (total bank assets as a % of GDP) is not giving correctly the overall picture, as it includes the following:

- Loans and bonds booked in Cyprus (with the subsidiary or branch), which are funded by the parent institution and credit risk remains also with the holding company. Mainly, booked in Cyprus for tax purposes.
- A bank is a subsidiary of a non EU government controlled banking institution (Bank assets around €11 billion).
- If the above assets are excluded, then the size of the banking sector is significantly reduced to almost 2/3 of the above %. Moreover 30% of the said assets are in the form of liquid assets which bear a low credit risk.

Conclusion: Size constitutes a potential risk. Therefore, regulation and supervision remain very conservative.
3. Overview – Cypriot Financial Sector
Banking Sector

<table>
<thead>
<tr>
<th>Bank Asset Structure</th>
<th>Assets</th>
<th>Weighted Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>31/12/2011</td>
<td>€ mln</td>
<td>€ mln</td>
</tr>
<tr>
<td>EU Branches</td>
<td>1.912</td>
<td>n.a.</td>
</tr>
<tr>
<td>Non EU Branches</td>
<td>6.351</td>
<td>n.a.</td>
</tr>
<tr>
<td>EU Subsidiaries</td>
<td>26.511</td>
<td>8.249</td>
</tr>
<tr>
<td>Non EU Subsidiaries</td>
<td>11.973</td>
<td>2.399</td>
</tr>
<tr>
<td>Local Banks</td>
<td>82.392</td>
<td>58.419</td>
</tr>
<tr>
<td>Coop Sector</td>
<td>17.066</td>
<td>9.296</td>
</tr>
<tr>
<td>Total Banking System</td>
<td>146.205</td>
<td>78.363</td>
</tr>
</tbody>
</table>
Moreover, it is very important to note that:

- Cyprus has a conservative regulatory framework.
- **Strict liquidity requirements:**
  - 20% minimum stock liquidity for Euro obligations + maximum mismatch ratios for short term deposits – 0-7 days -10% and 0-30 days -25%;
  - Mismatch ratios for liquidity requirements calculated after classifying all sight customer deposits as maturing in the 0-7 days;
  - 70% minimum stock liquidity for foreign currency deposits (70% must be in liquid assets rated A1 and above or ECB eligible);
  - Banks are required to undertake on a regular basis liquidity stress tests;
3. Overview – Cypriot Financial Sector
Banking Sector
(6)

- On site examinations for all banks carried out every year.
- Off site monitoring of liquidity on a continuous basis, at least on a weekly basis.
- The CBC carries out, on an annual basis for each bank, a Supervisory Review and Evaluation Process (SREP) to assess the adequacy of the bank's capital, imposing additional capital requirements in case capital is not commensurate with the bank's assessed risk profile, and taking into account the results of stress testing.
3. Overview – Cypriot Financial Sector Cooperative Sector

The Cooperative Credit Institutions (CCIs) continue to play an important role in the Cypriot banking system. Cooperatives’ overall market share has been broadly stable, at around 20% in terms of total loans and deposit. CCIs are involved only in traditional banking and have no activities in foreign markets.

The cooperative credit sector has been going through a major consolidation in the last 5 years, mostly in response to the new regulatory and competitive environment. The number of cooperative credit institutions, which was around 360 in 2005, has come down to 100. The 100 CCIs operating in Cyprus hold an operating license either on a stand alone basis (1 CCI) or through their affiliation to the Cooperative Central Bank Ltd (CCB) Ltd which acts as the Central Body (CB) based on article 3 of the EU directive 2006/48/EC.
3. Overview – Cypriot Financial Sector
Cooperative Sector
(8)

- All CCIs are regulated and supervised by the Authority for the Supervision and Development of Cooperative Societies (ASDCS). Additionally and due to the fact that CCB is also a bank, the CCB and affiliated CCIs are also subject to consolidated supervision by the Central Bank of Cyprus. The CCB engages in accepting deposits mainly from its member societies, financing their requirements and generally managing their liquid assets.

- The cooperative legislative and regulatory framework is fully harmonized with the EU Directives on credit institutions and is the same as that of the Central Bank of Cyprus. Basel II is applied to all CCIs since 1/1/2008. Capital requirements are met on a consolidated basis for all the institutions that are affiliated with the Central Body (CB) while for the one institution that stands alone requirements are met on a solo basis.
### 3. Overview of the Cypriot Financial Sector
Total Deposits held by banks in Cyprus (including CCIs)

<table>
<thead>
<tr>
<th>€ million</th>
<th>29/02/2012</th>
<th>31/12/2011</th>
<th>30/06/2011</th>
<th>31/12/2010</th>
<th>31/12/2009</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Deposits</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>69.600</td>
<td>69.301</td>
<td>71.075</td>
<td>69.941</td>
<td>58.155</td>
</tr>
<tr>
<td><strong>By currency</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Euro</td>
<td>48.436</td>
<td>48.595</td>
<td>49.822</td>
<td>47.260</td>
<td>41.942</td>
</tr>
<tr>
<td><strong>By residence</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Residents</td>
<td>43.387</td>
<td>43.751</td>
<td>44.114</td>
<td>45.386</td>
<td>41.012</td>
</tr>
</tbody>
</table>

*Companies registered in Cyprus with no physical presence are classified as residents in the table*
### 3. Overview – Cypriot Financial Sector Solvency Ratios and NPLs (CCIs not included)

(10)

<table>
<thead>
<tr>
<th></th>
<th>31/12/2011</th>
<th>30/09/2011</th>
<th>31/12/2010</th>
<th>31/12/2009</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Banks at consolidated level</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Solvency Ratio</td>
<td>9.44%</td>
<td>12.15%</td>
<td>12.22%</td>
<td>11.77%</td>
</tr>
<tr>
<td>NPLs as defined by the CBC*</td>
<td>10.92%</td>
<td>8.40%</td>
<td>7.33%</td>
<td>5.94%</td>
</tr>
<tr>
<td>NPLs including fully collaterilised loans</td>
<td>15.93%</td>
<td>13.23%</td>
<td>11.49%</td>
<td>8%</td>
</tr>
</tbody>
</table>

*Non Performing Loans are defined by the Central Bank of Cyprus as credit facilities in arrear over 3 months (classified at customer level) excluding those fully covered by collateral.*
4. Financial Stability Arrangements

- Monitor / Assess the contingent liabilities of the banking system:
  - Regular meetings (at least quarterly) of the “Financial Stability Committee” composed of representatives of CBC, the Cyprus Securities and Exchange Commission, the Insurance Companies’ Control Service, the ASDCS, and the MoF, to facilitate information exchange and coordination.
  - Within this framework there is a regular updating on the current situation of the banking system.
  - The committee has been set up on the basis of a MoU on co-operation between the supervisory authorities and the MoF in the field of financial stability, signed between the supervisory authorities and the MoF in 2007.
  - Frequent unofficial exchange of information and meetings between the MoF and the supervisory division of the CBC.
  - Stress testing undertaken on a regular basis by the CBC.
Unified supervision (Commercial Banks and Cooperative Credit Institutions) does not seem to be realistic in the short and medium term. The cooperative legislative and regulatory framework is fully harmonized with the EU Directives on credit institutions and is the same as that of the Central Bank of Cyprus (from 1st of January 2011, ASDCS has fully adopted the CBC methodology for NPLs).

Creation of the regulatory framework for covered bonds. It provides banks with another financing instrument – medium and long term financing at favourable terms. The Bill has been enacted in December 2010.

Law for the Management of Financial Crisis – enacted in December 2011

Law for the establishment of an Independent Financial Stability Fund - enacted in December 2011