GETTING THE DEAL THROUGH

Banking Regulation 2015

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Cyprus

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

In the past few years the banking sector in Cyprus has undergone intense legislative and regulatory activity, mainly in connection with the resolution of troubled local banks and its aftermath, but also in connection with the implementation of major European Union (EU) legislative initiatives. The main government and regulatory policies that govern the banking sector are therefore of EU origin and relate to the creation of a banking union within the eurozone (the Banking Union).

The objectives of the Banking Union are to establish a regulatory, supervisory and bank resolution structure that minimises the likelihood and severity of a future banking crisis, while lessening its potential impact on EU economies and taxpayers. It also aims at creating a more competitive banking environment, better able to sustainably finance European growth. The main pillars of the Banking Union are:

- introducing a more robust prudential regulation framework with common rules for banks in all 28 member states (the Single Rulebook), targeting excessive risk-taking by banks, introducing stronger risk-absorbing capital buffers and addressing the issue of regulatory arbitrage;
- introducing common implementation of the Single Rulebook in the Eurozone through a centralised bank supervision structure under the European Central Bank (the ECB), leveraging the independence of the ECB while also utilising the local expertise of national competent authorities (the NCAs) (the Single Supervisory Mechanism or SSM); and
- introducing a uniform approach to bank resolution within the Eurozone, for those cases where a bank fails notwithstanding the enhanced supervisory regime (a Single Resolution Mechanism, SRM) administered by a centralised body (the Single Resolution Board) and prioritising private sector tools, most notably the allocation of losses to shareholders and the bail-in of creditors to recapitalise the bank.

Further major government and regulatory policies not directly connected to the Banking Union initiatives but of particular relevance in Cyprus are the establishment of a sound arrears management framework and the ongoing initiatives to address money laundering.

2 Summarise the primary statutes and regulations that govern the banking industry.

As a member state of the EU since 2004 and of the eurozone since 2008, Cyprus's banking legislation is largely based on directly enforceable EU legislation and the transposition of EU directives into national law. The primary statutes and regulations that govern the banking industry relate to the licensing of banking activities, the regulation and supervision of credit institutions and their resolution:

- The Business of Credit Institutions Law of 1997 to 2015, Law 66(I) of 1997 as amended, (the Banking Laws) is the basic banking legislation, into which the provisions of Directive 2013/36/EU (CRD IV) on access to the activity of credit institutions and the prudential supervision of credit institutions have been transposed;
- Regulation (EU) No. 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions (CRR) setting out own funds requirements, limits on large exposures, liquidity requirements and public disclosure requirements and reporting requirements relating to leverage;
- The Macro-prudential Supervision of Institutions Law of 2015, Law 6(I) of 2015 (the Macro-prudential Supervision Law), which transposes the relevant provisions of Directive 2013/36/EU and sets out requirements for the establishment of additional capital buffers to address systemic and other risk;
- Regulation (EU) No. 1093/2010 of the European Parliament and of the Council establishing a European Supervisory Authority (European Banking Authority) as amended by Regulation No. 1022/2013 of the European Parliament and of the Council as regards the conferral of specific tasks on the European Central Bank;
- Council Regulation (EU) No. 1024/2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (Single Supervisory Mechanism Regulation);
- Regulation (EU) No. 468/2014 of the European Central Bank establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and the national competent authorities and with national designated authorities SSM Framework Regulation);
- Directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions (Bank Recovery and Resolution Directive, BRRD);
- Regulation (EU) No 806/2014 of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund (SRM Regulation);
- The Resolution of Credit and Other Institutions Law, Law 17(I) of 2013 as amended (the Resolution Law),
- The Central Bank of Cyprus Laws of 2002 to 2014, Law 138(I) of 2002 as amended, setting out the mandate and responsibilities of the Central Bank of Cyprus (CBC), including macro and micro-prudential supervision;
- The Law on the Establishment and Operation of Deposit Protection and Resolution of Credit and Other Institutions Scheme, Law 16(I) of 2013 as amended (the Deposit Protection Scheme Law);
- The Prevention and Suppression of Money Laundering Activities Law of 2007 to 2013, Law 188(I) of 2007 as amended (the AML Law), which transposes Directive 2005/6/EC (the AML Directive);
- The Payment Services Laws of 2009 to 2010, Law 128(I) of 2009 as amended;
- The Consumer Credit Law, Law 106(I) of 2010 (the Consumer Credit Law), which transposes Directive 2008/48/EC on credit agreements for consumers; and
- The Enforcement of Restrictive Measures on Transactions in case of Emergency Law of 2013, Law 12(I) of 2013 (the Restrictive Measures Law), which sets the legal framework under which the Minister of Finance issue, on the governor of the CBC's recommendation, issues decrees restricting certain transactions for the purposes of protecting the stability of deposits in Cyprus banks following the adoption of bail-in measures in the course of resolution of two of the Cyprus banks in 2013.

Key directives and decrees issued by the CBC and the Minister of Finance under powers granted by the Banking Laws and other relevant legislation include:

- the CBC Directive on the Assessment of the Fitness and Probity of Members of the Management Body and Managers of Authorised Credit Institutions of 2014;
- the CBC Directive on Governance and Management Arrangements in Credit Institutions of 2014;
- the CBC Directive on the Preparation and Submission of Recovery Plans of 2014;
- the CBC Directive on Loan Impairment and Provisioning Procedures of 2014;
- the CBC Directives on Arrears Management of 2013 and 2014; and
- Ministry of Finance decrees issued under the Restrictive Measures Law.

3 Which regulatory authorities are primarily responsible for overseeing banks?

Banks licensed and operating in Cyprus are supervised by both the ECB and the CBC in accordance with the SSM Regulation establishing the Single Supervisory Mechanism composed of the ECB and the NCAs and the SSM Framework Regulation, establishing a framework for cooperation between the ECB the NCAs.

Under the SSM Framework Regulation, the ECB has direct supervisory competence in respect of credit and other institutions established in participating member states that are classified as being significant, with NCAs assuming responsibility for directly supervising entities that are less significant. In September 2014 the ECB published lists of significant and less significant supervised entities, which listed four Cyprus banks as being significant supervised entities on the basis that they each held assets equivalent to more than 20 per cent of the country's GDP, namely Bank of Cyprus Company Ltd, Co-operative Central Bank Ltd, Hellenic Bank Ltd and RCB Bank Ltd.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Deposits are not insured by the Cyprus government. The Deposit Protection Scheme Law establishes a scheme (the Scheme) under which two funds have been set up to provide for compensation of depositors of eligible credit institutions that are not in a position to repay the deposits. The two funds are the Deposit Protection Fund for Banks and the Deposit Protection Fund for Cooperative Credit Institutions (the Deposit Protection Funds).

The Scheme and the Deposit Protection Funds are administered by a committee (the Committee), headed by the governor of the CBC. Under the Deposit Protection Scheme Law and related regulations issued by the Committee, depositors of banks and cooperative credit institutions covered by the Scheme are entitled to maximum compensation of €100,000 from funds held by the Deposit Protection Funds, payable within 20 days of the date when a deposit is rendered unavailable. The funds held by the Deposit Protection Funds are collected through mandatory contributions made by the institutions covered by the Scheme. Such contributions are calculated as a percentage of the deposit base of covered institutions, with the target balance of the Deposit Protection Funds being 1 per cent of each covered institution's deposit base.

The Deposit Protection Scheme Law and the regulations issued by the Committee address matters such as the categories of deposits and persons that are entitled to compensation, the timing of contributions, circumstances under which exceptional contributions will be made and powers of the Scheme to borrow in situations where the Deposit Protection Funds have insufficient balances to address compensation needs.

It is expected that the Deposit Protection Scheme Law will be amended through the transposition of the provisions of Directive 2014/49/EU of the European Parliament and of the Council on deposit guarantee schemes, in accordance with the July 2015 and May 2016 deadlines set out in it.

In March 2014, the Cyprus government injected €1.5 billion into the Central Cooperative Bank, acquiring a 99 per cent stake in the ownership structure of the institution, for the purposes of recapitalising and restructuring the cooperative credit institution sector. The funds for this capital injection were provided by the European Stability Mechanism, as part of a €10 billion financial assistance package for Cyprus agreed under a Memorandum of Understanding (MoU) prepared by the European Commission in liaison with the ECB and the International Monetary Fund.

The terms under which the capital injection was made include an option for the Central Cooperative Bank to buy out the government's stake through retained profits (on terms assuring a specified minimum rate of return for the government). After 1 January 2019 the government can offer its stake for sale to third parties, subject to pre-emptive rights in relation to this stake granted to the 1 per cent minority shareholders of the institution.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

The Banking Law (article 11) sets limits on a credit institution's exposure to members of its board of directors and shareholders holding more than 10 per cent of its share capital, and the CRR sets limits on a credit institution's large exposures (and imposes greater capital requirements for breach of such limits). There are no additional regulatory limitations on transactions between a bank and its subsidiaries.

The CBC Directive on Governance and Management Arrangements in Credit Institutions of 2014 does, however, impose an obligation on credit institutions to establish conflict of interest policies governing its relationships with its stakeholders, including shareholders, staff and subsidiaries.

Permitted activities for financial institutions are set out in Annex IV of the Banking Laws and include:

- taking deposits and other repayable funds;
- lending including: consumer credit, credit agreements relating to immoveable property, factoring, with or without recourse, and financing of commercial transactions (including forfaiting);
- financial leasing;
- payment services as defined in article 4(3) of Directive 2007/64/EC;
- issuing and administering other means of payment (eg, travellers' cheques and bankers' drafts) insofar as such activity does not fall under the scope of payment services;
- guarantees and commitments; and
- trading for own account or for account of customers in any of the following:
  - money market instruments (cheques, bills, certificates of deposit, etc);
  - foreign exchange;
  - financial futures and options;
  - exchange and interest-rate instruments;
  - transferable securities;
  - participation in securities issues and the provision of services relating to such issues;
  - advice to undertakings on capital structure, industrial strategy and related questions and advice as well as services relating to mergers and the purchase of undertakings;
  - money broking;
  - portfolio management and advice;
  - safekeeping and administration of securities;
  - credit reference services;
  - safe custody services; and
  - issuing electronic money.

The Banking Laws (article 12) prohibit the ownership of real estate other than in the ordinary course of business (for example, real estate used as headquarters and branches) or which is obtained as a result of enforcement of security, and the CRR (article 89) prohibits ownership of controlling stakes in a business which is not a banking or financial services business.

Cyprus legislators have also inserted a clause in the latest amendment to the Banking Laws prohibiting a licensed financial institution established in Cyprus from selling or otherwise transferring all or part of its loan portfolio or rights pertaining to such loans, other than to credit institutions that are licenced in Cyprus (and only following written approval from the CBC). This move reflects a broader resistance by political parties in Cyprus to any legislative action that would allow sales of bank assets to entities that are perceived as less accommodating to borrowers in difficulty. This restriction on banking activity appears to limit the tools available to banks to manage their assets and restore their balance sheet health, and the CBC has

submitted a further amendment to the Banking Laws to the legislature in order to remove them.

6 What are the principal regulatory challenges facing the banking industry?

While the regulatory regime establishing the Banking Union, as transposed into Cyprus law, is now considerably reinforced, the enforcement of regulations in the areas of arrears management and corporate governance will be particularly important for the future performance of Cyprus banks (see Update and trends section).

7 Are banks subject to consumer protection rules?

The Consumer Credit Law reinforces the Cyprus legal framework for the conduct of most forms of consumer credit involving sums between €200 and €75,000.

The Consumer Credit Law addresses the following issues:

- minimum information requirements to be provided in any marketing or advertising material before a consumer enters into a consumer credit contract;
- requirement for the conduct of a credit assessment on the borrower prior to entry into a consumer credit contract;
- minimum information requirements to be included in consumer credit contracts, including type of credit, duration, amount of credit, interest rate and method of calculation and reference rate, instalments, charges, default interest rate and rights of advance repayment;
- circumstances under which a consumer may withdraw from the consumer credit contract;
- conditions related to advance repayment;
- retention of rights following assignment of a consumer credit contract to another provider; and
- method of calculation of the annual percentage rate.

The Consumer Credit Law also grants supervisory and administrative powers to the Director of the Competition and Consumer Protection Authority of the Ministry of Trade, Industry and Tourism for the purposes of enforcing its provisions, subject to any contrary provisions of the Banking Laws. These powers include the power to supervise providers of consumer credit, to conduct research, to impose administrative fines and apply for court orders against entities violating the Consumer Credit Law.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

Given Cyprus's membership of the EU and the eurozone, it is anticipated that legal and regulatory change will be involve the evolution and further refinement of the three pillars of the Banking Union.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

In accordance with the provisions of the Single Supervisory Mechanism Regulation and the SSM Framework Regulation the ECB assumes supervisory responsibility for banks classified as systemically significant institutions and also maintains exclusive supervisory responsibility in relation to the following matters:

- Authorisation of credit institutions and withdrawal of authorisation;
- Assessment of notifications of acquisition and disposal of a qualifying holding (a direct or indirect holding in an undertaking which represents 10 per cent or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that undertaking) in a credit institution; and
- In carrying out its prudential tasks in relation to Cyprus banks, the ECB applies all relevant EU laws and, where applicable, the national legislation transposing them into Cyprus law. Where the relevant law grants options to Cyprus, the ECB will also apply the national legislation exercising those options. The ECB is supported by the CBC through participation in supervisory teams, exchange of information and notifications, where the CBC is the point of contact with the supervised institution.

Joint supervisory teams have been established for the supervision of each of the four Cyprus banks designated as a significant supervised entity by the ECB. Each joint supervisory team is led by an ECB staff member and composed of staff members from the ECB and from the CBC. They perform on- and- off-site supervisory examinations, the extent and frequency of which are determined by the systemic importance of the institution, its compliance status with regulatory requirements and the level of perceived systemic risk at any point in time.

Under the same supervisory framework the CBC retains supervisory responsibility over less systemically significant credit institutions established in Cyprus, under the oversight of the ECB.

10 How do the regulatory authorities enforce banking laws and regulations?

Under the SSM Framework Regulation and the Banking Laws, the ECB and the CBC have been granted powers to impose sanctions on banking institutions and individuals that are in breach of EU and national banking laws and regulations.

The SSM Framework Regulation empowers the ECB to directly impose administrative pecuniary penalties on significant banking institutions that are in breach of a requirement under relevant directly applicable acts of EU law (eg, requirements under the CRR) amounting to up to twice the amount of profits gained or losses avoided as a result of the breach, or, if these amounts cannot be ascertained, penalties of up to 10 per cent of total annual turnover (defined as gross income consisting of interest receivable and similar income, income from shares and other variable or fixed-yield securities, and commissions or fees receivable).

In the cases where the ECB seeks to impose a non-pecuniary penalty, or a pecuniary penalty against an individual, it must initiate infringement proceedings through the CBC. Such penalties are set out in the Banking Laws (article 30) in relation to breaches of the Banking Laws or the CRR and involve powers to require the credit institution to adopt corrective measures, or to limit its operations by restricting the scope of its operating licence. These measures include, but are not limited to:

- the imposition of restrictions on collection of deposits, granting of loans or undertaking of investments;
- the imposition of restrictions on any other type of transactions;
- requiring a credit institution remove any member of its board of directors or any executive;
- requiring the credit institution to maintain capital levels higher than those set out under the Banking Laws;
- requiring a credit institution to reinforce its governance structure, risk management procedures and policies and internal control mechanisms;
- requiring a credit institution to implement specific provisioning policies;
- restricting or prohibiting the distribution of profits by a credit institution;
- requiring a credit institution to reduce the proportion of variable executive pay;
- requiring a credit institution to submit a step plan for compliance with prudential standards; and
- withdrawing the credit institution's authorisation to provide banking services.

The CBC maintains the power to impose pecuniary and non-pecuniary penalties in accordance with the relevant provisions of the Banking Laws, in relation to less significant banks.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

There are only three publicly available decisions of the CBC imposing fines on Cyprus banks. They relate to the breach of the AML Regulation and the breach of obligations in connection with investment services to clients.

12 How has bank supervision changed in response to the 2008 financial crisis?

The current legislative framework has been initiated by the EU and has been largely designed to address the fallout from the global financial crisis. The EU's response has been the adoption of the Banking Union as a means of establishing a regulatory, supervisory and bank resolution structure that minimises the likelihood and severity of a future banking crisis, while lessening its potential impact on EU economies and taxpayers.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

Cyprus has obtained concrete experience in bank resolution since 2013, when, as part of its MoU (see question 4) it undertook the resolution of its two largest banks under a newly drafted Resolution Law, on terms effectively imposed by its lenders under the MoU.

The restructuring of the Cyprus banking sector through the resolution of the two largest banks involved:

- the immediate resolution of Laiki Bank through the creation of a 'bad' bank and the transfer of certain of its assets and of insured deposits to Bank of Cyprus;
- the recapitalisation of Bank of Cyprus through the bail-in of uninsured depositors, shareholders and other creditors of the bank; and
- the sale of the Greek branches of Bank of Cyprus, Laiki Bank and Hellenic Bank.

Although the Resolution Law has yet to be amended to transpose the BRRD (the 31 December 2014 deadline for transposition having passed), it nevertheless reflects the main principles underlying the BRRD as well as the main resolution tools provided in it.

The Resolution Law sets out the following circumstances under which the Resolution Authority (defined as the CBC in the Resolution Law) may initiate resolution measures with the agreement of the Finance Minister:

- where the supervisory authority body in cooperation with the Resolution Authority jointly decide that the credit institution concerned is not viable or may become non-viable with reasonable risk that it may not be able to fulfil its obligations;
- where the supervisory authority considers that the in the absence of resolution measures, any other actions that may be reasonably taken by the credit institution will not be sufficient to allow it comply with minimum capital and liquidity requirements; and
- where the adoption of resolution measures is necessary for public benefit and public interest purposes.

The Resolution Law makes explicit reference to the protection of shareholder and creditor rights. Accordingly, where the Resolution Authority applies any of the available resolution measures such as sale of operations, sale of assets and liabilities to a bridge bank, transfer of assets and rights to an asset management company and bail of shareholders and creditors, the rights of parties to guarantee agreements, financial collateral agreements, set-off agreements, netting agreements, assignment and indemnity agreements and structured finance agreements are preserved.

Beyond this point, and to the extent that there are clear public policy and public interest considerations in the application of resolution measures, including the maintenance of confidence in the banking sector and shifting the cost of resolution away from taxpayers, the protection of creditor and shareholder rights is subordinated to those other considerations. In terms of the losses that may be imposed on shareholders and creditors, the Resolution Law does, however, specify that the adoption of resolution measures should not result in greater losses than would have been incurred had the credit institution been liquidated instead.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

Under the Banking Laws (article 30B), credit institutions are obliged to put in place recovery plans, which set out the steps that the institution would take to restore its financial state in the event of an adverse occurrence.

The CBC has also issued a directive (the Directive on the Preparation and Submission of Recovery Plans of 2014) specifying that such plans are to be submitted by the governing body of the credit institution and that they should involve private sector means for achieving recovery, such as raising capital, restructuring liabilities and divesting assets.

The submission of recovery plans by bank management is also a key tenet of the BRRD.

15 Are managers or directors personally liable in the case of a bank failure?

Although supervisory authority sanctions on credit institutions under the Banking Laws can be extended to bank directors and management, and both the Banking Laws and the Resolution Law include the power to require the removal of directors and management, bank failure does not of itself result in liability on the part of directors.

Nonetheless, under both the BRRD and SRM Regulation, it is specified as one of the principles governing the application of resolution measures that natural and legal persons are made liable, subject to national law, under civil or criminal law, for their responsibility for the failure of the institution under resolution.

It remains to be seen whether this resolution principle will translate into the widening of criminal liability in Cyprus for actions related to bank failures. For the time being, bank directors may be held liable under civil law for breach of their fiduciary duties and duty to exercise care and skill owed to the bank, under common law and equity principles.

16 How has bank resolution changed in response to the recent crisis?

Before the recent banking crisis, which was particularly severe in Cyprus given the large size of the banking sector relative to the size of the economy, and before the adoption of the Resolution Law, it was understood that the CBC in accordance with the Banking Laws (as they stood at the time) together with the government would have broad discretion to devise a rehabilitation scheme and provide the necessary financial support.

Prior to the adoption of the euro in 2008, when Cyprus maintained its own currency, the Cyprus pound, the options available could have included the recapitalisation of the banks and the injection of liquidity through the issue of additional currency.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

Article 4(2)(b) of the Banking Laws specifies a minimum initial capital requirement for the commencement of banking activities (subject to certain exceptions) of €5 million. The form of the initial capital is prescribed in subparagraphs (a) to (e) of paragraph 1 of article 26 of the CRR.

In terms of the ongoing own funds requirement for credit institutions, the CRR (article 92) specifies a total capital ratio of 8 per cent composed of a Common Equity Tier 1 capital ratio (CET 1) of at least 4.5 per cent, with the overall Tier 1 capital ratio being at least 6 per cent. The capital ratios are expressed as a percentage of the total risk exposure amount. In terms of the calculation of CET 1, additional Tier 1 and Tier 2 capital certain items that were considered eligible under the previous regulations will gradually be phased out by 2017.

The Banking Laws (article 22B) also require that credit institutions create a capital conservation buffer composed of CET 1 capital equal to 2.5 per cent of their total risk exposure to cover possible losses under adverse economic scenarios. The ECB or the CBC, as applicable, have additional discretion under the Banking Laws (article 30) to further increase a credit institution's capital requirements if, pursuant to their supervisory duties, they determine that it is deficient in any significant area of corporate governance or risk management or that it is exposed to particular risks that would justify a larger capital buffer.

Over and above the basic ongoing capital adequacy ratios set out in the Banking Laws and the CRR, the Macro-prudential Supervision Law, which enters into force from January 2016, provides for additional capital elements to be established by credit institutions, as follows:

- individual countercyclical capital buffers, reflecting the risk to the banking sector of excessive credit growth, of up to 2.5 per cent of risk exposure calculated for different markets and composed of CET 1;
- systemic risk capital buffer reflecting long-term non-cyclical systemic or macro-prudential risks not covered by the CRR, of at least 1 per cent of risk assets composed of CET 1 elements; and
- capital buffers on systemically important institutions (global systemically important institutions G-SII and other systemically important institutions O-SII) of up to 3.5 per cent for G-SIIs and 2.0 per cent for O-SSIs composed of CET 1 elements and reflecting the particular need to mitigate risks of failure of such institutions that could have far-reaching impact on the broader economy.

18 How are the capital adequacy guidelines enforced?

The Banking Laws (article 30) set out the actions (including the imposition of sanctions) that can be taken by the ECB or CBC, as applicable, for the purposes of enforcing the capital adequacy guidelines. They include the following measures:

- request that the credit institution rectify any breach of the provisions of the Banking Laws and of the CRR (including any capital adequacy provisions); and
- impose any one or more of the sanctions listed in article 30 (see question 10, above), including the requirement that the credit institution apply net profits towards the reinforcement of minimum capital adequacy ratios, or the imposition of restrictions on operations or the divestment of certain operations.

19 What happens in the event that a bank becomes undercapitalised?

In the event that a bank becomes undercapitalised, the ECB or CBC, as applicable may require it, under the powers vested in them by the Banking Laws (including the powers set out in question 18, above) and under any recovery plans that have been approved (as set out in question 14, above), to take the necessary corrective action (such as raising additional capital or disposing of operations) to restore its capital levels.

To the extent that such measures as are required to restore capital adequacy ratios cannot be taken or fail to address the issue, the ECB will notify the Single Resolution Board (in case of a systemically significant bank) or CBC in its capacity as Resolution Authority (in case of a systemically less significant bank), either of which may initiate a resolution process or insolvency proceedings.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

The Single Rulebook and the Single Supervisory Mechanism are designed to reduce the likelihood of a bank becoming insolvent. The ECB or CBC, as applicable, should be in a position to recognise that a bank is facing financial difficulties at an early stage and take steps to prevent further deterioration by requiring the bank to implement its recovery plan, or such other action that the ECB or CBC may demand, in accordance with their powers under the Banking Laws. At a second stage, and to the extent that the bank's efforts to restore its financial condition fail, the Single Supervisory Board or the CBC in its capacity as Resolution Authority would determine whether the bank should enter a resolution process.

A bank liquidation process would be considered in circumstances where the CBC or the Single Resolution Board, as applicable, decides that as a matter of public policy or public interest, liquidation would be preferable to a resolution process, or, where, as part of a resolution process involving the sale of business tool, the bridge institution tool or the asset separation tool, the surviving entity is to be wound down.

Article 33B-bis of the Banking Laws provides for a special liquidation process applicable to banks. This involves the appointment of a special liquidator, who applies the relevant provisions of the Companies Law Cap.113 or the Cooperative Companies Law, except where specific powers and restrictions set out in the Banking Laws prevail. A key feature of special liquidation applying to banking institutions is that the special liquidator is nominated by the CBC and that the exercise of his or her functions is subject to CBC instructions.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

The latest changes were adopted through the transposition of CRD IV into the Banking Laws and directly through the CRR. Certain forms of additional capital will be phased in gradually through the Macro-prudential Supervision Law.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

The Banking Laws, which govern the authorisation of credit institutions in Cyprus and the approval of any controlling interest, do not set any explicit limitation on the type of entity or individual that may own a controlling interest. However, in the assessment of the potential acquirer of a controlling stake, the structure of the acquiring entity and the impact that such structure might have on the ability of the competent authorities to exercise effective supervision are taken into account. The full list of factors that are considered in the assessment of a potential acquisition (in accordance with the Banking Laws) is set out in question 29.

A controlling stake is referred to as a 'qualifying holding' in the Banking Laws, which is defined in the CRR as 'a direct or indirect holding in an undertaking which represents 10 per cent or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that undertaking'.

23 Are there any restrictions on foreign ownership of banks?

There are no legislative restrictions on the foreign ownership of banks. Under the Banking Laws, the factors that may be taken into account in the assessment of a potential acquisition relate primarily to the potential acquirer's capacity to ensure the sound management of the credit institution in question.

24 What are the legal and regulatory implications for entities that control banks?

An entity which controls a bank will be assessed based on the criteria set out in question 29, should it wish to acquire a qualified holding, and will need to satisfy the requisite criteria for the duration of the holding period.

If the controlling entity of bank qualifies as an EU financial holding company or an EU mixed financial holding company (as these terms are defined in the CRR) it will be subject to consolidated supervision.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

An entity or individual that controls a bank is required to notify the CBC or ECB, as applicable, of any intention to sell a qualifying holding or increase or decrease its holding in the bank beyond or below the 20 per cent, 30 per cent and 50 per cent thresholds.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

A controlling entity or individual is likely to be requested to inject additional capital under the terms of a recovery plan in the event that the bank is in danger of becoming insolvent.

A controlling entity or individual may incur liability on the insolvency and liquidation of the bank for any role they may have had in transactions that are found to be void or illegal under the insolvency provisions of the Companies Law Cap. 113.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

The Banking Laws (article 17) specify that any potential acquirer acting alone or in concert with other persons and wishing to acquire directly or indirectly a qualifying holding (as defined in question 22, above) in a credit institution, or increase his or her holding in a credit institution such that his or her voting rights exceed 20 per cent, 30 per cent or 50 per cent or otherwise such that the credit institution becomes a subsidiary, must notify the CBC in writing.

Within two days of receiving the notification the CBC must issue written confirmation of receipt and specify the information that the potential acquirer will need to provide for the purposes of assessing the proposed change in control, and confirm of the deadline for completion of the assessment. The assessment period is set at 60 days, subject to a 20-day extension should the CBC request additional information.

If the ECB (which has ultimate decision-making authority following a recommendation from the CBC) refuses the proposed acquisition, it must respond in writing before the assessment deadline, setting out the rationale for its decision. If the ECB does not respond in writing within the assessment deadline, the proposed acquisition is deemed to be accepted.

The ECB can set the deadline within which the proposed acquisition must be completed.

Update and trends

The Cyprus banking sector underwent very significant changes under the resolution regime adopted in 2013 and although surviving banks have been recapitalised, it will take further significant efforts to fully restore depositor confidence in the banking sector and for the banks to fully resume their role in financing the economy.

One major challenge is to fully remove the restrictive measures on deposit withdrawal, which were imposed as a matter of urgency in March 2013 in connection with the bail-in of depositors' funds as part of the resolution of Bank of Cyprus and Laiki Bank. The measures adopted under the Restrictive Measures Law in a series of CBC and Finance Ministry decrees were aimed at preventing a run on deposits and while they have been progressively eased following the gradual improvement in the economic climate and the recapitalisation of the banking sector, a firm date for their complete removal has not been set.

A second major challenge, which may also influence the speed with which the restrictive measures will be lifted, is the high proportion of non-performing loans in the portfolio of Cyprus banks. It remains to be seen how the much anticipated foreclosure legislation (already approved by the Cyprus parliament, though with implementation effectively postposed) will be applied and whether it will indeed provide the banks with the necessary tools to effectively and quickly realise the value of their real estate security. The large volume of real estate collateral relative to the size of the economy will probably limit the banks' ability to proceed with substantial foreclosures on loans without unduly depressing real estate prices.

Finally, the implementation of stricter corporate governance practices is another important objective that must be attained if the Cyprus banking sector is to achieve a sustainably stronger and more solid future. In this respect, the appointment of experienced foreign bankers on the board of Bank of Cyprus following its recent recapitalisation (through the participation of foreign funds) is a welcome development, reinforcing both the independence and the skills available to the board.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

Under the Banking Laws, there is no differentiation between domestic and foreign owners, with the same assessment criteria being used to assess both (as set out in question 29).

The only slight difference is that the CBC can extend the time frame for assessment of a potential acquirer's notification by 10 days (to 30 days in total) when requesting additional information from a potential acquirer who is not based in a member state that has transposed EU Directives, including the CRD IV.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

The factors taken into account by the CBC in its recommendation to the ECB, regarding approval of acquisition of control are set out in the Banking Laws (article 17A) relate primarily to the proposed acquirer's capacity to ensure the sound management of the credit institution in question, having in mind the likely influence the acquirer will have on it. The factors the CBC considers are:

- the reputation of the proposed acquirer;
- the reputation, knowledge, competence and experience of the directors and management team which may be put in place following the acquisition;
- the financial health of the proposed acquirer;
- the ability of the credit institution to continue to comply with regulatory requirements under the Banking Laws and the CRR and other legislation relevant to its operations, with due consideration to the structure of the acquiring group (if applicable) and the ability of the relevant competent authorities to cooperate and exercise effective supervision; and
- the extent to which there is any reasonable suspicion that the proposed acquisition is related to money laundering or financing of terrorist activities as defined under the AML Law.

In assessing the proposed acquisition, the CBC does not impose any conditions precedent with regard to the size of the acquisition, nor does it take into account the economic needs of the market.

30 Describe the required filings for an acquisition of control of a bank.

Article 17A of the Banking Laws specifies that the CBC should publish the information requirements for the purposes of the assessment of the potential acquisition. Such information should address the assessment factors (set out in question 29) and should be adapted to the nature of the potential acquirer and to the nature of the potential acquisition.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

See response to question 27.

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