

# CYPRUS BANKING INSIGHT

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-GROWTH-



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## MREL: A BIG CHALLENGE



**MICHAEL KRONIDES**  
Manager

In early March 2019, EU authorities reached an agreement on the Bank capital legislative package, including changes to the Bank Recovery and Resolution Directive (BRRD2). The legislation is not yet final as official vote is expected in May 2019.

One of the main components of the legislative package is the setting of the Minimum Requirement of Eligible Liabilities and Own Funds (MREL). The purpose of MREL is to ensure effective implementation of the bail-in tool, that is shareholders and creditors are the first to absorb losses when a Bank fails. MREL was first implemented through the BRRD in 2014 and upcoming amendments are expected to be applicable from January 2024.

The toughest part of the previous years' negotiations revolved around the issue of capital amount required and the degree of subordination. The MREL is composed of the Loss Absorption Amount (LAA), comprising the Pillar 1 and Pillar 2 Requirement capital, and the Recapitalization Amount (RCA), comprising the Pillar 1, Pillar 2 Requirement and a buffer capital. The issue of subordination relates to how much of the MREL capital requirement will have to be met with subordinated liabilities (ranking below senior debt).

From the above, it is obvious that the MREL implementation is a huge challenge for European Banks, let alone local Banks, both in terms of capital requirement and subordination. For the first, a rough calculation indicates that the MREL capital requirement is expected to be at least twice the capital requirement of the Bank. For the second, it is obvious that issuance of MREL eligible instruments will increase funding costs and consequently impact the profitability of the Bank.

It is expected that Banks from peripheral countries, including Cyprus, will display greater MREL shortfalls in comparison with Banks from core countries. These shortfalls are due to the fact that some Banks and financial systems rely to a greater extent on senior debt as their source of funding (core countries) while others tend to focus on deposits (peripheral countries and small Banks). In addition, Banks from peripheral countries have limited access to international capital markets, a fact that will further hamper their efforts to raise the required subordinated debt.



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**YIANNIS TOMASIDES**  
General Manager  
Artemis Bank  
Information  
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## ARTEMIS BANK INFORMATION SYSTEMS LTD: LOOKING BACK WITH PRIDE AND FORWARD WITH PASSION

The year 2018 was a milestone for Artemis Bank Information Systems Ltd (“Artemis”) since it marked the completion of 10 years since its establishment as the first Credit Bureau in Cyprus. To date, Artemis is the only recognized Credit Bureau in Cyprus by the World Bank and its presence helps the competitiveness of the Cyprus economy.

Artemis had from the very beginning a two-fold vision: On the one hand, to assist the financial institutions in the evaluation of the repayment ability of prospective and existing borrowers (“Responsible lending”) and on the other to educate the public about the proper management of their credit facilities (“Responsible borrowing”). Both pillars are key to the smooth functioning of the Cyprus economy.

This 10-year journey of Artemis was highlighted with a number of important achievements for the company and consequently the financial sector. From Artemis' operation initiation in 2009 where the four biggest banks at the time were exchanging data through Artemis on a voluntary basis, Artemis today serves efficiently a total of 30 financial institutions submitting and receiving data by Law. In these years, the Artemis' register was significantly enriched with data categories which are considered instrumental in the efficient evaluation of a customer's creditworthiness by the financial institutions: From only legal measures data initially, the Artemis database contains today a full array of financial behavior data, placing Artemis highly compared to other credit bureaus at European level regarding the completeness of data. Another important achievement was the development of a new, upgraded data exchange software system which was custom-designed by Artemis to meet the specific needs of users in the Cyprus banking sector and developed entirely by JCC Payment Systems Ltd. Artemis implements continuous enhancements to its system with an aim to constantly increase its value to the users.

At the same time Artemis, being fully aware of the importance of its mission and the responsibility undertaken in safeguarding the public interest, continues to place high importance to the respect and protection of individuals' rights and provides

“Artemis enjoys today a positive image in the financial sector and is valued as a trusted Data Controller and provider.”

all means for exercising their legal rights.

The year 2018 was a year of consolidation in the operations of Artemis as the company further developed its infrastructure and services with an aim to increase efficiency in servicing financial institutions and the public but also to ensure compliance with the newly established General Data Protection Regulation (GDPR). The categories of Artemis' data recipients were expanded to include Credit Acquiring Companies.

Artemis enjoys today a positive image in the financial sector and is valued as a trusted Data Controller and provider. A recent example was the assignment to Artemis of the role of the host for the software and the database of the ESTIA project, which is currently at the preparation stage. Being an integral part of the financial system, Artemis retains very good cooperation with all relevant authorities; the Central Bank of Cyprus, the Ministry of Finance and the Office of the Commissioner for Personal Data Protection, to the benefit of the financial sector, the Cyprus economy and the citizens.

Artemis has a clear strategic roadmap which is similar to the path followed by well-established Credit Bureaus abroad, aiming to strengthen further its role in safeguarding commercial credit, mitigating credit risk and promoting the reliability of transactions. The implementation of its strategy will allow Artemis to further increase its value to its stakeholders in the ecosystem. Artemis has plans to enter new sectors which are also in need of creditworthiness information exchange and, for this purpose, several new projects and initiatives are currently underway.

Credit reporting systems are key to supporting the development of a country's financial infrastructure and economy. Artemis, as a Credit Bureau, feels proud for its achievements so far and looks forward to a bright future lying ahead.

## FINANCING THE EUROPE OF TOMORROW



**CHRISTINA ANTONIOU PTERIDES**  
Senior Advisor

In September 2018, the European Banking Federation (EBF) organized a summit on Financing Growth where it presented its vision paper: “Financing the Europe of Tomorrow – How to unlock Europe’s latent growth potential”.

For several years since the 2013 crisis, public discourse on the banking sector justifiably focused on how to regulate the banking sector to achieve more financial stability. This led to stricter rules, higher capital requirements as well as greater transparency. The European Banking Federation, recognizing that banking stability is a necessary but not sufficient goal for banks, has published this vision paper where it outlines the role of banks as agents to fuel dynamic, sustainable and strong economic growth in Europe.

To be able to fulfil this role, while at the same time not sacrificing safety and stability, EBF outlines its recommendations for:

- enabling banks to provide more financing to corporates and households;
- building and integrating capital markets;
- bringing more investors into the market;
- ensuring fair competition; and
- achieving sustainability.

The vision outlined by EBF is: An integrated, single European financial sector that fuels dynamic, sustainable and strong economic growth.

### Europe needs more capital markets but not less banking

EBF emphasizes that each type of financing has its unique features which benefit the economy. Far from being mutually exclusive, market-based financing and banking finance work together to meet the needs of companies and investors. For both corporates and households, bank financing in Europe remains the cornerstone of economic activity and forms the basis of access to other kinds of financing. Therefore, instead of “reducing dependency to banks” Europe should focus on promoting the diversity of funding for different needs.

To ensure that bank lending continues playing its role in meeting economic actors’ needs, a priority from a policymaker and regulator perspective should be to review and where necessary revise the current prudential regulation where it hinders banks’ lending capacity (for both capital and liquidity issues). In addition, companies’ access to basic bank services must not be constrained through excessive regulation. Furthermore, more focused use should be made of

public and blended finance funds (such as those of the EIB, EBRD) to avoid crowding out private financing. EBF also advocates facilitating cross-border retail banking activities to create a truly integrated banking market across the EU.

### Strengthening European capital markets with coordinated action

EBF explains that a deeper, more diversified and larger capital market strengthens the resilience of the financial system and mobilizes greater amounts of savings that can be put to efficient use in the economy. However, European capital markets remain small and underdeveloped compared to the size of the economy, whereas the goal of an integrated Capital Markets Union remains elusive. EBF believes it is very important to address this, since strengthening European capital markets will strengthen the banking system as well as the economy. The key priorities of the banking sector are as follows:

- Establishing a Europe-wide discussion through a “Wise Person Committee” to define the fundamental structural obstacles that stand in the way of an integrated Capital Markets Union,
- Promoting best practices from regions that have successfully developed their markets,
- Promoting a more calibrated regulatory framework to enable local actors (banks, accountants, advisers etc) to access capital markets and fulfil their roles within them effectively,
- Developing private equity markets and alternative ways of financing to function as complements to capital markets,
- Developing a well-functioning pan-European securitization market, in particular for SME and real estate loans,
- Ensuring that regulation does not limit banks’ capacity to finance the economy in terms of funds available or activities that can be offered,
- Building an equity culture in Europe supported by better opportunities for investing in capital markets.

### Bringing the investors in through investor protection and financial education

Recognizing that investor protection is quintessential, EBF proposes a number of measures to ensure that a spectrum of attractive investment opportunities is available to investors, in a transparent and accessible manner. EBF is advocating for more initiatives to reduce obstacles for



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investors to invest cross-border. To promote financial literacy, EBF has spearheaded an initiative called the Financial Education Platform and will seek for more ways to cooperate with the public sector to build up the skills of retail investors. In addition, EBF believes in giving greater choice and control to retail investors through well-targeted regulation.

### Fair competition inside and outside Europe

EBF outlines the need for banks to face fair competition, to ensure that households, companies and investors of banks will benefit from access to the best possible services, on the best possible terms. According to EBF, the major aspects affecting competition in the European financial sector relate to:

- the digital field, where the regulatory environment must allow competition from new non-banks (“fintechs”) based on equal treatment, that is, the same services and risks should be subject to the

same rules and supervision,

- international competitiveness, where European banks must be allowed to face fair competition against their global competitors; and
- the competitiveness of the EU’s capital markets, which must maintain their attractiveness to investors and issuers.

### European banks’ commitment to sustainability

EBF stresses that banks can pay a key intermediation link to a greener and sustainable business environment. In this context, European banks are actively promoting international best practices to meet the increasing demand for green, social investments. An example of this is the engagement of a number of leading banks to help establish the Principles for Responsible Banking under the United Nations Environmental Program – Finance Initiative (UNEP-FI). Furthermore, European banks support the European Commission’s Action Plan on Sustainable Finance to achieve the Paris climate targets and will align themselves with this plan to deliver on these goals. EBF advocates further analysis of possible ways of incentivizing green lending and investment through the review of capital requirements, without jeopardizing the effectiveness of the current risk-based prudential network in the EU.

## DIGITALIZATION: AN OPPORTUNITY FOR THE WHOLE SOCIETY



**MARIA IOANNOU**  
Senior Advisor

The European Union (EU) Regulation 910/2014 (“eIDAS”) has been designed to ensure that international standards of digital identity and trust services are in place in all member states. The Regulation sets guidelines for the use of electronic identification and electronic signatures (including electronic seals and timestamps) in the European Single Market.

The regulation is characterized as one of the EC’s goals to achieve a full digital market. eIDAS came into force in September 2014, replacing the Electronic Signatures Directive 1999/93/EC. It has been applied in phases since July 2016 and is fully operational since 29 September 2018.

The Regulation itself encourages EU member states to work together with the private sector to deliver electronic identification means in their economies. The Regulation is only mandatory for the public sector. Private companies are free to decide whether or not to opt to follow this digital transformation. On these grounds, the local Ministry of Internal Affairs called the Association of Cyprus Banks to join forces and develop a partnership for the benefit of both the financial and the public sector. The local authorities aim to promote a single national mechanism for electronic identification and electronic signatures (the «e-identity model») which (if agreed between the parties) shall be adopted both by the public sector and member banks of the Association. In this context, citizens either as individuals or as representatives of companies, will be served with the same e-identity by financial institutions and public services, as well as by any other organization that chooses to use the e-identity model. This will facilitate the development of new products and services while at the same time improved and faster services will be provided to the public.

In light of the above model, certificates for e-identification and e-signatures will be issued by any authorized Trust Service Provider which complies with the regulations of the national framework and which is approved by the local competent authorities - the Department of Electronic Communications of the Ministry of Transport, Communications and Works.

### Benefits for banks and customers

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market with innovative offers which put pressure on established financial service providers and (b) customers moving towards online shopping, expecting to access more digital products.

In a competitive environment, banking institutions need to digitize their internal procedures and develop new digital models. The paper-based methods will be replaced by new electronic mechanisms. Money and time will be saved leading to reductions in operational costs of financial institutions. Digitization affects the entire operations of the bank, such as compliance and risk management, security, IT, electronic and mobile banking solutions and more. Financial institutions have already started working on this tool in order to evaluate which parts of business need to be transformed and which technologies can facilitate this transition.

One example would be the opening of a bank account. Account opening is one of the most time consuming and costly process for banking institutions. It involves checking all KYC documents and performing all applicable Anti-Money Laundering activities. Electronic identification procedures will significantly speed up the process of account opening and reduce compliance costs. Once customers have passed AML verifications and can be granted a trusted identity, they will be able to conduct all of their banking activities digitally. A share of these savings could be passed to customers.

Furthermore, banks will benefit from a binding commitment when a customer e-signs a document, which is the legal equivalent of a handwritten



signature. Banks will also benefit from effective and secure electronic transactions, considerable savings in document management and a more modern client relationship, one that is in line with today’s expectations for digital services.

Citizens on the other hand will have the opportunity to choose in a simple and quick way from a variety of new and securely offered innovative products, both nationally and cross border. Consumers will

be able to choose the best products according to their personalized needs. Even more under national schemes, their electronic ID would not only be applicable for banking products and financial services but for public services and other sectors of the economy (insurance, health, etc) as well as under a trusted and secure environment. Certainly, digital signatures and identification are set to make life easier for everyone.

## SEPA CREDIT TRANSFERS INSTANT PAYMENTS: THE FUTURE OF ELECTRONIC PAYMENTS



**MARIOS  
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Senior Advisor

The SEPA Credit Transfer Instant Payments Scheme (SCT Inst) was created by the European Payments Council (EPC) in response to the Euro Retail Payments Board's (ERPB) invitation at the end of 2015. Chaired by the European Central Bank, the ERPB is a high-level entity bringing together the supply and demand sides of payments. In close cooperation with the rest of the payment chain (technical providers, representatives of customers, etc), the EPC created the scheme's rulebook and implementation guidelines in just one year.

The SCT Inst is the fourth payment scheme made available by the EPC, after the SEPA Credit Transfer, the SEPA Direct Debit Core (for the general public), and the SEPA Direct Debit Business-to-Business schemes. These schemes are used every day by Europeans and facilitate over 39 billion electronic transactions every year.

SCT Inst was created for everyone: consumers, businesses, large companies and administrations. SCT Inst works like a regular SEPA credit transfer – but much, much faster. Instead of having to wait up to one business day to see the money credited in the account, the beneficiary receives the funds in a matter of seconds – ten seconds maximum, to be precise.

The checks performed by the beneficiary's Bank and the clearing and settlement of the transaction (i.e. the behind-the-scenes processes moving the money from one Bank to another), have to take place within this ten second threshold. This is a challenging undertaking for Banks in terms of risk management. To limit the risk of fraud, the maximum amount per SCT Inst transaction is limited to €15,000 for the time being. The transaction has to be denominated in euros, even if this is not the currency of the account of the originator and/or beneficiary of the payment.

Though SCT Inst is currently not yet pan-European, it has the potential geographical scope to cover all 34 European countries and territories: the 28 European Union Member States, plus Iceland, Norway, Liechtenstein, Switzerland, Monaco and San Marino (post, hard-Brexit UK included, as it has decided to remain within the SEPA zone).

As the scheme is optional (there is no European regulation mandating implementation yet), it is up to each Bank to decide to join the instant payments journey. Once decided, it nevertheless has to follow

the rules outlined in the SCT Inst scheme rulebook, and it is free to propose additional features, as long as it respects the scheme and does not hinder its interoperability with other Banks. It can choose the channels on which its customers use the service (e.g. on mobile devices only), or it can choose its own name for the service offered. 'SCT Inst' is more a kind of code name among the payment community, as it will mostly remain unknown to the general public.

Instant payments can be extremely useful in a number of situations. These include all circumstances where the immediate availability of funds is needed, for instance, to urgently send money to a relative living abroad. In addition, instant payments can be an excellent substitute for cash – minus the latter's disadvantages – as they become particularly convenient when paying for goods or services that require on-the-spot payments. In the context of person-to-person payments, they can, for example, be used to reimburse a friend for one's share of a restaurant bill, or to pay a partner back one's share of a household invoice. Second, a pan-European instant payment scheme is necessary to ensure ongoing payment integration in the area. Instant payments are in the spirit of the times. Unsurprisingly, several euro countries had plans to develop their own solutions, all stopping at their national borders. To avoid the multiplication of national instant payment schemes, a pan-European scheme for instant euro credit transfers becomes particularly useful, as it covers both national and cross-border transactions.

The journey to instant payments is moving fast. In fact, 2049 Banking Institutions (counting to about 50% of European Banks from several EU countries), have already adhered to the scheme in order to give

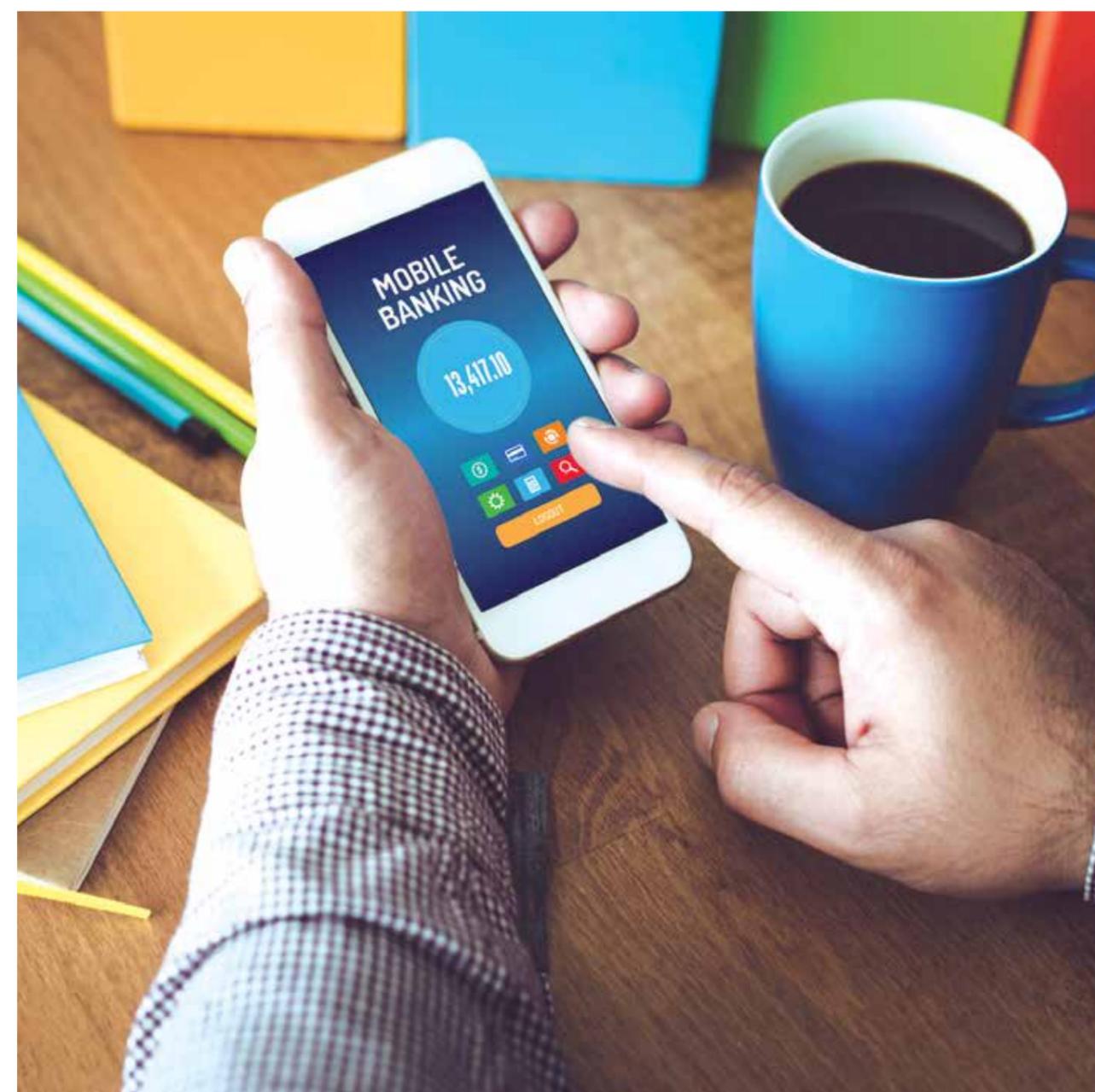
“ Instant payments can be extremely useful in a number of situations. These include all circumstances where the immediate availability of funds is needed, for instance, to urgently send money to a relative living abroad.

it full momentum and make it more attractive to customers. Although Cypriot Banks have not adhered yet, they are in close contact with the Central Bank of Cyprus in order to examine all current options and take appropriate action.

The EPC, in close collaboration with other payment stakeholders, will help the scheme evolve to better meet customers' needs. Over the last year, a public consultation was organised in order to gather the views of the market on the proposed evolution of the

scheme. This will lead to the publication of an updated rulebook and implementation guidelines with an effective date of November 2019.

Trying to bring 500 million people into a single instant payments scheme for euro transactions is seen as a major goal. Advocates of the single market, see the SCT Inst as the catalyst for broad transformation that, along with the Revised Payment Services Directive (PSD2), will considerably alter the face of the European payments system.





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## NEW SECURITIZATION FRAMEWORK

**S**ecuritisations are a financing technique by which homogeneous income-generating assets – such as loans – are pooled and sold to a specially created third party (securitization special purpose entity or SSPE or issuer). Thereafter, the SSPE converts the portfolio into bonds by issuing securities and channeling them to investors. In a securitization plan non-performing loans can also be included.

### The benefits

Soundly structured securitisation is an important channel for diversifying funding sources and enabling a broader distribution of risk by allowing banks to transfer the risk of some exposures to other banks, or long-term investors such as insurance companies and asset managers. This presents advantages to the banks because it allows them to remove NPLs from their balance sheets, to “free” the part of their capital that was set aside to cover for the risk in the sold exposures, thereby allowing them to generate new lending, while still satisfying regulatory capital requirements.

Apart from banks, securitization presents advantages to investors and markets and it may even have broader economic and social benefits, as follows:

**1.** Taking into account that in the European financial system bank lending accounts for 75-80% of total funding of the economy, securitisation can lead to more credit for businesses and households.

**2.** Securitisation can also provide additional investment opportunities by allowing banks to transfer assets to institutional investors (such as pension funds) to meet those investors’ asset diversification, returns and duration needs.

**3.** More securitization would encourage market participants to develop standardisation further. This in turn should reduce operational costs for securitisations. Since these costs are higher for the securitisation of SME loans than average, the drop in price should have an especially beneficial effect on the cost of credit for SMEs.

**4.** For SMEs in particular, boosting securitisation markets would:

- help banks to free up capital that can then be used to grant new credit to firms, most of which are SMEs in the EU and Cyprus;
- foster issuance of asset-backed commercial paper products, which represent an important source of short-term SME financing;

- allow banks to securitise and therefore finance loans to SMEs more easily.

### Securitisations Law of 2018

The Securitization Law was voted in July 2018. The purpose of the new law is to grant power to the Central Bank to authorise, regulate and supervise the activity of securitisations, in order to ensure the proper functioning of the securitisation market in Cyprus.

The scope of this Law is limited to the securitization of credit facilities or other form of receivables and / or exposures that were either originated or acquired by credit or financial institutions or that were acquired by credit acquiring companies.

Below follows a summary of the Law in ten key points:

**1.** An originator (e.g. a bank) that intends to engage in a traditional securitisation shall apply to the Central Bank for authorization and shall submit specific information. An originator that intends to engage in synthetic securitisation shall notify in writing the Central Bank of its intention, which may request any information it deems necessary.

**2.** An “SSPE” needs to be established for every securitisation captured under the Law. This is a special purpose entity that is established as a limited liability company, trust or other legal entity, with a purpose to take on one or more securitisations, and the activities of which are limited to the necessary actions for the achievement of this purpose and the structure of which is, or the contractual provisions relating to it are, intended to separate the obligations of the SSPE from those of the originator.

**3.** The SSPE must appoint a Servicer to carry out the day to day administration of the securitised exposures. Under the Law, credit institutions may act as servicers. The Law also creates a new category of authorised Servicers. These shall be limited liability companies incorporated in the Republic to which authorisation was granted by the Central Bank by virtue of the Law.

**4.** The Law sets out the functions and responsibilities of both the SSPE and the Servicer.

**5.** The Central Bank shall be responsible for the supervision of SSPEs and Servicers mainly in order to safeguard the financial stability in the Republic. It shall have the power to ask for access to books and records but shall act under confidentiality.

**6.** The originator has an obligation, under the Law, to provide a written notification to the underlying debtors, the collateral providers and guarantors of the relevant



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credit facilities, at least forty-five (45) business days before proceeding with the transfer of the exposures to the SSPE.

**7.** The Law includes certain clauses on set-off of the underlying securitisation exposures with credit balances held by the underlying debtor to the originator.

**8.** The Law provides for various methods of transfer of exposures to the SSPE to be decided between the originator and the SSPE which may be, without limitation, by transfer, assignment or declaration of trust.

**9.** The Law includes certain provisions on the matter of true sale and insolvency remoteness. This way it is ensured that a true sale has taken place and that the SSPE issuer is “bankruptcy remote”, meaning that if the Originator goes into bankruptcy, the assets of the issuer will not be distributed to the creditors of the Originator. These

statutory provisions are important and provide legal certainty to rating agencies and investors. Of course, accounting standards govern when such a transfer is a true sale, a financing, a partial sale, or a part-sale and part-financing. In a true sale, the originator is allowed to remove the transferred assets from its balance sheet.

**10.** The Law includes a general provision to the effect that the transfer of the underlying debts and/or the receivables and/or expenses and the relevant collaterals to an SSPE incorporated in the Republic, is not subject to any tax, duties, charges or other costs borne by the underlying debtors and/or the originator, and any amounts payable by the underlying debtor to the servicer of the said SSPE in accordance with the terms of the securitised exposures, shall not be subject to any withholding, reduction or deduction as a result of any tax.

### The European Commission Proposal

The European Commission believes that securitization has a role to play in the financial stability (by reducing NPLs) and the broader economy. For this reason, an EU Regulation 2017/2402 was issued, which establishes a general framework for securitisation and creates a specific framework for simple, transparent and standardised (STS) securitisation.

The Regulation was published in the Official Journal of the European Union on 28 December 2017, and is a cornerstone of the EU’s efforts to establish a capital markets union, by creating a single market for investment services and activities and to ensure a high degree of harmonised protection for investors in financial instruments.

The main features of this package are:

**1.** It introduces a clear set of criteria to identify simple, standardised and transparent securitisation (STS), and aims to make securitisation sustainable; It is believed that STS securitisation can act as an effective funding channel to the economy;

**2.** It differentiates between simpler and more transparent securitisation products and other products which don’t satisfy such criteria; such differentiation should restore an important funding channel for the EU economy without endangering financial stability. The aim here is to promote longer-term investors including non-bank institutions. It is also clear that this market is not for retail investors;

**3.** It allows securitisation to function as an effective funding mechanism for some non-banks (such as insurance companies) as well as banks;

**4.** It aims to protect investors and to manage systemic risk.