

**Cyprus: Detailed Assessments of Observance of Standards and Codes
for Banking Supervision, Insurance Supervision, and Securities Regulation**

These detailed assessments of the observance of standards and codes in the financial sector of Cyprus were prepared by a staff team of the International Monetary Fund. They are based on the information available at the time the report was completed in July 2006. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Cyprus or the Executive Board of the IMF.

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OFFSHORE FINANCIAL CENTER ASSESSMENT PROGRAM

CYPRUS

DETAILED ASSESSMENTS OF OBSERVANCE OF STANDARDS AND CODES

JULY 2006

The information and data in this paper refer only to the government-controlled areas of the Republic of Cyprus (the GC areas).

INTERNATIONAL MONETARY FUND
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GLOSSARY

AML/CFT	anti-money laundering and combating the financing of terrorism
BCBS	Basel Committee on Banking Supervision
AOCS	Audit Office of Cooperative Societies
BL	Banking Law
BCP	Basel Core Principles for Effective Banking Supervision
BSD	Banking Supervision and Regulation Division
CAD	Capital Adequacy Directive
CBC	Central Bank of Cyprus
CCB	Cooperative Central Bank
CESR	Commission of European Securities Regulators
CCI	cooperative credit institution
CIFSA	Cyprus International Financial Services Association
CM	cooperative movement
CSL	Cooperative Societies Laws
CSSDA	Cooperative Societies' Supervision and Development Authority
CySEC	Cyprus Securities and Exchange Commission
EU	European Union
FATF	Financial Action Task Force
FSI	Financial Stability Institute
GAAP	generally accepted accounting principles
MiFID	markets in financial instruments
MOU	memorandum of understanding
IBU	International Banking Unit
IAC	Insurance Advisory Committee
IAIS	International Association of Insurance Supervisors
IAS	International Accounting Standards
ICCS	Insurance Companies Control Service
ICIS	International Collective Investment Schemes
ICPAC	The Institute of Certified Public Accountants of Cyprus
Ifs	investment firms
IFAC	International Federation of Accountants
IFCs	International Financial Services Companies
IFRSs	International Financial Reporting Standards
IFSCs	International Financial Services Companies
IOSCO	International Organization of Securities Commissions
OFC	offshore financial center
MOKAS	Unit for Combating Money Laundering (the Cypriot FIU)
PSMLAL	Prevention and Suppression of Money Laundering Activities Laws
SI	Superintendent of Insurance
UCITS	undertakings for the collective investment of transferable securities
UCML	Unit for Combating Money Laundering (also MOKAS)

PREFACE

This report for the Republic of Cyprus contains detailed reports on the assessments of financial supervision and regulation in the government-controlled areas. The assessment of supervision of banks and of cooperative societies was carried out on the basis of the Basel Committee's *Core Principles for Effective Banking Supervision* and of insurance supervision on the basis of the IAIS's *Insurance Core Principles*. The assessment of regulation of the securities sector was based on IOSCO's *Objectives and Principles of Securities Regulation*. The banking supervision assessment updates the 2001 assessment for the international banking sector and assesses supervision of domestic banks.

The assessments were carried out during a mission from March 28 to April 8, 2005 whose members included Ms. Mary G. Zephirin (Mission Chief), Mr. Ahmed Zorome (Economist), and Ms. Bärbel Bernhardt (Assistant), (all MFD), Messrs. Marcel Maes (Consultant, Banking Supervision), Timothy Sullivan (Consultant, Banking Supervision), Henning Goebel (Insurance supervision expert, German Federal Financial Supervisory Authority, BaFin), and Michael Deasy (Securities regulation expert, Irish Financial Services Regulatory Authority). The assessment team received excellent cooperation from the authorities and market participants. Factual updates, concerning in particular laws passed since the assessment mission, have been included.

An assessment of the arrangements to combat money laundering and the financing of terrorism (AML/CFT) based on the FATF 40+9 Recommendations was carried out by a mutual evaluation mission of the Council of Europe Select Committee of Experts on the Evaluation of Money Laundering Measures (MONEYVAL). The field visit took place from April 3 to 9, 2005. The Assessment of Financial Sector Supervision and Regulation (AFSSR) for the Republic of Cyprus summarizes key findings of the AML/CFT assessment (AFSSR information refers only to the government-controlled areas).

I. DETAILED ASSESSMENT OF COMPLIANCE WITH THE BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

A. General

1. With the agreement of the Central Bank of Cyprus (CBC) and the Cooperative Societies' Supervision and Development Authority (CSSDA), the mission assessed these institutions' compliance with the Basel Core Principles for Effective Banking Supervision (BCP) using the Core Principles Methodology. The assessments were undertaken in the context of the Offshore Financial Center (OFC) Assessment Program.
2. The domestic and offshore sectors of the banking sector were not subject to individual assessments since they are both covered by the same legislation and are similarly supervised by the Banking Supervision and Regulation Division (BSD) of the CBC.
3. The assessment of the CSSDA took note of its ongoing program to substantially expand and enhance its supervisory capacity and activities and the effects of the transition period available to the credit cooperative institutions to achieve required prudential standards or affiliate with the Cooperative Central Bank (Central Body), pursuant to an arrangement reached by the government as a part of its accession to the European Union (EU).
4. The assessments took place in March and April 2005 and were undertaken by Marcel Maes, formerly with the Commission of Banking, Finance, and Insurance of Belgium, and Timothy Sullivan, formerly with the Office of the Comptroller of the Currency of the United States.

B. Information and Methodology used for Assessment

5. The assessment of compliance with the core principles is not, and is not intended to be an exact science. Banking systems differ from one country to the next as do their domestic circumstances. Furthermore, banking activities are changing rapidly around the world, and theories, policies, and best practices of supervision are swiftly evolving. Nevertheless, it is internationally acknowledged that the core principles are seen as minimum standards.
6. This assessment of compliance with each principle has been made on a qualitative basis. A five-part assessment system is used: compliant, largely compliant, materially noncompliant, noncompliant, and not applicable. To achieve a "compliant" assessment with a principle, all "essential" criteria generally must be met without any significant deficiencies. There may be instances where a country can demonstrate that the principle has been achieved through different means. Conversely, due to specific conditions in individual countries, the essential criteria may not always be sufficient to achieve the objective of the principle, and therefore, one or more additional criteria and/or other measures may also be deemed necessary by the assessor to judge that compliance is achieved. A "largely compliant" assessment is given if only minor shortcomings are observed, and these are not seen as sufficient to raise serious doubts about the authority's ability to achieve the objective of that principle. A "materially noncompliant assessment"

is given when the shortcoming is sufficient to raise doubts about the authority's ability to achieve compliance, but substantive progress had been made. A "noncompliant" assessment is given when no substantive progress towards compliance has been achieved, or when insufficient information was available to allow a reliable determination that substantive progress had been made towards compliance. An assessment of "not applicable" is rendered for a principle deemed by the assessors to not have relevance.

7. The assessment was based on a review of the applicable laws, regulations, and prudential guidelines, although the assessment of the CSSDA was affected by the absence of English-language translations of many documents. The assessors held discussions with officers and staff of the CBC and the CCSDA. They also met with the auditor general of Cyprus and the Director of the Audit Office of Cooperative Societies (AOCS), officers and staff of the Cooperative Central Bank, representatives of individual financial institutions, professional associations, and bank external auditors. Before the mission, both the CBC and the CSSDA had separately prepared formal self assessments.

C. Institutional and Macprudential Setting, Market Structure

8. Cyprus, as a recent entry to the European Union (EU) (in May 2004), has benefited from the structure, institutions, and rules whose adoption is required for acceptance. From being a relatively closely controlled system, the requirements of accession resulted in both a liberalization and a tightening of prudential regulation. Thus, on January 1, 2001, a nine percent ceiling on interest rates that had been in place since 1944 was removed as an initial step to capital account liberalization. At the same time, the authorities instituted a three-phase process of exchange control relaxation which was completed on accession at May 1, 2004, when the Capital Movement Law repealed the Exchange Control Law. The exchange rate of the Cypriot pound, whose central rate has been pegged to the Euro since January 1999, had its fluctuation margins widened to ± 15 percent in August 2001, and the authorities are pursuing a Euro-adoption strategy. This will foster required fiscal adjustment. Inflation, averaging about three percent a year over the past four years, is expected to remain subdued.

9. Cyprus adopted International Accounting Standards (IAS) in 1981 and has a large professional body of accountants as well as a strong association of certified accountants who have disciplinary powers and arrangements. The big four accounting firms are represented.

10. Deposit protection schemes were established in September 2000 for banks and cooperative societies. Compensation is set at 90 percent of total deposits of each depositor up to a maximum of EUR 20,000. In addition, the cooperative societies laws (CSL) provides that the CSSDA, in cooperation with the Pancyprian Cooperative Confederation Ltd., can issue a legally binding regulation requiring the establishment of a solidarity fund in which cooperative credit institutions' (CCIs) participation is mandatory. The solidarity fund would be used to address liquidity or solvency issues before the deposit protection scheme. A preliminary regulation is in draft.

11. Through their participation in the work of the Banking Supervision Committee of the European System of Central Banks, its Working Group on Macro-prudential Analysis, and in the "Coordinated Compilation Exercise for Financial Soundness Indicators," the

CBC has established the basis for developing a framework for macro-prudential surveillance and analysis.

12. The banking industry consists of three distinct segments. The domestic market is supplied by two: 11 commercial banks with three specialized institutions (each of which has a commercial banking license) and some 358 cooperative credit institutions. Domestic commercial banking is dominated by three banks which together hold about 70 percent of system assets, excluding the cooperative banks, and about half of system assets, including the cooperatives.¹ The three largest banks, all locally owned, are international groups² with major insurance companies as subsidiaries. The three specialized institutions are a mortgage bank (a subsidiary of the largest commercial bank) which lends longer term for tourism and manufacturing, the Cyprus Development Bank which, in addition to standard development bank services, provides consulting services, and the Housing Finance Corporation which provides long-term housing loans to low and middle-income families. The latter two are publicly owned, but total assets of the three are only a small portion of the banking system. The remaining domestic banks include 3 small local banks and foreign-owned branches (2) and subsidiaries (3).

13. Cooperative credit institutions³ have maintained a strong role, with their deposits representing 32 percent of total deposits in local currency at end-2004. As a result of their nonprofit nature, lower operating costs and lower regulatory costs, they have been able to compete effectively with commercial banks. Most Cypriots continue to deposit with their local cooperatives. Their clearing agent, the Cooperative Central Bank, is a licensed commercial bank.

14. The third segment of the banking market are the 26 international banking units, the largest number of which are from Lebanon (8), Jordan (4), and Russia (3). Until recently, with the new rules introduced by EU accession, they were ring-fenced from the domestic market, although subject to supervision by the central bank similar to that of domestic commercial banks. At the end of 2004, IBU assets of \$12.5 billion represented 30 percent of domestic banking assets (excluding the cooperatives).

¹ Information from Fitch Sovereign Ratings for Cyprus, August 17, 2004. The banks' published consolidated balance sheets do not provide financial information for the individual banking entities.

² The term "group" is used in this report to accord with the definitions of the CBC's "Directive for the supplementary supervision of banks in a financial conglomerate" issued in September 2005. The directive defines a "group" as a group of undertakings consisting of a parent, subsidiaries, entities in which the parent or a subsidiary have a shareholding of at least 20 percent, and entities related by unified management, and sets a size threshold on the smallest sector for classification as a financial conglomerate of a group with cross-sectoral holdings.

³ Credit societies with unlimited liability and savings societies with limited liability.

15. The economy of government-controlled Cyprus is heavily banked. As a result, the larger banks are expanding by establishing branches and subsidiaries in overseas markets with important Greek communities.

16. As a result of the fallout from the bursting of the 1999 stock market bubble, lower output in the tourism sector and depressed activity in the world economy, domestic banks have had losses in both 2002 (negative return on equity of 11.1 percent) and 2003 (negative 4.7 percent). In 2004, however, performance improved to a positive 4.3 percent ROE at mid-2004. Non-performing loans to total gross loans were 11.7 percent at mid-2004. The central bank has begun to require the suspension of interest on non-performing loans by the banks. Despite improved collections, the reported NPL ratio may deteriorate when the calculation is brought fully into line with EU requirements at start-2006. Overall risk-weighted capital remains adequate at roughly 13 percent in 2004.

17. The principle-by-principle assessments for banking in this volume (see Tables 1 and 2) reflect the different supervisory regimes applied in the market. While domestic commercial banks and international banking units are similarly supervised by the CBC, CCI's are supervised by the CSSDA.

18. The CCI's have heretofore been subject to fewer regulations; however, the need to be in line with EU banking directives requires that all credit cooperatives sharply improve their prudential ratios by end-2007. A number of CCI's will comply on an individual basis; the remaining CCI's will comply by affiliating themselves with the CCB and by meeting the prudential requirements on a consolidated basis. The assessment therefore evaluates supervision for the commercial banks (whether domestic or international) separately from that of credit cooperatives (see Tables 1 and 2).

D. General Preconditions for Effective Banking Supervision

19. The preconditions for effective banking supervision in Cyprus are generally in place. Currently, there are no macroeconomic vulnerabilities and risks that could have implications for the effectiveness of prudential safeguards or the stability of the financial system. The public infrastructure provides for an environment that fosters the honoring and enforcement of financial contracts.

20. There is a comprehensive set of laws, which governs the financial sector. These laws are supported by a body of professional lawyers and judges. The court system is efficient. Cyprus has adopted both International Accounting Standards and International Auditing Standards. The supervision of other financial sectors and markets is generally efficient. There has been no evidence of government efforts to influence lending operations. There is a deposit insurance program in place. The financial services regulators have a process in place to address distressed financial institutions.

E. Principle by Principle Assessment—Central Bank of Cyprus

Table 1. Detailed Assessment of Compliance of the Basel Core Principles (CBC)

Principle 1.	<p>Objectives, Autonomy, Powers, and Resources</p> <p>An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to the authorization of banking establishments and their ongoing supervision; powers to address compliance with laws, as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.</p>
Principle 1(1)	<p>An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks.</p>
Description	<p>The Banking Law N°66(1) of 1997 (the BL) provides in Section 26 that the Central Bank of Cyprus (the CBC) is responsible for the supervision of banks in order to ensure the orderly functioning of the banking system.</p> <p>The original law setting up the Central Bank of Cyprus came into effect in 1963. The new Central Bank of Cyprus Law of 2002 (N. 138(1) 2002 (the CBC Law) defines the main tasks of the Bank as follows:</p> <ul style="list-style-type: none"> • The definition and implementation of monetary policy; • The conduct of the exchange-rate policy and the management of the official foreign reserves of the Republic; • The supervision of banks in the Republic; • The promotion, regulation, and oversight of the smooth operation of payments and settlements systems; • To act as banker and financial agent of the Government of the Republic. <p>All responsibilities for banking supervision rest solely and entirely with the CBC. According to Section 30(1) of the BL, the CBC may take the necessary measures when a bank fails to comply with any provision of the BL or with any regulations made under the BL.</p> <p>The minimum prudential standards that banks should meet are the following:</p> <ul style="list-style-type: none"> • Limitation of credit exposures; • Limitation on holdings of immovable property; • Limitation of shareholdings; • Prohibition of commercial trading; • Prohibition of dealing in own shares; • Prior approval for amalgamation; • Limitations on large shareholdings; • Persons disqualified to act as directors in banks; • Direction and management by at least two individuals (Four-eyes principle); • Minimum capital; • Capital adequacy ratio; • Computation of capital; • Minimum liquidity; • Compensation of depositors (Deposit Protection Scheme). <p>The CBC is empowered to issue directives for the purpose of implementing the objectives and provisions of the BL. Banks are required to comply with both the provisions of the BL and the directives of the CBC. To this effect, the CBC has issued directives on the following:</p> <ul style="list-style-type: none"> • Computation of prudential liquidity; • Computation of the capital base of banks;

	<ul style="list-style-type: none"> • Computation of banks' capital adequacy ratio; • Capital adequacy; • Layout and contents of banks' annual accounts; • Monitoring and control of credit facilities (large exposures); • Framework for the evaluation of internal control systems; • Foreign currency positions and exposures; • Employment of funds derived from foreign currency deposit liabilities; • Cross-border credit transfers; • Establishment and operation of the Deposit Protection Scheme; • Freedom of establishment and freedom to provide banking related activities by European Union authorized credit institutions. <p>The above directives issued by the CBC are based on respective European Union ("EU") Directives and the recommendations of the Basel Committee on Banking Supervision ("BCBS").</p> <p>The CBC has also issued a notice on the following:</p> <ul style="list-style-type: none"> • Relationship between the CBC and the external auditors of banks. <p>Regulations have also been issued on the following:</p> <ul style="list-style-type: none"> • Establishment and Operation of an Investor Compensation Fund for Clients of Banks. <p>Cyprus's accession to the EU has triggered a number of fundamental amendments to the regulatory framework in view of the necessary and timely harmonization of supervision with the <i>acquis communautaire</i>.</p> <p>In April 2004, the Banking Amendment No. 2 Law was enacted in order to harmonize Cyprus's legislation with Directive 2001/24/EC, which introduces the principle of mutual recognition by the EU member states with regard to the reorganization measures or winding up proceedings adopted by the home country of credit institution, in case these run into difficulties.</p> <p>The CBC decides when and how to effect the orderly resolution of a problem bank situation.</p> <p>The CBC publishes an Annual Report of its activities in each financial year, which covers its banking regulatory and supervisory activities. The CBC Annual Report also includes a short description of the developments in the banking industry in Cyprus as well as a brief assessment of the performance of the above sector for the year under review.</p> <p>In addition, the CBC publishes current and historical statistics on the banking industry.</p> <p>Moreover, all Cyprus incorporated banks are required to publish, within six months from the end of each financial year, the balance sheet and profit and loss account for that year together with the auditor's report.</p>
Assessment	Compliant.
Comments	None.
Principle 1(2)	Each such agency should possess operational independence and adequate resources.
Description	<p>Section 7 of the CBC Law states that when carrying out the tasks conferred upon them under this, neither the Bank nor any member of its decision-making bodies shall seek or take instructions from the government or any other body.</p> <p>The CBC is therefore an independent organization, separate from the government or governmental agencies. There is, in practice, no evidence of government or industry interference in the operational independence of the CBC and in its ability to obtain and deploy the resources needed to carry out its mandate.</p> <p>The management of the CBC is in the hands of the board of directors consisting of the governor,</p>

	<p>the deputy governor, and five directors.</p> <p>The governor and the deputy governor are appointed by the president and the vice resident of the Republic, respectively. The independence of the CBC is secured by the Cyprus Constitution.</p> <p>The supervision of banks is carried out by the Banking Supervision and Regulation Division, which consists of two departments. The total number of staff in each department is as follows:</p> <ul style="list-style-type: none"> a) Domestic Banks Supervision Department: 32 staff members. b) Supervision of International Banks, Regulation and Financial Stability Department: 19 staff members. <p>The senior manager of the Banking Supervision and Regulation Division as well as the managers of the two departments mentioned above, in addition to their academic/professional qualifications, have had a long experience in their respective positions having been promoted from the ranks. Supervisory staff are also well educated being in possession of academic/professional qualifications and have had considerable hands-on experience in the supervision of banks.</p> <p>Salary levels of the supervisory staff within the CBC (officers, administrative, and clerical staff) are comparable to the salary levels in the private banking industry. Salary levels of senior managers within the CBC remain, however, below the salary levels of general managers in the private banking sector.</p> <p>Training programs for bank supervisory staff cover a variety of areas related to banking supervision and regulation. Staff members regularly attend courses organized by the Financial Stability Institute of the Bank for International Settlements, the Bank of England, the Deutsche Bundesbank, the Banque de France, the Nederlandsche Bank, the United States (U.S.) Federal Deposit Insurance Corporation, the U.S. Federal Reserve System, and other central banks/banking supervisory authorities, as well as private institutions. Staff also visit other domestic regulators when that is deemed appropriate within the scope of the MOU between the CBC and the securities, insurance, and cooperative credit institutions supervisory authorities, as well as overseas supervisory authorities in accordance with MOUs signed with them. In addition, the CBC is a subscriber to the "FSI Connect" service provided by the Financial Stability Institute of the Bank for International Settlements, which is an online information resource and training tool for bank supervisors worldwide.</p> <p>Emphasis is also placed on developing and maintaining a modern information technology infrastructure to support the key activities of the Banking Supervision and Regulation Division.</p> <p>The budget of the CBC's supervisory function (covering recruitment, hiring outside experts, training, information technology (IT) expenditure, travel etc.) forms part of the CBC's overall budget.</p> <p>The CBC is also authorized to charge fees in connection with expenses incurred for the supervision and inspection of banks.</p> <p>The Governor of the CBC is appointed for a renewable term of office of five years. He may be relieved from office only if, in the opinion of the Council of Ministers, he no longer fulfills the conditions required for the performance of his duties or in the event of serious misconduct. This provision which is in accordance with the Statute of the European System of Central Banks has also been incorporated in the Cyprus constitution.</p> <p>Although the CBC Law does not specify that the reason for the Governor's removal from office must be publicly disclosed, it is expected that, in such an event, the reasoning behind the decision will be made public in accordance with the established principles of administrative law.</p>
Assessment	Largely Compliant.
Comments	The increasing demands on the Banking Supervision and Regulation Division's officers and

	<p>staff emanating from the substantial requirements relating to the accession of Cyprus to the EU, as well as other developments in the financial supervisory and regulatory sector, have interfered with the execution of a number of supervisory tasks and slowed the fulfillment of the regular on- and off-site supervisory programs. Since this problem is one of a permanent structural nature, the authorities should take action to ensure that properly trained and experienced staff are provided for in numbers that will assure timely and adequate fulfillment of the CBC's supervisory responsibilities.</p>
Principle 1(3)	<p>A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.</p>
Description	<p>The CBC is the banking supervisory authority responsible for granting and withdrawing banking business licenses.</p> <p>The Cooperative Societies' Supervision and Development Authority (CSSDA) is the supervisory and licensing authority of cooperative credit institutions in Cyprus (a separate assessment addresses the implementation of the Basel Core Principles for Effective Banking Supervision regarding the cooperative credit institutions).</p> <p>Section 3(3) of the BL authorizes the CBC to:</p> <ul style="list-style-type: none"> • grant a license without any condition or subject to such conditions as the CBC may consider proper to impose; or • refuse to grant a license. <p>The CBC may amend or cancel whenever, either permanently or temporarily, any condition imposed on a license, or impose any new conditions thereto [Section 3(4) of the BL]. The CBC shall not take into consideration the economic need criterion for purposes of granting a bank license [Section 4(5)].</p> <p>The CBC is empowered to set prudential rules administratively for the following:</p> <ul style="list-style-type: none"> • Bank capital base (definition of the constituent parts; BL Section 22); • Capital adequacy ratio [BL Section 21(1)]; • Liquidity [BL Section 23(1)]. <p>The CBC may, for the purpose of implementing the objectives of the BL and subject to the provisions of the BL, issue general or specific directives which are communicated in any manner that the CBC may determine [BL Section 41(1)].</p> <p>In exercising its discretionary power under the Banking Law, the CBC is required to act after taking into consideration, by way of guidance, the international practice and the directives and regulations of the European Union.</p> <p>Sections 24 and 25 of the BL require licensed banks to submit prudential returns. The CBC is authorized to determine their contents and frequency.</p>
Assessment	Compliant.
Comments	None.
Principle 1(4)	<p>A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws, as well as safety and soundness concerns.</p>
Description	<p>The BL [Section 30(1)] enables the CBC to address compliance with laws and the safety and soundness of the banks under its supervision.</p> <p>The CBC is authorized to exercise qualitative judgment in applying these measures.</p> <p>Section 26 of the BL gives the CBC unfettered access to all of the institutions records and books.</p> <p>Section 30(1) of the BL determines the powers of the CBC where a bank fails to comply with laws and regulations or is likely to be engaged in unsafe or unsound practices. According to this section, the CBC requires the bank to take such action as deemed necessary to rectify the</p>

	situation and is authorized to impose a range of sanctions, including the revocation of the license.
Assessment	Compliant.
Comments	None.
Principle 1(5)	A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.
Description	<p>Neither, the CBC nor any person who is a director or an officer of the CBC, is liable in any action suit or other legal proceedings for damages for anything done or omitted in the discharge or purported discharge of the functions and responsibilities of the CBC under the BL, unless it is shown that the act or omission was not in good faith or was the result of gross negligence.</p> <p>The defense of CBC staff against lawsuits rests with the Office of the Attorney General and all legal expenses incurred are covered by the Cyprus government.</p>
Assessment	Compliant.
Comments	None.
Principle 1(6)	Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Description	<p>A memorandum of understanding (MOU) has been signed between the CBC, the Cyprus Securities and Exchange Commission, the Insurance Companies' Control Service, and the Cooperatives Societies Supervision and Development Authority (CSSDA). The MOU came into effect on January 1, 2003. The four parties to this MOU meet at least quarterly to discuss matters of mutual interest. Also, at the technical level, supervisors meet at least on a monthly basis and communicate, if need be, on an ongoing basis.</p> <p>This MOU is based on the application of Section 27(1) which allows the competent supervisory authorities of the financial sector to cooperate and exchange information between them and/or with other supervisory authorities, whether in Cyprus or elsewhere, with a view of discharging their functions and responsibilities in a more effective manner. Any exchange of information will only take place when the CBC is satisfied that the information provided is subject to the same confidentiality rules in the hands of the receiving competent supervisory authority as apply to the CBC.</p> <p>Section 27(1) of the BL enables the CBC to provide to home country supervisory authorities information, which in the opinion of the CBC enables the home country supervisory authority to exercise consolidated supervision. Information on individual deposit accounts is excluded. However, in practice, such information can be passed by the affected subsidiary or branch to its parent or head office or the foreign regulator may choose to visit Cyprus to conduct an on-site review of the operations.</p> <p>The information exchange between the competent supervisory authorities is exclusively used in the discharge of their functions and responsibilities and is subject to confidentiality rules in the hands of the receiving supervisory authority as applied to the supervisory authority which provides the information on the basis of legislation in force from time to time.</p> <p>Confidential information exchanged between the competent supervisory authorities on the basis of the legislation in force may not be disclosed without the express agreement of the competent supervisory authority which disclosed it and, where appropriate, solely for the purposes for which this authority gave its agreement.</p> <p>Memoranda of Understanding ("MOUs") have been signed, largely on the initiative of the CBC, with the following overseas banking supervisory authorities:</p> <ul style="list-style-type: none"> • Central Bank of the Russian Federation; • Bulgarian National Bank; • National Bank of the Republic of Belarus; • National Bank of Ukraine; • National Bank of Yugoslavia;

	<ul style="list-style-type: none"> • National Bank of Romania; • Financial and Capital Market Commission of the Republic of Latvia; • National Bank of Slovakia; • Bank of Tanzania; • Central Bank of Jordan; • Bank of Greece; • Central Bank of the Lebanon. <p>In addition, MOUs are under negotiation with a number of overseas banking regulatory and supervisory authorities, including authorities in the United Kingdom and Ireland.</p> <p>MOUs have been signed with the following overseas regulators in the field of international financial services:</p> <ul style="list-style-type: none"> • Greek Capital Markets Commission; • Federal Commission for the Securities Market of Russia; • Czech Securities Commission; • Lithuanian Securities Commission. <p>With regard to the securities and investment business, a member of the CBC's staff, appointed by the Governor of the CBC, participates on the Board of the Cyprus Securities and Exchange Commission. The above person does not have the right to vote but has the right to raise issues, participate in discussions, and convey the opinion of the CBC during Board meetings.</p> <p>The CBC also has on-going contact and cooperation with the Official Receiver and Registrar of Companies as well as with the Head of the Unit for Combating Money Laundering. The above unit is the investigative and law enforcement authority in regards to money laundering, whereas the CBC is the supervisory authority of the banking system in regard to anti-money laundering compliance.</p> <p>Every director, officer, or employee of the CBC is bound to secrecy. The CBC's governor, directors, officers, and employees take the oath of fidelity and secrecy before assuming their duties.</p>
Assessment	Compliant.
Comments	None.
Principle 2.	<p>Permissible Activities</p> <p>The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word "bank" in names should be controlled as far as possible.</p>
Description	<p>The term "bank" is defined in the BL as a body corporate licensed to carry on banking business under the provisions of the BL.</p> <p>"Banking business" is defined as business carried on in Cyprus or abroad from within Cyprus consisting of lending of funds acquired from the assumption of obligations to the public, whether in the form of deposits, securities or other evidence of debt.</p> <p>Licensed banks are authorized to carry on banking business as defined in Section 2 of the BL.</p> <p>In addition, licensed banks are authorized to carry out, directly or through subsidiaries, the following activities which are integral or closely related to banking business (Section 13 of the BL):</p> <ul style="list-style-type: none"> a) financial leasing, including hire purchase financing; b) money transmission services; c) issuing and administering means of payment including credit cards, travellers cheques and bankers drafts; d) guarantees and commitments;

	<p>e) trading for own account or for account of customers in:</p> <ul style="list-style-type: none"> (i) money market instruments including cheques, bills, CDs; (ii) foreign exchange; (iii) financial futures and options; (iv) exchange and interest rate instruments; (v) securities; <p>f) participation in securities issues and the provision of services related to such issues;</p> <p>g) advice to undertakings on capital structure, industrial strategy and related questions and advice and services relating to mergers and the purchase of undertakings;</p> <p>h) money broking;</p> <p>i) portfolio management and advice;</p> <p>j) safekeeping and management of securities;</p> <p>k) credit reference services;</p> <p>l) safe custody services;</p> <p>m) data processing services;</p> <p>n) insurance brokerage services;</p> <p>o) any other activity which may be specified by the CBC.</p> <p>No person, other than a bank, shall use in any language on use of the word "bank" or any grammatical variation thereof of the word "bank" in connection with any trade or business carried on by him unless the CBC has granted its prior written approval and subject to any conditions which the CBC may consider proper to impose.</p>
Assessment	Compliant.
Comments	None.
Principle 3.	<p>Licensing Criteria</p> <p>The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organization's ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.</p>
Description	<p>The statutory criteria for the licensing of a bank are contained in Sections 3 and 4 of the BL. The CBC is both the licensing and supervisory authority for banks.</p> <p>The CBC supervises domestic banks, International Banking Units (IBUs) (formerly "offshore banks"), as well as representative offices of foreign banks. At present, 14 domestic banks, 26 IBUs, and 1 representative office of a foreign bank operate in Cyprus. It should be clarified that the term International Banking Unit (IBU) is not a legal term but a purely descriptive term denoting banks licensed to operate in and from within Cyprus, which are owned by nonresidents of Cyprus and which by the conditions attached to their banking licenses deal in currencies other than the Cyprus Pound and primarily with other nonresidents. The above-mentioned category of banks is officially coming to an end when the transitional period allowed under the provisions of the Income Tax Law of 2002 expire on December 31, 2005.</p> <p>The BL provides for one type of license. The CBC may, with an adequately reasoned decision, grant a license without any condition or impose conditions on the license or refuse to grant a license (Section 4 of the BL).</p> <p>Due to a condition attached to all IBUs' banking-business licenses, IBUs have in the past been prohibited from raising funds in the form of any deposits, extending credits facilities, or offering any banking services whatsoever to both residents and nonresidents in Cyprus pounds.</p> <p>However, upon accession of Cyprus to the EU on May 1, 2004, all exchange control restrictions have been abolished, and residents of Cyprus are now allowed to transfer funds operate payments, and deal in foreign currencies without any limitations or restrictions.</p> <p>As a result of all these changes, the CBC's Circular Letter of May 25, 2004 has amended the</p>

range of permissible operations of the IBUs which operate in Cyprus today. Those IBUs, already subject to the ten percent tax rate, that was generally applicable to the domestic banks, either because they had been licensed after December 31, 2001 or have, subsequent to the 2002 tax reform, elected to be taxable at ten percent, were free to offer all types of banking services to permanent residents of Cyprus, the only restriction being, for the moment, the acceptance of deposits in Cyprus pounds. This restriction, which is the only one that distinguishes the operations of domestic banks from those of IBUs, will be abolished on Cyprus' entry into the Euro zone.

Until that time, individual IBUs that may wish to engage in banking business in Cyprus pounds must request the CBC to delete the relevant condition attached to their banking business license.

Those IBUs, which were licensed prior to December 31, 2001 and which have elected to continue generating their income exclusively outside Cyprus, thus paying a reduced rate of tax of 4.25 percent, are obliged to continue restricting their activities to transactions with nonresidents and in currencies other than the Cyprus pound, despite the repeal of the exchange control laws, until December 31, 2005.

The licensing criteria applied by the CBC encompass compliance of the applicant with the requirements stipulated in the BL as well as a judgmental evaluation of the applicant by the CBC. Thus, the principal licensing criteria are the following:

- At least two directors are required to participate and concur in the effective direction and management of the bank (Section 19 of the BL).
- A bank incorporated in the Republic must have at all times a minimum capital of not less than £C 3 million or such other higher amount that the CBC might determine (Section 20 of the BL).
- Directors, chief executives, and managers of the proposed bank must satisfy the CBC that they are fit-and-proper persons (Section 18.2).
- Short history and business objectives of the applicant bank, including the reasons for wishing to establish a presence in Cyprus.
- Detailed description of the proposed banking operations, including details of the banking services proposed to be offered and the proposed management structure of the applicant bank.
- Feasibility study of the bank's proposed banking operations incorporating projected financial statements for the first five years of its operation.

In the case of foreign banking organizations the CBC, in addition to the licensing criteria above, approaches directly the applicant bank's home supervisory authority and obtains its consent as well as undertaking that it will exercise consolidated supervision over the global activities of the applicant bank, including the operations proposed to be carried out in Cyprus. In the case of foreign banking organizations, the CBC also obtains Letters of Comfort or Letters of Guarantee from the principal shareholders.

Upon accession of Cyprus to the EU on May 1, 2004, the provisions of the BL allowing freedom of establishment and cross-border provision of banking services by banks authorized in other member states of the EU entered into force and the BL has been amended to that effect (Banking Amendment Law of 2003). Conversely, banks incorporated in Cyprus are free to establish branches in another member state and/or provide cross-border provision of services in member states of the EU.

Following these fundamental changes, the CBC has issued in July 2004 a "Policy statement and Guidelines on the establishment and cross-border provision of services in the Republic of Cyprus by a credit institution incorporated in another member state of the EU," which includes the terms and conditions for the conduct of banking business in accordance with the above as well as details with regard to the procedure that must be followed.

	<p>There is no time limit on banking licenses issued by the CBC. However, the CBC may, under Section 30 of the Banking Law, revoke a banking license in circumstances where a bank's condition is irretrievably impaired.</p> <p>As part of the review process, information/references are also obtained from third parties, such as the applicant bank's home supervisory authority, correspondent banks, etc.</p> <p>The information received from the applicant is reviewed and judgmentally assessed by the CBC. If all the above criteria are satisfied and the judgmental evaluation is positive, a banking license is issued by the CBC.</p> <p>Directors, chief executives and managers of licensed banks have to satisfy the CBC that they are "fit-and-proper persons" to be involved in the provision of banking services. The "fitness and propriety" of the above persons is determined, to the extent possible, by means of detailed questionnaires which are required to be completed by the persons concerned. In certain circumstances, applicants are currently required to submit a police clearance certificate from their country of origin.</p> <p>All licensees are required to establish a real presence in Cyprus and actually carry out real business. All licensees must, therefore, operate as fully staffed units as required by the scale of operations in each case. The scale of operations and, therefore, the size of staff varies considerably. There is at least one IBU with almost 100 persons and, on the other hand, one unit is considered fully staffed with three persons.</p> <p>In one of the cases (application for the establishment of a domestic bank), the CBC rejected the application as one of the major prospective shareholders was a company whose background and activities rendered it unsuitable. Two of the applications were successful, whereas two remaining cases were unable to satisfy the eligibility criteria.</p> <p>Notwithstanding the above, it should be noted that in the case of IBUs, the policy of the CBC is to discourage the submission of formal applications under the Banking Law by banks which do not meet the eligibility criteria as set out in the bank's "Policy Statement and Guidelines for the establishment and operation of IBUs." The CBC also requires prospective applicant banks to obtain the prior approval and support of their home banking regulatory/supervisory authority before submitting a formal application to the CBC for a banking license. In this way, besides the cases referred to in the preceding sentence, a number of prospective applicant banks have been discouraged in the last two years from actually submitting an application.</p> <p>With respect to the transparency of the ownership structure and the source of capital, the CBC indicated that its policy is to license only branches or subsidiaries of existing international banks.</p> <p>The CBC has in place a process of ongoing supervision and monitoring to determine whether the licensing criteria continue to be met and that the institution is meeting its business goals. The CBC is home supervisor for 16 banks (10 domestic and 6 IBUs). Three of the domestic banks maintain branches/subsidiaries in foreign jurisdictions.</p> <p>The CBC is empowered to revoke the licence of the bank if it is revealed that the decision to grant the licence of the bank was knowingly based on false information [Section 30(1)].</p> <p>The applicant bank is required to submit to the CBC a list of the prospective shareholders with their proposed percentage shareholding in the bank. Major and/or controlling shareholders who are natural persons must submit a brief outline of their financial standing and complete a "Personal Questionnaire," while corporate bodies must submit their full particulars and latest audited accounts. The CBC reserves the right to enquire into the individuals who control such corporate bodies. In this regard, the shareholders of the applicant bank must be able to supply additional financial support, if needed. Major and/or controlling shareholders are required to</p>
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	<p>provide the CBC with appropriate “Letters of Comfort” or “Letters of Guarantee.”</p> <p>The CBC requires that the directors of the applicant bank must have substantial experience and sound knowledge of all types of financial activities the bank intends to pursue.</p> <p>Once licensed and following the commencement of its operations, the banking subsidiary or branch is subject to the supervision of the CBC through regular off-site monitoring and on-site examinations. The aim of on-site examinations is to assess the quality of the bank’s assets, its financial soundness, the adequacy of liquidity, its earning capacity, the adequacy and quality of management, the adequacy of internal control systems, the implementation of prudent policies, and its compliance with the conditions that may be attached to its banking licence.</p>
Assessment	Compliant.
Comments	None.
Principle 4.	Ownership Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.
Description	<p>Section 17(1) of the BL stipulates that no person shall, without the prior written approval of the CBC, either alone or with an associate or associates, acquire or have control over any bank incorporated in Cyprus or its holding company.</p> <p>"Control" is defined in Section 2 of the BL as:</p> <ul style="list-style-type: none"> a) beneficial ownership by a person of its share capital or of its holding company which carries ten percent or more of the voting power at any general meeting of the company or its holding company; or b) ability by a person to determine in any manner the election of a majority of the directors of the company or of its holding company. <p>Regarding foreign banks’ ownership, the CBC considers applications only from banks licensed in jurisdictions, which, in its judgment, exercise proper licensing and banking supervision. In addition, applicant banks should be institutions enjoying a good reputation internationally and having an established record of growth and profitable operation.</p> <p>In addition, it must be noted that the CBC does not grant licenses to "de novo" banks or banks which are ultimately beneficially owned and/or controlled by a non-established, non-financial institution.</p> <p>Notwithstanding the provisions of any other law, section 16 of the BL stipulates that:</p> <ul style="list-style-type: none"> a) a bank incorporated in Cyprus shall not sell or dispose the whole or part of its business in Cyprus by amalgamation or otherwise, except with the prior written approval of the CBC; and b) a bank other than a bank incorporated in Cyprus shall not sell or dispose the whole or part of its business in Cyprus, except with the prior written approval of the CBC. <p>Moreover, no person shall, without the prior written approval of the CBC, either alone or with any associate or associates acquire or have control over any bank incorporated in Cyprus or its holding company. Any intention to increase the holding in a bank or its holding company above the level that has initially been approved by the CBC requires the prior approval of the CBC. Any intention to decrease a holding in a bank or its holding company will also require notification to the CBC [Section 17 (1)].</p> <p>Notwithstanding any provisions of the Companies Law or any other law in force in Cyprus from time to time, if a holding in a bank or its holding company is acquired despite the opposition of the CBC, it shall, regardless of any other sanctions to be adopted, provide either for exercise of the corresponding voting rights to be suspended, or for the nullity of votes cast or for the possibility of their annulment [Section 17(2)].</p> <p>The CBC, in deciding whether to grant a license approval, will ensure that persons of dubious</p>

	<p>reputation or persons who may pose a threat to the interest of depositors and integrity of the bank are excluded.</p> <p>In the course of on-site examinations, the CBC obtains the names and holdings of all significant shareholders.</p>
Assessment	Compliant.
Comments	None.
Principle 5.	Investment Criteria Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Description	<p>Section 13 of the BL regulates investments by banks and sets limits on the acquisition of shares by banks in other companies.</p> <p>Specifically, the BL [Section 13(1)] provides that a bank shall not acquire or hold directly or indirectly more than ten percent of the share capital of any other company, and, in the case of a bank incorporated in Cyprus, the value of any share capital held in any other company shall not exceed ten percent and for all companies in aggregate shall not exceed 25 percent of the bank's capital base. These limits apply to all investments excluding investments in shares of insurance companies and companies which carry out banking business or functions which are integral to or closely related to banking business provided that such companies are incorporated in Cyprus.</p> <p>Any bank investments exceeding the limits mentioned above require the prior written approval of the CBC.</p> <p>Before granting its approval for any new acquisition by a bank, the CBC requires that any new acquisitions and investments do not expose the bank to undue risks or hinder effective supervision. The bank must demonstrate that it has, from the outset, adequate financial and organizational resources to handle the acquisition/investment.</p> <p>Investments in non-consolidated subsidiaries are deducted from the bank's capital base for purposes of consolidated supervision. In the course of on-site examinations, the CBC inspectors ensure that investments in banking and non-banking companies do not expose the bank to undue risks.</p> <p>In addition, Section 12 of the BL prohibits the acquisition or purchase of immovable property by banks, except in certain cases as provided in Section 12 of the BL.</p> <p>Notification after the acquisition or investment is sufficient in the case of activities closely related to banking and where the investment is small relative to the bank's capital. EU Directive 2000/12/EC, which is to be transposed, limits individual participation to 15 percent of capital and aggregate participation to 60 percent.</p>
Assessment	Compliant.
Comments	None.
Principle 6.	Capital Adequacy Banking supervisors must set minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. For internationally active banks, these requirements must not be less than those established in the Basel Capital Accord.
Description	<p>Cyprus incorporated banks, including subsidiaries of foreign banks, are required to have a minimum capital and to maintain capital adequacy ratios. These requirements do not apply to branches of foreign incorporated banks.</p> <p>A bank incorporated in Cyprus should have at all times a minimum capital base of not less than €C 3 million (€5 million) or such other higher amount that the CBC might determine in line with EU requirements (Section 20).</p> <p>Banks incorporated in Cyprus are also required to maintain a capital adequacy ratio at such</p>

	<p>minimum level as may be determined by the CBC from time to time for each bank individually having regard to its circumstances provided that such ratio shall be uniform for all banks within the same class [Section 21(1)].</p> <p>The capital adequacy ratio is in the form of mandatory maintenance of a capital base in relation to total assets including off-balance sheet exposures or to categories of assets specified by the CBC from time to time at such minimum ratio or ratios as is prescribed by the CBC [Section 21(2)]. At present, the required capital adequacy ratio stands at 10 percent. All banks comply with the ratio and the average ratio for the sector exceeds 14 percent.</p> <p>The CBC has issued two directives (January 1999) to all banks incorporated in Cyprus:</p> <ul style="list-style-type: none"> • Directive on the computation of the capital adequacy ratio in relation to credit risk (excluding risks arising from the trading book); and • Capital adequacy directive in relation to a bank's trading book business and in respect of the foreign exchange and commodity derivatives risks resulting from all of its business activities. <p>These directives conform to the Basel recommendations and make use of the Basel risk weights and components of capital.</p> <p>The capital adequacy ratios of banks are calculated on both a consolidated and solo basis. Banks are required to report capital adequacy ratios and their components to the CBC on a semi-annual basis. The above ratios are verified in the course of on-site examinations.</p> <p>Off-balance sheet risks, subordinated debt, revaluation gains, and unrealized losses are treated in accordance with Basel recommendations for purposes of determining capital adequacy.</p> <p>Off-balance sheet items are grouped into four categories depending on the risk that they entail, and each category carries out a different risk conversion factor. Then the values of these items, as adjusted by the conversion factor, are multiplied by the risk weightings attributable to the relevant counterparties.</p> <p>Subordinated debt is included in tier two capital and cannot exceed 50 percent of tier one capital. Moreover, the total of tier two capital cannot exceed the total of tier one capital. Revaluation gains are credited to a revaluation reserve, and the balance of this reserve is included in tier two capital.</p> <p>Unrealized losses are debited to the revaluation reserve to the extent that these are covered by revaluation gains individually for each item concerned. Any shortfall is debited to the Profit and Loss Account, which is included in tier one capital.</p> <p>Under Section 30(1) of the BL, the CBC has broad powers to take remedial measures. This would no doubt include requiring institutions to take corrective action where their capital ratios fell below a certain limit.</p> <p>Branches of foreign incorporated banks are not required to have capital and, therefore, they do not maintain a capital adequacy ratio.</p> <p>Banks are required to have an internal process for assessing their overall capital adequacy in relation to their risk profile. Banks are required to provide the CBC with all the information necessary for the assessment of their compliance with the requirements of the Capital Adequacy Directive. The banks' internal control mechanisms and administrative and accounting procedures should be such as to permit the CBC to verify the banks' compliance with these requirements at all times.</p> <p>The adequacy of the internal process of banks for assessing their overall capital adequacy in relation to their risk profile is evaluated in the course of on-site examinations.</p>
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	In addition, the expansion of banks abroad, especially in Greece, requires additional capital funds. In such a case, the prior approval of the CBC is required. The CBC grants its approval only if it is satisfied that the bank has sufficient capital funds to support the expansion abroad.
Assessment	Compliant.
Comments	None.
Principle 7.	Credit Policies An essential part of any supervisory system is the independent evaluation of a bank's policies, practices, and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios.
Description	<p>Both domestic and international banks operating in Cyprus are subject to the same responsibilities and oversight regarding their credit and investment risk-related policies, procedures, and systems. Pursuant to its authority under the BL, through a series of directives and circulars and direct communication with the banks, the CBC has established and implemented its requirements that banks have established and well-documented credit and investment policies, practices, and procedures, approved by their Board of Directors and implemented by bank management. Such requirements include the establishment of internal risk management and control systems and asset classification and provisioning requirements by the banks and their establishment of effective internal communications systems to transmit those processes to bank management and staff involved in the credit granting and control process. Section 11(1) of the BL prescribes limitations on large exposures and aggregate large exposures, as well as on credit facilities to directors and their interests. The CBC reviews and evaluates compliance with all legal and prudential requirements through both off-site monitoring and on-site examination.</p> <p>The CBC requirements include policies on ongoing organization-wide credit and investment risk assessment, management, control, and reporting systems, asset quality classification, large exposures, establishment and monitoring of limitations, connected lending, assurance that the credit approval process is free of inappropriate external pressure and conflict of interest, and other related matters. Section 26 (2) of the BL requires that banks provide all necessary information to the CBC, which facilitates both the off-site supervision and on-site monitoring processes.</p> <p>Off-site monitoring is effected by the regular collection of a variety of information through the collection of detailed periodic returns on all aspects of credit and investment risks in the banks. Such reporting includes, inter alia, a monthly balance sheet with detailed asset and liabilities breakdown; information on asset quality, non-performing loans, and provisioning; large exposures; and, investments. Returns are reviewed and analyzed and the results are provided to appropriate examination staff and senior CBC management for necessary action.</p> <p>The scope of the on-site examination process includes an assessment of all aspects of credit administration, credit control, and credit risk evaluation. Appropriate asset quality classification and provisioning, including the adequacy of credit loss reserves, is addressed, as is the bank's ongoing credit authorization, information, and documentation systems and senior management oversight. Information systems must include information on customer outstandings, delinquencies and other problems, sectoral exposures, and corrective action. On-site examinations also evaluate the understanding of the credit risk system by bank management and staff. The results of on-site examinations are reviewed with bank senior management and corrective action is required.</p>
Assessment	Compliant.
Comments	None.
Principle 8.	Loan Evaluation and Loan-Loss Provisioning Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices, and procedures for evaluating the quality of assets and the adequacy of loan-loss provisions and reserves.
Description	All licensed banks are subject to regular on-site examinations. One of the prime objectives of these examinations is to assess the quality of the assets of the banks. In the course of an on-site examination, the CBC examiners review extensively the bank's lending practices, its credit

	<p>granting standards, and the level and adequacy of provisions. Banks themselves are required to review individual credits, asset classifications, and provisioning, including those for both on- and off-balance sheet exposures, at least annually. In addition, the external auditors of banks, when conducting the audit of each bank's financial statements, review their provisioning policies and adequacy.</p> <p>During the course of on-site examinations, the CBC examiners assess the quality of assets individually, especially major loan accounts, and the level and adequacy of provisions and compare their results with those of the bank. In view of the small number of banks, CBC examiners are able to review a sample of more than 50 percent of the balance sheet value of bank credit exposures; the sample selected is biased towards large or problematic loans and includes both on- and off-balance sheet exposures. Each borrower selected is individually assessed by account, collateral held, financial condition, and other pertinent factors. Then, according to the risk entailed, each account is classified on the basis of CBC's established asset quality classification criteria. These classifications are Pass, Special Mention, Substandard, and Doubtful; the definition of the characteristics of each of these classifications is very comparable to the definitions of similar classifications that are used by other competent supervisory authorities worldwide.</p> <p>In the course of on-site examinations, the CBC inspectors review the bank's provisioning policies, as approved by the Board of Directors, together with the guidelines that are set for considering specific credits for provision. Since CBC examiners are able to review more than 50 percent of the balance sheet value of credit exposure, they can more adequately assess the level and adequacy of each bank's provisioning policies, as well as their implementation in practice. The CBC requires banks to have appropriate procedures and the necessary organizational resources for the ongoing oversight of problem credits and for identifying and collecting past due loans. The CBC meets twice yearly with each bank's management to review the bank's provisioning policy and practices and the progress made in the collection of past due loans. The banks provide the CBC with quarterly reports on provisioning, non-performing assets, and assets where interest has been suspended.</p> <p>In January 2004, the CBC established more stringent criteria for the suspension of the recognition of interest on problem-credit facilities. The time period beyond which interest will be suspended for such credit facilities that are in arrears or where limits are in excess, provided that there is no adequate tangible security, was reduced from nine months to six months. In December 2004, the time period was further reduced from six months to ninety days, to be effective from January 1, 2006. The CBC plans to further modify its policy in the near future to require the suspension of interest in such cases, irrespective of the existence of tangible security, in line with international practice and the provisions of the proposed Capital Adequacy Directive of the EU.⁴</p> <p>Section 30(1) of the BL empowers the CBC, when a bank fails to comply with any provision of law or regulations or the conditions of its license, or the liquidity or character of its assets have been impaired, to, inter alia, require the bank to forthwith take such action as the CBC may consider to rectify the matter. Consequently, the CBC is empowered to require a bank to strengthen its lending practices, credit-granting standards, level of provisions and reserves, and overall financial strength if it deems the level of problem assets to be of concern. Section 20 of the Banking Act empowers the CBC to increase the capital requirement of a bank in order to deal with shortfalls in provisions.</p> <p>The CBC collects information from the banks quarterly on provisioning, non-performing loans,</p>
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⁴ The relevant CBC directive setting 90 days in arrears as the criteria for the classification of credit as nonperforming, and defining procedures for the suspension of interest and other income came into force on January 1, 2006

	<p>and assets where interest is suspended. Further information on provisioning is obtained at semi-annual meetings with the banks and annual tri-lateral meetings with the banks and their external auditors. In the course of on-site examinations, the CBC examiners require details on the bank's classification of assets and provisioning.</p> <p>In keeping with the basic principles and standards for risk control contained in its "Framework for the Evaluation of Internal Control Systems," the CBC would expect the banks to have processes in place for continually identifying, measuring, analyzing, and controlling risk in its credit portfolio, including mechanisms for continually assessing the strength of guarantees and appraising the worth of collateral and identifying and classifying problem credits as impaired. The CBC has issued specific guidelines on determining the value of collateral held by banks, which specify that the valuation of collateral is required to reflect its net realizable value. The CBC directives also provide that the refinancing of loans that would otherwise fall into arrears does not lead to improved classification. The CBC requires that the valuation, classification, and provisioning for large credit exposures be conducted on an individual item basis.</p>
Assessment	Largely Compliant.
Comments	Pending the full completion of the ongoing implementation of the more stringent criteria for the suspension of the recognition of interest on problem facilities on January 1, 2006, Cyprus remains largely compliant with this Principle. ⁵
Principle 9.	<p>Large Exposure Limits</p> <p>Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.</p>
Description	<p>Sections 11(1) and (2) of the BL establish limitations on exposures extended to individual borrowers and their interests (i.e., a closely related group) generally to 25 percent of the bank's capital base. However, the CBC has discretionary power to grant very limited exceptions to this limitation in cases involving the public interest or exceptionally low risk arising from the exposures concerned, provided that such exemptions are not in conflict with EU acts in force in Cyprus. The aggregate of large exposures (i.e., exposures in excess of 10 percent of the bank's capital base) is limited to 800 percent of the bank's capital base. The law empowers the CBC to establish lower limits, as it deems necessary. Section 11(3) establishes the criteria for determining what constitutes a closely related group ("connected persons") and section 11(4) defines a credit exposure, which includes both on-and off-balance sheet exposures. Section 43 of the BL provides for monetary penalties for non-compliance with these requirements.</p> <p>In June 2004, the CBC re-issued its Directive 7, Monitoring and Control of Credit Facilities to Individual Borrowers or Bank Directors and their Connected Persons, which, inter alia, describes the determination of a connected person, the definition of the bank's capital base, and the credit exposures to be included. It also includes the requirements for monitoring exposures on both a consolidated and non-consolidated basis, as appropriate. It requires the maintenance of accounting, administrative, and internal control systems to monitor these exposures and prescribes periodic reporting of the exposures to the CBC.</p> <p>Banks are required to submit semi-annual reporting on concentrations of lending. The scope of on-site examinations includes a review of concentrations of lending and compliance with the requirements of the law as well as the management systems that monitor such exposures on both a solo and consolidated basis, as appropriate. It also determines the accuracy of management information systems and reporting to the CBC.</p>
Assessment	Compliant.
Comments	The CBC may wish to consider establishing a centralized registry of information on large credit exposures as would be defined by them to be regularly collected from banks and other credit

⁵ See footnote 4.

	providers in Cyprus, aggregated by the CBC for each borrower and then made available to the banks and other credit providers for their use in evaluating their credit risk exposures.
Principle 10.	Connected Lending In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arm's-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.
Description	<p>In addition to the general large exposure limitations on exposures to individual borrowers and their closely related groups prescribed in Section 11(1)(a), section 11(1)(d) of the BL, as amended, establishes limitations on credit facilities extended to all of the bank's directors together to 40 percent of the bank's capital base. Section 11(1)(e) limits the unsecured credit exposure of each individual director to 5 percent of the bank's capital base. Section 11(c) requires that the approval of all credit exposures to directors be approved by a resolution of a minimum of two-thirds of the directors with the effected director not present for the discussion and voting, and that such credit exposures be granted on the same commercial conditions as would apply to any customer in the ordinary course of business. Section 11(3) establishes the criteria for determining what constitutes a closely related group ("connected persons") and Section 11(4) defines a credit exposure, which includes both on- and off-balance sheet exposures. Section 22 would permit the CBC to deduct credit exposures to directors and their interest in the computation of the bank's capital base; although, this has not been done. Section 42 provides the CBC with authority to impose administrative fines for non-compliance with these requirements. In addition, Section 43 of the BL provides for the imposition of administrative fines and imprisonment in situations where a case of criminal prosecution by the Attorney General is involved.</p> <p>In June 2004, the CBC re-issued its Directive 7, Monitoring and Control of Credit Facilities to Individual Borrowers or Bank Directors and their Connected Persons, which, inter alia, describes the determination of a connected person, the definition of the bank's capital base, and the credit exposures to be included. It also includes the requirements for monitoring exposures on both a consolidated and non-consolidated basis, as appropriate. It requires the maintenance of accounting, administrative, and internal control systems to monitor these exposures and prescribes periodic reporting of the exposures to the CBC.</p> <p>Banks are required to submit semi-annual reporting on all concentrations of lending, including exposures to their directors and their interests. The scope of on-site examinations includes a review of concentrations of lending and compliance with the requirements of the law as well as the management systems that monitor such exposures, on both a solo and consolidated basis, as appropriate. It also determines the accuracy of management information systems and reporting to the CBC.</p>
Assessment	Compliant.
Comments	None.
Principle 11.	Country Risk Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring, and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risks.
Description	<p>The CBC has not prescribed specific, formal country risk limitations for banks; however, country risk exposures are monitored through a monthly return that is filed by all internationally active banks. Exposures that are of concern are addressed through direct communication with the bank. Banks with material country risk exposure would be expected to establish, monitor, and control their own internal country risk limitations, pursuant to the nature of their business as part of an overall risk management system. In addition, Cyprus-incorporated banks have a physical presence in only three foreign developed countries, and the CBC insures that the activities/exposures in these countries are adequately supported by each bank's capital base.</p> <p>Likewise, the CBC has not mandated overall, formal transfer risk limitations but would expect that each internationally-active bank include transfer risk-related limitations in its overall risk management process and appropriately monitor, review, and control any such exposures. In addition, the CBC expects that banks maintain correspondent accounts only with prime banks</p>

	<p>and has established a limit for maximum allowable placements with each foreign bank of 20 percent of the depositing bank's capital base. The bank's compliance with this limitation and any internally-imposed limitations is reviewed by the CBC during each on-site examination.</p> <p>The bank's systems to identify, monitor, and control country/transfer risk are reviewed during each on-site examination. These matters are discussed with bank management during the examination and concerns are communicated to the bank.</p>
Assessment	Largely Compliant.
Comments	The CBC should consider establishing formal guidance on a framework for country risk and transfer risk management, which could be used by all banks located in Cyprus to formulate their own specific internal limitations, as appropriate, to the nature of their business and their ability to identify, monitor, and control such risks.
Principle 12.	<p>Market Risks</p> <p>Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor, and adequately control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposure, if warranted.</p>
Description	<p>In the course of the periodical on-site examinations, the CBC verifies that banks have information systems, risk management systems, and internal controls that enable them to measure, monitor and control market risk.</p> <p>During these on-site examinations, the CBC also ensures that there are appropriate limits, including stop-loss limits, for various risks. Moreover, open positions in foreign currency are subject to limits imposed by the CBC. These limits are currently 6 percent of capital base for the overall open position (coming down from 15 percent) and 3 percent of capital base for the open position in each currency (coming down from 10 percent). In addition, there are intra day limits in place. The overall open foreign currency position is the sum of all the net short positions or the net long positions, whichever is greater.</p> <p>During on-site examinations, the CBC reviews the banks' systems and assesses compliance with internal limits. The limits imposed by the CBC on open positions in foreign currency are monitored through monthly prudential returns submitted to the CBC.</p> <p>The CBC has adopted as from January 1, 2003, the provisions of the EU Capital Adequacy Directive (CAD) (Council Directive 93/6/EEC dated March 15, 1993 as subsequently amended by Council Directives 98/31/EC and 98/31/33/EC dated June 22, 1998), thereby requiring a capital charge for market risk, including commodity derivatives position risk.</p> <p>Section 20 of the BL enables the CBC to increase the capital requirements of banks if it deems necessary.</p> <p>The presence of adequate systems and controls, ensuring that all transactions are captured on a timely basis and that the banks' positions are revalued frequently, using reliable and prudent market data, is not directly assumed by the CBC.</p> <p>In this area the CBC relies on the work carried out by the banks' internal as well as external auditors.</p> <p>At present, there are no formal supervisory requirements with respect to scenario analysis, stress testing, and contingency planning. However, the presence of market risk in bank operations has up to now been minimal. In the case of those banks which are relatively active in market operations and which are subsidiaries of EU banks, there is a close cooperation with the consolidating/lead supervisory authority.</p> <p>As to the required expertise needed to monitor the actual level of complexity in the market activities of banks, it is to be noted that with the exception of perhaps one or two banks, the level of market activities of banks is low and, therefore, until now, there has been no practical need for specialization in monitoring market risk in the Banking Supervision and Regulation Division.</p>

	<p>As a result, non-specialized bank supervisors can easily review the market operations of banks during on-site examinations. However, the CBC realizes that market sophistication of banks is imminent so the mission has been informed of the plans to develop the required expertise among its supervisors through the attendance of specialized training courses offered by the FSI and other organizations. In the case of those banks which are relatively active in market operations and which are subsidiaries of EU banks, there is a close cooperation with the consolidating/lead supervisory authority, thus mitigating the lack of expertise at the local level.</p> <p>The CBC holds meetings with senior management to discuss findings of on-site inspections. During these meetings, the CBC determines that the senior management understands the market risks undertaken and the risk management information that they receive.</p> <p>With the exception of one bank which is relatively active in market operations and which is a subsidiary of an EU bank permitting a close cooperation with the consolidating/lead supervisory authority, the CBC has not so far allowed any other banks to use sophisticated models to calculate their regulatory capital requirements.</p>
Assessment	Largely Compliant.
Comments	<p>The CBC has to be commended for the adoption of CAD.</p> <p>However, while acknowledging that activities generating market risk in this market are limited, in order to be fully compliant and to prepare for future expansion of such activities, the CBC should :</p> <ul style="list-style-type: none"> • satisfy itself that there are systems and controls in place to ensure that all transactions are captured on a timely basis, and that the banks' positions are revalued frequently, using reliable and prudent market data; • determine that banks perform scenario analysis, stress testing, and contingency planning, as appropriate, and periodic validation or testing of the systems used to measure market risk; • build up the expertise needed to monitor the actual level of complexity in the market activities of banks and acquire the expertise in order to validate itself the internal model of the foreign subsidiaries for which the CBC is the home regulator.
Principle 13.	<p>Other Risks</p> <p>Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor, and control all other material risks and, where appropriate, to hold capital against these risks.</p>
Description	<p>Section 23(1) of the BL empowers the CBC to establish a minimum ratio of liquefiable assets to be held by banks. In November 2001, the CBC issued its Directive #11 on the Computation of Prudential Liquidity, which sets out its requirements for maintaining bank liquidity. Pursuant to the directive, banks are required to manage their liquidity through the use of time-band analysis for assets and liabilities and maintaining maximum allowable maturity mismatches (excess liabilities over assets) within limitations prescribed in Directive #11. The directive requires consideration of both on- and off-balance sheet assets and liabilities. Liquidity is monitored by the banks on a daily basis, and a quarterly liquidity return is required by the CBC. Information on foreign currency liquidity is collected monthly. During on-site examinations, compliance with the prescribed requirements and limitations is verified.</p> <p>Banks are permitted to set their own internal interest rate risk-related limitations, with respect to both Cyprus pounds and foreign currencies, which are to be monitored using their own models. These limitations and compliance with them is reviewed during on-site examinations. The CBC reports that the banks' current self-imposed limitations are conservative and below the level that it would find acceptable. Banks submit quarterly returns on interest rate risk exposure.</p>

	<p>The CBC requires that banks maintain adequate systems of measuring and monitoring their interest-rate risk exposures on a daily basis. Banks currently assess their interest-rate risk exposures using the “gap-analysis” method with simple maturity/repricing schedules. Banks are also required to have in place a system of interest rate risk limits, maintaining banks’ interest rate risk exposures within self-imposed parameters. The CBC has the right to request the revision of a bank’s upper operating limit for interest-rate risk exposures if it considers that this limit has been set at an excessively high level. In addition, the adequacy and effectiveness of banks’ interest-rate risk measurement and management processes is assessed by the CBC during on-site examinations.</p> <p>To facilitate the monitoring of interest-rate risk exposures by the CBC across institutions, banks are required to perform stress tests and provide to the CBC, on a quarterly basis, the results of their internal measurement systems, expressed in terms of a change in net-interest income, using a standardized interest rate shock of 1 percent in the base interest rate.</p> <p>The CBC requires that banks limit their overnight foreign exchange net-open positions in any one currency to the equivalent of 3 percent of their capital base; the intra-day maximum limit is 5 percent. The overall aggregate net-position limit for all currencies together is the equivalent of 6 percent of their capital base, measured as the sum of the absolute values of the individual net-currency positions; the intra-day maximum is 8 percent. Also, banks must establish stop-loss limits on both a daily and cumulative basis. Monthly returns on foreign currency positions are filed with the CBC.</p> <p>The CBC’s Directive on the “Framework for the Evaluation of Internal Control Systems” requires banks to have contingency plans to enable the continuation of services and operations and provide for the restoration of controls. Included in these requirements are the basic requirements and criteria for the ongoing maintenance of and contingency planning for the recovery of the bank’s information systems and other operational risk-related matters.</p> <p>Banks are required to have appropriate management systems and systems to measure, monitor, and control these risks as well as internal management reporting systems to provide for oversight by senior management. Also, a required task for the internal auditor is to evaluate compliance with, and the efficiency of, risk control/management procedures and to estimate any potential loss that the bank might incur as a result of its exposure to risks.</p> <p>The directive requires that banks have a structure appropriate to the scope and complexity of its activities and that tasks and responsibilities for each activity and operational unit be clearly stated in the bank’s operational manuals.</p> <p>During on-site examinations, the CBC reviews the adequacy and effectiveness of all of the bank’s systems to identify, analyze, monitor, and control risks and compliance with limitations imposed by the CBC as well as verification of periodic reporting. Off-site monitoring of returns also identifies issues of concern and compliance with limitations.</p> <p>Section 20 of the BL empowers the CBC to increase the banks’ minimum capital requirement to include consideration of other risks. In its Directive #10, Monitoring of Foreign Currency Exposures, for banks whose business is carried out primarily in Cyprus pounds, the CBC has imposed a minimum liquidity ratio for liabilities in foreign currencies, currently set at 75 percent, and specifies the types of assets that may be treated as liquid. The CBC does not currently require that banks include a statement on their risk management policies and procedures in their published accounts. However, these accounts are prepared according to International Accounting Standards, which require certain disclosures on risk management.</p>
Assessment	Compliant.
Comments	Beginning on January 1, 2007, the CBC will require banks to comply with the requirements the EU Capital Requirements Directive, which includes disclosures on risk management.
Principle 14.	<p>Internal Control and Audit</p> <p>Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements</p>

	<p>for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls, as well as applicable laws and regulations.</p>
Description	<p>The CBC issues Directives pursuant its authority under Section 41 of the BL. In April 2004, the CBC updated its previously-issued Directive #8 on the Framework for the Evaluation of Internal Control Systems, which establishes general principles and standards for ensuring adequate internal control systems and recommends the tasks and responsibilities that should be given to internal audit units of banks. The directive sets out the objectives of the internal control system; the basic principles and standards for the overall system and for the organizational structure and operational procedures of the bank; basic principles and standards for risk control and accounting and information systems; the responsibilities of the Board of Directors and senior bank management (with regard to all aspects of risk management), including the establishment of an audit committee and the establishment, tasks, and operational principles of the internal audit department. The directive requires the Board of Directors and senior management to develop and implement a risk control system appropriate to the specifics of the bank and the complexity of its operations.</p> <p>In addition, various general provisions in the BL and the Companies Law include duties and responsibilities of directors. Section 19 of the BL requires that at least two individuals participate and concur in the effective direction and management of the business of the bank (the “four-eyes” principle) and the Companies Law provides that the business of the company will be managed by the directors and that the duties of directors are the fiduciary duties of loyalty and good faith and the statutory duty of disclosure.</p> <p>Section 18(2) of the BL empowers the CBC to assess the fitness and propriety of the directors, the chief executive officer, and managers of banks and, if they are found to be not fit and proper, to direct that they not be a director, chief executive officer, or manager. Prospective directors and senior management that are not known to the CBC provide detailed background information to the CBC prior to their appointment, and the CBC conducts investigations on those individuals to determine whether they have the necessary skills to assume their proposed position. Section 30(1)(a)(v) of the BL empowers the CBC to require the removal of any director, controller, or manager of a bank. Competence and skills of bank management are assessed during on-site examinations and in direct contacts between CBC officers and bank management.</p> <p>On-site examination procedures include review and assessment of internal audit, credit review, control, and administration, treasury management, management information systems, organizational structure, recruitment policies, and other internal control functions to evaluate the adequacy and effectiveness of back office and operational functions, relative to the bank’s business. The on-site examination also includes a comprehensive review of the adequacy and effectiveness of the internal audit function to ensure complete access to all aspects of and records on the bank’s business, staff adequacy, independence, and reporting lines to the Audit Committee of the Board of Directors, and senior management attention to the issues and exceptions raised by the internal audit function. Section 26(2) of the BL provides the CBC with access to all records and other information of the bank, including all reports of the internal and external audit functions. The off-site supervision and on-site examination functions include contact with bank’s internal audit and internal control and compliance staff.</p> <p>The Directive on the Framework for Evaluation of Internal Control Systems requires that the Audit Committee of the Board of Directors be composed of non-executive directors, thus ensuring that there are non-executive directors on the Board. It also requires that the internal audit function report directly to the Audit Committee of the Board.</p>
Assessment	Compliant.
Comments	None.
Principle 15.	<p>Money Laundering</p> <p>Banking supervisors must determine that banks have adequate policies, practices, and procedures in place, including strict “know-your-customer” rules, that promote high ethical and</p>

	professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.
Description	<p>The Prevention and Suppression of Money Laundering Activities Laws of 1996 to 2004, (hereafter referred to as the "PSMLAL"), establish a solid framework that covers the various aspects of money laundering and the role of the financial system in this regard. The salient features of the PSMLAL are as follows:</p> <ul style="list-style-type: none"> • It defines and criminalizes laundering of proceeds from all criminal offenses punishable with imprisonment in excess of one year. • It provides for the confiscation of proceeds from all serious crime. • It empowers courts to issue freezing and restraint orders in respect of such. • It requires suspicion of money laundering to be reported to the Unit for Combating Money Laundering (MOKAS) without this being treated as a breach of confidentiality. • It empowers the courts to order the disclosure and production of information held by natural or legal persons, including banks, related to money laundering investigations. • It requires all persons carrying on relevant financial or other business, as defined by the law, to maintain procedures in relation to customer identification, record keeping, internal control, and communication and staff training in the recognition and handling of suspicious transactions. • It enables the registration and enforcement of foreign orders for the freezing and confiscation of proceeds. <p>In November 2004, the CBC issued a Guidance Note to banks which consolidates in one single document all the previous Guidance Notes and Supplements/Amendments. The revised Guidance Note takes into account:</p> <ol style="list-style-type: none"> i) the harmonization of Cyprus's legislation with the EU Directive 2001/97EC; ii) the revised recommendations for combating money laundering issued by the Financial Action Task Force (FATF) on money in June 2003 and the nine special recommendations against terrorist financing; iii) the recommendations included in the paper on "Customer Due Diligence for Banks" issued in October 2001, by the Basel Committee on Banking Supervision. <p>The revised Guidance Note requires banks to implement measures to prevent money laundering and contains requirements in respect of the following:</p> <ul style="list-style-type: none"> • Customer identification and due diligence procedures; • Record keeping procedures; • Cash deposits in foreign currency notes; • The role of the Money Laundering Compliance Officer; • Recognition and reporting of suspicious transactions to the financial intelligence unit ("MOKAS"); • Prudential reporting to the CBC; • Internal control procedures and risk management; • Education and training of employees. <p>CBC's supervision in this area entails, besides the issuance of Guidance Notes for the implementation of preventive measures, off-site monitoring and on-site examinations which aim at assessing bank's compliance with their anti-money laundering obligations.</p> <p>The PSMLAL, the Banking Law, and CBC's Guidance Note prohibit banks from opening and maintaining secret, anonymous, or numbered accounts, or accounts in fictitious names, or accounts not in the full name(s) of the holder(s) as per the identification documents.</p> <p>Additionally, the Guidance Note requires banks to identify, in the case of private and non-listed</p>

	<p>public companies, the identity of the principal ultimate beneficial owners. The latter are defined to be persons with direct or indirect interest of 5 percent or more in a company's share capital.</p> <p>Apart from beneficial owners, banks must also establish the identity of any person(s) who have control over a company's business and assets, even if that person has an interest of less than five percent in a company's share capital.</p> <p>The CBC's Guidance Note requires that records maintained by banks in respect of any customer account should contain the following minimum information:</p> <ul style="list-style-type: none"> • the identity of the account holder(s); • the identity of the beneficial owner(s) of the account; • the identity of the authorized signatory(ies) to the account; • the volume of funds or level of transactions flowing through the account; • connected accounts; • for selected transactions: • the origin of the funds; • the type and amount of the currency involved; • the form in which the funds were placed or withdrawn; i.e., cash, cheques, wire transfers, etc.; • the identity of the person undertaking the transaction; • the destination of the funds; • the form of instructions and authority; • the type and identifying number of any account involved in the transaction. <p>In accordance with the CBC Guidance Note, when opening accounts for trusts and nominees of third persons, banks should ascertain, without any exception, the identity of all the settlors and the true beneficiaries of the said accounts.</p> <p>The PSMLAL requires banks, when forming a business relationship or carrying out a one-off transaction with or for another, to apply appropriate procedures of internal control, communication, and detailed examination of any transaction, which, by its nature, may be considered to be associated with money laundering for the purpose of preventing or forestalling money laundering.</p> <p>As a means of assisting persons employed by banks in recognizing the most basic ways through which money laundering may occur, the CBC's Guidance Note contains an extensive list of examples of suspicious transactions and activities. In the period from June 1998 to June 2004, banks reported a total of 375 suspicious transactions to the FIU (75 in 2002, 99 in 2003 and 77 in 2004).</p> <p>The CBC's Guidance Note also requires that banks put in place by June 30, 2005, the latest, adequate management information systems for the on-going monitoring of accounts and transactions. In the course of developing these systems, banks should give particular attention to the effective monitoring of higher-risk customer accounts and transactions, which, by their nature, may be associated with money laundering.</p> <p>Furthermore, banks should not accept cash deposits in foreign currency notes in excess of \$100,000 (one hundred thousand U.S. Dollars) or the equivalent in other foreign currency per calendar year from any person (resident or nonresident) or a group of connected persons. Such cash deposits should be accepted only with the prior written approval of the CBC.</p> <p>The PSMLAL requires that banks institute internal reporting procedures and that they identify a person (known as "the Money Laundering Compliance Officer") to whom the bank's employees should report their knowledge or suspicion of transactions/activities involving money</p>
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	<p>laundering. The CBC's Guidance Notes requires that the person so appointed should be sufficiently senior to command the necessary authority.</p> <p>The CBC's Guidance Note requires that the banks' Board of Directors and Senior Management establish an anti-money laundering program through the implementation of appropriate internal control procedures.</p> <p>In the course of an on-site examination for the evaluation of security and internal control systems, CBC examiners ensure that banks have established lines of communication both to management and to an internal security function for reporting problems.</p> <p>Banks are required to inform the CBC if they have any indication that they may face serious difficulties or become unable to meet their obligations; or if they are about to suspend payment or become aware of any material adverse change in their condition (Section 40 of the BL).</p> <p>Section 27 of the PSMLAL requires that any knowledge or suspicion of money laundering should be promptly reported to a police officer or MOKAS. The law also provides, under Section 26, that such a disclosure cannot be treated as a breach of the duty of confidentiality owed by banks to their customers by virtue of the contractual relationship existing between them.</p> <p>In case of bank employees, the PSMLAL recognizes, under Section 26, that internal reporting to the Money Laundering Compliance Officer will satisfy the reporting requirement imposed by virtue of Section 27, i.e., once a bank employee has reported his/her suspicion to the Money Laundering Compliance Officer, he or she is considered to have fully satisfied his/her statutory requirements under Section 27.</p> <p>The CBC is carrying out off-site monitoring and on-site examinations which aim at assessing banks' compliance with their anti-money laundering obligations as set out in the law and the CBC's Guidance Note. The CBC developed a special "examinations manual" for checking and evaluating banks' internal control arrangements for money laundering prevention.</p> <p>As a result of the on-site examination, the CBC may issue to the bank concerned a letter with recommendations for corrective action in order to rectify weaknesses and strengthening controls in anti-money laundering procedures.</p> <p>Section 58(2)(a) of the PSMLAL authorizes the CBC to impose an administrative fine of up to €3,000 to any person under their supervision who allegedly fails to take the preventive measures against money laundering prescribed in the law. The PSMLAL provides that the allegedly non-compliant person should first be given the opportunity to be heard before a Supervisory Authority determines the imposition of the administrative fine.</p> <p>Section 27(1) of the BL provides that the CBC may cooperate and exchange information with domestic and foreign banking, insurance, and securities market supervisory authorities in order to assist the discharge of its own or the other supervisory authorities' functions and responsibilities. The said exchange of information and cooperation covers anti-money laundering matters as well.</p> <p>The CBC's directive entitled "Framework for the Evaluation of Internal Control Systems" provides for putting in place mechanisms ensuring that all policies of a bank are enforced. Although not directly specified in this directive, some aspects related to ethics and professional behavior are indirectly addressed.</p> <p>Currently, the CBC is in the process of preparing and issuing a Directive on Corporate Governance, whereby the issue of having a policy statement on ethics and professional behavior will be explicitly addressed.</p> <p>The Council of the Institute of Certified Public Accountants of Cyprus also issued a number of guidance notes, the latest of which is a consolidated version dated November 2004. These notes are addressed to all accountants, auditors, and their staff. The Council of the Institute has been</p>
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	appointed by the Cyprus Government's Council of Ministers in March 2000 as the supervisory authority for accountants and auditors in accordance with Section 59 of the Prevention and Suppression of Money Laundering Activities Laws of 1966 to 2004.
Assessment	Compliant.
Comments	<p>The CBC is commended for the efforts undertaken in order to strengthen the regulatory AML regime by issuing a number of Guidance Notes and by training efforts to increase the awareness and professionalism of the financial community for the prevention of money laundering.</p> <p>The mission has also noted the increase of the supervisory resources by two staff members and the increase of the number of on-site examinations during which the AML-procedures have been tested.</p>
Principle 16.	<p>On-Site and Off-Site Supervision An effective banking supervisory system should consist of some form of both on-site and off-site supervision.</p>
Description	<p>Section 26(2) of the BL requires that banks provide access to the CBC to all of their books, records, documentation, and other reports as necessary to carry out the supervision authority that is granted to it in Section 26(1). Section 25 requires the bank to provide a monthly statement of assets and liabilities to the CBC and empowers the CBC to require banks to periodically or at its request submit other reporting as it may specify. Complete access to such information, including information and reports generated by the bank's internal and external auditors, provides the CBC with the ability to perform its supervisory function. Section 26 of the BL provides that any information received as part of the supervisory process must be kept confidential. Section 29 defines under what circumstances such information may be disclosed.</p> <p>The CBC exercises supervision in a twofold manner: on-site examination and off-site monitoring. The two modes of supervision complement one another. There are no material differences between the CBC's supervision of domestic banks and its supervision of international banks. The specific scope of off-site monitoring and on-site examination for each bank is determined by each bank's particular conditions and circumstances. The quality of internal audit work is assessed in order to determine the reliance that might be placed on it during the on-site examination. Both off-site monitoring and on-site supervision are performed by the same division, within the CBC, thereby integrating the framework of the two functions.</p> <p>The purpose of an on-site examination is to evaluate the condition of a bank and its future prospects at a given time, including providing verification that adequate risk management and controls are in place. In this respect, the following main areas are covered:</p> <ol style="list-style-type: none"> a) the quality of the management of the bank by the directors and senior management, including internal controls and procedures, including internal audit; b) the bank's loan portfolio, with emphasis on credit risk management, evaluation, and controls; the quality of the loan portfolio; and the adequacy of the provisions for bad and doubtful debts; c) the bank's treasury operations with emphasis on risk management; d) the profitability of the bank, including the analysis of its income generation and costs and the assessment of the returns achieved; e) the compliance with the law, the conditions of the bank's license, and the CBC Directives; regulations and instructions on capital adequacy; large exposures, etc.; and f) adherence to the requirements of the anti-money laundering legislation and guidance notes. <p>CBC policy requires that on-site examinations be conducted annually for the domestic banks, annually for the subsidiaries of foreign banks, and every two years for the branches of foreign banks. However, due to the resource requirements necessary for the implementing of the EU Directives as part of the accession of Cyprus to the EU, the originally-planned examination schedule has been delayed. Now that this work is well underway, the CBC is confident that it can properly fully resume its planned on-site examination program. Special examinations may</p>

	<p>also be conducted, as necessary. The on-site examination findings are communicated to the bank's management and discussed with the bank's senior management in a meeting especially convened for this purpose. A management letter containing the on-site examination findings and conclusions is transmitted to bank senior management, and a response detailing corrective measures is required.</p> <p>Off-site monitoring involves the submission of various periodic prudential returns such as monthly balance sheet, profit and loss account, capital adequacy, prudential liquidity, large exposures and facilities to directors, foreign currency exposure, interest rate risk, anti-money laundering procedures, etc. Findings emerging in periodic prudential returns submitted by banks are analyzed, trended, and compared with other banks. This process enables the CBC to monitor the condition of banks as well as their compliance with the BL and other relevant prudential legislation and directives on an on-going basis. The accuracy of these returns is independently verified during the on-site examinations.</p> <p>The CBC supervisors, in the course of on-site examinations, assess the risk profile of each bank and, based on this assessment, on-site and off-site work is prioritized. For its international banks, the CBC has decided to adopt a risk-based approach in carrying out its supervisory activities. The main objectives are to allow the supervisors to focus on the banks that are confronted with higher risk and to allocate staff more efficiently. In the model adopted, risk elements are grouped into two major categories: Business Risks and the Control Risks. Based on this framework, the total Business and Control risks of each bank are assessed and a Total Business Risk Score/Total Control Risk Score map is created, indicating the position of each bank. In order to improve the model, the CBC has decided to review it once a year. In preparing its on-site examination program, the CBC considers three main factors: the positioning of each bank on the map, an ageing factor setting the maximum interval between two consecutive on-site examinations, and its knowledge of the bank based on the returns submitted; its ongoing contact with bank management; and the results of previous examinations. The CBC is in the process of designing and implementing a risk-based supervision methodology for the domestic banks.</p> <p>Bank examination report findings and conclusions as well as the analysis of periodic returns are reported to the governor of the CBC.</p>
Assessment	Compliant.
Comments	Since no formal procedure is in place to assess the effectiveness of supervisory functions, the CBC may wish to consider establishing an internal quality control function within the Banking Supervision and Regulation Division to assess the effectiveness of its off-site and on-site supervisory activities and address any weaknesses identified.
Principle 17.	Bank Management Contact Banking supervisors must have regular contact with bank management and a thorough understanding of the institution's operations.
Description	Section 28 of the BL requires that the CBC conduct a tri-lateral meeting with senior bank management and the bank's external auditor at least annually to discuss matters of supervisory relevance that might arise in the audit, including relevant aspects of the bank's business, its accounting and control systems, and its financial statements. Senior CBC officers conduct at least semi-annual meetings with senior bank management on matters of interest, including provisioning and financial performance results, and at the conclusion of on-site examinations, to discuss results and plans to correct identified deficiencies. Meetings with senior bank management are conducted during and subsequent to on-site examinations, and regarding matters that arise as a result of ongoing off-site monitoring. Off-site monitoring and on-site examination provides the CBC with frequent contact with and a thorough understanding of the bank and its management and operations. Visits of parent/head office senior management and internal auditors of foreign banks operating subsidiaries/branches in Cyprus offer further opportunity to understand the bank's activities and operations. These and other meetings provide the CBC with the opportunity to evaluate management's abilities and its performance. The evaluation of prospective management is also included in the CBC's licensing process (see CP-3, above).

	<p>In practice, the governor of the CBC also meets with all banks as a group at least semi-annually to discuss matters of general interest and changes in supervisory policy and practice.</p> <p>Section 40 of the BL requires banks to inform the CBC when it has any indication that it may face serious difficulties or if it is about to suspend payment on its obligations. Banks are also required by law to report any material changes in their circumstances. Information on changes in circumstances and other relevant information is also provided through the wide range of periodic prudential returns that are required.</p>
Assessment	Compliant.
Comments	None.
Principle 18.	Off-Site Supervision Banking supervisors must have a means of collecting, reviewing, and analyzing prudential reports and statistical returns from banks on a solo and consolidated basis.
Description	<p>Section 26(2) of the BL empowers the CBC to obtain from banks any information and with whatever frequency that it deems necessary. As a result, the CBC periodically obtains a wide range of information on banks' financial condition and performance at regular intervals from both domestic and international banks. There are no restrictions to the CBC's access to information about any aspect of the bank's business and their related companies. Both domestic banks and international banks provide virtually the same information, as appropriate to their operations and activities, with the same frequency. The information is provided through a series of standardized returns supported by comprehensive instructions. The information provided through bank returns is verified during on-site examinations to determine if it's accurate, properly classified, and in conformity with CBC instructions.</p> <p>Prudential returns include detailed information regarding on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, loan loss provisioning, market risk, and deposit-related matters at a frequency commensurate with the nature of the information. Specific details about the loan classifications performed by the banks themselves are not disclosed in the standardized reports; this information is collected, assessed, and analyzed during the on-site examinations carried out by the examiners of the CBC. The CBC also requires submission of copies of the management letter from the bank's external auditor and the minutes of the Audit Committee of its Board of Directors. Section 42 of the BL provides for a range of monetary penalties for failure to provide requested information within specified time limits, knowingly or negligently providing inaccurate or misleading information, or knowingly or negligently providing incomplete information.</p> <p>The internal auditors of banks are required to submit reports to the CBC every 18 months on the results of their activities. The external auditors of international banks must submit reports on the bank's compliance with any conditions of their license; a reconciliation of any differences between the information provided on returns to the CBC and audited financial statements; the adequacy of internal controls; the correctness/adequacy of information that the local operations provide to their parent/head office, and the adequacy of provisioning. International banks must also provide the CBC with copies of internal audit reports prepared on local operations by their parent/head office.</p> <p>Section 24 of the BL requires that banks produce annual audited financial statements and also allows the CBC to prescribe the manner and form in which accounts must be prepared. The CBC has issued directives specifying the content of financial statements and the manner in which they must be presented. The CBC in its directives has adopted International Accounting Standards. With regard to the audit of bank annual financial statements, Section 24 of the BL also requires that the audit of banks be carried out in accordance with International Auditing Standards and any additional requirements specified by the CBC. International Accounting Standards have been used in Cyprus since 1981 through the action of the Institute of Certified Public Accountants of Cyprus (the regulatory body for accountants/auditors) to require auditors to state in their audit report that the financial statements of the audited company have been prepared in accordance with the International Accounting Standards. Furthermore, through an amendment to the Companies Law in 2003, legal backing has been given to the International Accounting Standards implementation, which is compulsory for all companies, including banks,</p>

	<p>incorporated in Cyprus. The auditors' report is required to state that the audit has been carried out in accordance with International Auditing Standards.</p> <p>All statistical and prudential reports filed with the CBC, are processed and analyzed. The conclusion of this analysis forms part of various internal reports that identify compliance or not with rules and regulations, and highlight intra-market comparisons and trends, with a view to prompting further action by the CBC. This information is readily available to all supervisors who are required to utilize it for planning future on-site visits to the banks. This reporting forms part of the CBC's comprehensive information system. This analysis, along with the results of on-site examinations and information acquired through meetings with bank officials, provides the basis for the CBC's early identification of potential problems, difficulties, and trends in banks, although there is, as yet, no formal early warning system in place.</p>
Assessment	Compliant.
Comments	The CBC may wish to consider developing and implementing a more formal, comprehensive early warning system to provide timely alerts to prospective issues affecting individual banks, groups of banks, or the system as a whole. Such a system may permit the CBC to more easily set supervisory priorities and to react more timely and adequately to identified issues.
Principle 19.	Validation of Supervisory Information Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.
Description	<p>On-site examinations are conducted annually for the domestic banks, annually for the Cyprus subsidiaries of foreign banks, and every two years for the Cyprus branches of foreign banks. Examinations of foreign subsidiaries and branches of Cyprus banks are conducted annually for operations in Greece and every two years for operations in other countries when they are material (i.e., more than 5 percent of the total balance sheet assets of the entity of which it is a part). Special examinations may also be conducted.</p> <p>Pursuant to Section 26 of the BL, the CBC has the legal right of full access to all bank records for the furtherance of supervisory work. The information provided through bank returns is verified during on-site examinations to determine if its accurate, properly classified, and in conformity with CBC instructions.</p> <p>The CBC maintains a coherent process for planning and executing these on-site examinations. The same process is applied to the on-site examinations of all banks, both domestic and international. The criteria used by the CBC for the planning and executing of on-site examinations are: (a) the relative size of the banking operation; (b) the annual growth rate of the operation; (c) the relative contribution of the operation to the group as a whole; (d) the results of off-site review monitoring and analysis; (e) any special issues; and (f) the availability of resources.</p> <p>Section 26 of the BL provides that the CBC examiners may be assisted in the course of their work by a duly qualified person nominated for this purpose by the CBC provided that this person shall be bound by the same requirements regarding confidentiality as those applicable to the CBC officials. This would permit external auditors to assist, as necessary, in on-site examinations and to be commissioned by the CBC to perform special work for it in the banks. The auditing and accounting profession in Cyprus is well developed and professionally independent and operates within the international auditing and accounting standards framework.</p> <p>Section 28 of the BL provides that the CBC will arrange, at least once a year, tri-lateral meetings with each bank and its auditors to discuss matters relevant to the CBC's supervisory responsibilities that arise in the course of the audit of all banks. The CBC is also entitled to hold bi-lateral meetings with external auditors, to the exclusion of the bank concerned, if the CBC considers such a meeting necessary for the protection of the bank's depositors. Under the same section of the BL, the external auditors may freely report to the CBC any information that is relevant to its supervisory responsibilities. The BL protects the auditor from the consequences of any breach in his duty of confidentiality by providing that no duty of confidentiality to which an auditor of a bank may be subject will be regarded as contravened by reason of his communication in good faith to the CBC, whether or not it is responding to a request made by</p>

	<p>the CBC, any information or opinion which is relevant to the CBC's functions and responsibilities under the BL.</p> <p>The CBC has issued a notice to the banks on the relation between the CBC and the external auditors of banks. The purpose of this notice is to provide the guidelines for the arrangements of tri-partite meetings between the CBC, the banks, and their external auditors and give a general description of the situations and conditions under which the CBC may invite the auditors of banks to bi-lateral meetings in accordance with Section 28(2) of the BL.</p> <p>Section 24 of the BL requires that each bank, at the end of its business year, provide the CBC with a copy of its consolidated balance sheet and profit and loss account for that year, duly certified by an approved external auditor. Section 2 of the BL requires that the external auditors of banks be approved by the CBC; in practice, banks are audited by local offices of the big four accounting/auditing firms.</p> <p>In addition to the tri-lateral meetings between the CBC, the banks, and their external auditors, the CBC regularly holds meetings with the banks' management and/or board of directors to discuss all matters pertaining to the operations of the bank and, particularly, all issues identified during the on-site examinations and off-site surveillance conducted by the CBC.</p>
Assessment	Compliant.
Comments	None.
Principle 20.	Consolidated Supervision An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.
Description	<p>Section 39 of the BL permits the CBC to determine that the holding company and any of the subsidiaries of the bank and of its holding company will be deemed to be a bank for the purposes of the BL, as may be specified by the CBC, whereupon the relevant provision or provisions will apply to any such company either singly or on a consolidated basis. The CBC practices consolidated supervision. In this regard, the CBC has exercised its power under Section 39 of the BL and has extended its supervision to all bank subsidiaries carrying out banking-related activities, as defined in Section 13 of the BL. Thus, the CBC requires bank subsidiaries that carry out banking-related activities to be consolidated on a worldwide basis.</p> <p>Within the scope of consolidated supervision, the CBC obtains information on the nature of activities of non-banking related subsidiaries as well as the level of their assets, liabilities, and profitability. The CBC may require the holding company to take any action relating to non-bank subsidiaries, as it may deem necessary. Moreover, the investment in non-banking related subsidiaries, including lending of a capital nature to such subsidiaries, is deducted from the consolidated capital base of the group.</p> <p>There are no obstacles to direct or indirect supervision of bank subsidiaries or affiliates that carry out banking-related activities as defined in section 13 of the BL. The CBC conducts on-site examinations of material subsidiaries carrying on banking or banking-related activities. The condition of non-material subsidiaries is monitored and assessed through the submission of periodic returns.</p> <p>The CBC is empowered to impose any prudential standards on a consolidated basis. In this respect, the CBC Directives on capital adequacy, large exposures, and foreign currency exposure apply on a consolidated basis. The CBC requires that each bank submit audited consolidated financial statements annually.</p> <p>Pursuant to Section 27 of the BL, the CBC may co-operate and exchange information with the competent banking and/or insurance and/or securities markets supervisory authorities whether in Cyprus or elsewhere. To this end, the CBC has signed an MOU with local securities, insurance, and cooperatives societies supervisory authorities and MOUs with foreign supervisory authorities in the financial sector. In this context, the CBC receives and shares information on the financial condition and risk management of such companies.</p>

	<p>Section 7 of the BL provides that banks must obtain the prior approval of the CBC to establish business outside of Cyprus. The CBC may impose conditions on such establishments. Moreover, Section 13 of the BL imposes limits on the investments of banks in the capital of other companies. The CBC exercises this power to limit the expansion of banks overseas so as to ensure that banks possess adequate financial resources to conduct such operations. Periodic on-site examinations are conducted at the bank's overseas locations.</p> <p>Section 39 of the BL provides that the holding company and any of the subsidiaries of a bank shall be deemed to be a bank for the purpose of any of the provisions of the BL. Thus, the CBC is empowered to impose standards and measures, including remedial action, on the non-banking subsidiaries and/or holding company of a bank. Also under Section 39 of the BL, the holding company of a bank may be deemed by CBC to be a bank and, consequently, the provisions of Sections 17 and 18 of the BL regarding the fitness and propriety of owners and senior management of a bank holding company apply to these persons.</p>
Assessment	Compliant.
Comments	None.
Principle 21.	<p>Accounting Standards Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly reflect its condition.</p>
Description	<p>Any bank that fails to provide requested financial information within specified time limits, knowingly or negligently provided inaccurate data or misleading information, knowingly or negligently made available in an incomplete form, records, books, accounts, or other information is subject to an administrative fine (Section 42 of the BL).</p> <p>The BL provides that where an offense is committed as a result of an infringement of the provisions of this law, by a bank or by an organisation of persons incorporated or unincorporated, then any director, chief executive, manager, partner or other officer or employee of the bank or of the organization, who authorizes or knowingly permits such infringement shall be guilty of an offense and in case of conviction shall be liable to penalties provided in the BL, depending on the provisions infringed.</p> <p>Every bank should, within four months from the end of each financial year, submit to the CBC a copy of the balance sheet and profit and loss account for that year in the form prescribed by the CBC, duly certified by an approved auditor, together with a signed copy of his report in the form prescribed by the CBC. Branches of foreign incorporated banks are not required to publish their financial statements.</p> <p>The CBC Directive on the framework for the evaluation of internal control systems requires banks to maintain comprehensive and reliable financial reporting to ensure the accurate and timely disclosure of the bank's financial position and the production of reliable financial statements. In this respect, information from bank records, such as prudential returns submitted to the CBC, is verified periodically in the course of on-site examination.</p> <p>The CBC has issued a notice on the relationship between the CBC and the external auditors of banks. The purpose of the above notice is to:</p> <ol style="list-style-type: none"> a) Provide the guidelines for the arrangements of tripartite meetings between the CBC, the banks and their external auditors; and b) Give a general description of the situations, and the conditions under which the CBC may invite the auditors of banks to bilateral meetings in accordance with Section 28(2) of the BL. <p>The CBC aims at the creation of a constructive relationship with the external auditors of banks, through the medium of which there will be such an exchange of information so as to facilitate the supervisory activity of the CBC, as this arises from the provisions of the BL. This</p>

	<p>relationship consists of:</p> <ul style="list-style-type: none"> a) Tri-partite meetings with the external auditors of each bank during which the following will be discussed: <ul style="list-style-type: none"> (i) the balance sheet and the profit and loss account for each year, copies of which each bank is obligated [under Section 24(1) of the BL] to submit to the CBC, in a form to be determined by the CBC, within four months from the end of the financial year; (ii) the report of the external auditor that has to be submitted with (i) above, in a form to be determined by the CBC; (iii) matters arising from the audit work of the external auditors in relation to (i) and (ii) above. b) bilateral meetings with the external auditors of a bank, either with the knowledge of the bank concerned or not, whenever this is considered desirable or necessary by the CBC, in the interests of depositors, in accordance with Section 28(2) of the BL. <p>The CBC is authorized to set accounting standards for banks provided that the CBC is guided in this respect by international practice and the EU directives. To this effect, the CBC has issued a directive on the layout and content of annual accounts of banks, which requires compliance with international accounting standards modified as necessary to comply with EU directives.</p> <p>Chapter 4 of the CBC's Directive on the layout and content of annual accounts, entitled valuation rules, describes in detail the supervisory requirements for banks to utilize valuation rules that are consistent, realistic, and prudent, taking into account values where relevant.</p> <p>Moreover, International Accounting Standards that have been adopted in Cyprus since 1981 through the action of the Institute of Certified Public Accountants of Cyprus (the regulatory body for accountants/auditors) require auditors to state in their audit report that the financial statements of the audited company have been prepared in accordance with the International Accounting Standards. Furthermore, through an amendment to the Companies Law in 2003, legal backing has been given to the International Accounting Standards implementation, which is compulsory for all companies, including banks, incorporated in Cyprus.</p> <p>The confidential character of the financial information gathered by the CBC is legally enforced by the BL [Sections 17(4) and 18].</p> <p>The external auditors of banks, prior to their appointment, are required to be expressly authorized by the CBC (Sections 2 and 24 of the BL). In practice, most banks are audited by the big four international firms of accountants/auditors.</p> <p>The CBC relies on its own experienced bank supervisory staff for the conduct of on-site examination and does not generally need to employ the services of external auditors at the present time, although section 26(2) of the BL would permit the CBC to use duly qualified persons, as necessary.</p> <p>There are no supervisory requirements in respect of the scope and conduct of audit programs as the CBC is not legally empowered to set standards for external audit review. However, as mentioned above, external auditors are required to conduct their audits in accordance with the International Auditing Standards.</p> <p>Section 28 of the BL provides that auditors may freely report to the CBC any information which is relevant to the latter's supervisory responsibilities. The BL protects the auditor from the consequences of any breach in his duty of confidentiality, by providing that no duty of confidentiality to which an auditor of a bank may be subject shall be regarded as contravened by reason of his communication in good faith to the CBC, whether or not to a request made by the CBC, any information or opinion which is relevant to the CBC's functions and responsibilities under the BL.</p>
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	The CBC has issued a notice on the relationship between the CBC and the external auditors of banks. This notice provides, inter alia, that the external auditors are expected to report to the CBC matters of material significance or matters which may be of material significance to the latter's supervisory functions or responsibilities.
Assessment	Compliant.
Comments	<p>It must be noted that external auditors do not have a legal duty to report to the CBC on matters of material significance. But, the tri-partite and bi-partite meetings described above, as well as mandatory transmission by the external auditors to the CBC of their written communications with the banks on matters of material significance, do seem to provide a valuable communication system.</p> <p>However, Cyprus may consider amending the BL to introduce a mandatory duty for auditors to report matters of material significance to the supervisor, as provided for in the pertinent EU Directive.</p>
Principle 22.	<p>Remedial Measures Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking license or recommend its revocation.</p>
Description	<p>Section 30 of the BL provides the CBC with extensive remedial powers where a bank fails to comply with any of the provisions of the BL, including power to require the bank to take such action as the CBC may consider necessary to rectify the matter, the power to prohibit the acceptance of deposits or the granting of credit facilities by the bank, or both; both assume control of the business of a bank and revoke the bank's license.</p> <p>Section 42 of the BL empowers the CBC to impose administrative fines if a bank fails to provide information to the bank within specified time limits. Other offenses and penalties are covered in detail in Sections 42 and 44. Administrative penalties have been imposed on numerous occasions.</p> <p>Where an offense is committed as a result of an infringement of the provisions of the BL, by a bank or by an organization of persons incorporated or unincorporated, then any director, chief executive, manager, partner or other officer or employee of the bank or of the organization, who authorizes or knowingly permits such infringement shall be guilty of an offense and, in case of conviction, shall be liable to the penalties provided in subsections 43(1) or 43(2) of the Banking Law depending on the provisions infringed.</p> <p>Pursuant to Section 30(2) of the BL the CBC shall, before taking any remedial measure, furnish a report to the bank inviting its comments thereon within a specified period, which should not be less than three days from the date of delivery of the report.</p>
Assessment	Compliant.
Comments	None.
Principle 23.	<p>Globally Consolidated Supervision Banking supervisors must practice global consolidated supervision over their internationally active banking organizations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organizations worldwide, primarily at their foreign branches, joint ventures, and subsidiaries.</p>
Description	Pursuant to Section 13 of the BL, banks are not allowed to extend their direct or indirect operations outside Cyprus without obtaining the prior written approval of the CBC. The CBC makes its approval conditional upon the on-going availability of information from the overseas operation, including the ability to carry out on-site examinations and to exercise consolidated supervision. On-site and off-site supervision of overseas operations of Cyprus-incorporated banks has been routinely carried out for many years.

	<p>In the course of an on-site examination, the CBC inspectors determine that the bank maintains proper oversight of its foreign operations by examining the following: (a) the centralization of credit control and internal audit; (b) the identification, measurement, control, and monitoring of risks on a global consolidated basis at head office level; (c) the monitoring of the overseas operations through the regular submission by head office; (d) the credit review by head office of foreign operations; and (e), the involvement of head office management in strategic decision-making. In the course of on-site examinations, the CBC inspectors establish that bank management's oversight includes: a) information reporting on its overseas operations that is adequate in scope and frequency and is periodically verified; (b) assessing in an appropriate manner compliance with internal controls; and (c) ensuring effective local oversight of foreign operations. The CBC places special emphasis on the foreign operations of domestic banks by requiring senior management to closely monitor and control risks undertaken on a global basis.</p> <p>Pursuant to its authority under Section 7 of the BL, if the CBC is not satisfied that the bank maintains proper oversight of its foreign operations, it may amend or impose additional conditions on the foreign operation's license. In extreme cases, if the need arises, the CBC may revoke the approval. Section 30 of the BL confers upon the CBC a range of powers to take measures to address prudential and compliance issues arising from the supervision of foreign operations of Cyprus banks.</p> <p>On-site examinations of overseas subsidiaries/branches of Cyprus-incorporated banks are planned and executed by the CBC as follows: annually for banks with operations in Greece and every two years for banks with operations in the United Kingdom and Australia. The CBC may also conduct ad hoc on-site examinations if and when the need arises in relation to special issues.</p> <p>Meetings with local supervisors are arranged during the on-site examinations for overseas subsidiaries/branches of Cyprus-incorporated banks. The assessment of host country supervision is carried out in the spirit and letter of the MOUs signed and in the course of on-site examinations, the findings of which are discussed with host supervisors.</p>
Assessment	Compliant.
Comments	None.
Principle 24.	<p>Host Country Supervision</p> <p>A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.</p>
Description	<p>Section 27(1) of the BL permits the CBC to cooperate and exchange information with competent banking and/or insurance and/or securities markets supervisory authorities, whether in Cyprus or elsewhere, including member states of the EU, in order to assist these supervisory authorities in the discharge of their functions and responsibilities or to enable the effective exercise of their functions, including consolidated supervision. Section 27(4) prescribes that any exchange of information will only take place when the CBC is satisfied that the information provided is subject to the same confidentiality rules in the hands of the receiving competent supervisory authority as apply to the CBC. Section 27(5) prescribes that where the information received by the CBC originates in another member state of the EU, it may not be disclosed without the express agreement of the competent authorities that have disclosed it and, where appropriate, solely for the purposes for which those authorities gave their agreement.</p> <p>MOUs have already been signed or are in process of negotiation with a number of overseas supervisors, including the United Kingdom, Lebanon, and Ireland, where Cyprus-incorporated banks have overseas operations. The MOUs include statements on the scope of information to be exchanged and stipulate details on the cooperation regarding on-site examinations in the host country, and the confidentiality of the information received from the other supervisory authority. Consequently, the MOUs facilitate the close cooperation and exchange of information between the CBC and other overseas banking supervisory and regulatory authorities in the discharge of their functions and responsibilities, including the overall framework of supervision in which a banking group operates, and, to the extent appropriate, concerning significant problems arising in the head office or in the group as a whole. In practice, there is close and frequent contact with</p>

	<p>host country supervisors. The CBC cooperates and exchanges information with all foreign supervisory authorities in jurisdictions in which Cyprus-incorporated banks operate subsidiaries and branches, regardless of their significance.</p> <p>Pursuant to Section 13 of the BL, banks are not allowed to extend their direct or indirect operations outside Cyprus without obtaining the prior written approval of the CBC. In this regard, the CBC is empowered to prohibit banks or their affiliates from establishing operations in countries with secrecy laws or other regulations prohibiting flows of information deemed necessary for adequate supervision. The CBC makes its approval conditional upon the on-going availability of information from the overseas operation, including the ability to carry out on-site examination and to exercise consolidated supervision. On-site examination and off-site supervision of overseas operations of Cyprus-incorporated banks has been routinely carried out for many years by the CBC.</p>
Assessment	Compliant.
Comments	None.
Principle 25.	<p>Supervision Over Foreign Banks' Establishments</p> <p>Banking supervisors must require the local operations of foreign banks to be conducted with the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.</p>
Description	<p>Cyprus branches and subsidiaries of foreign-incorporated banks are subject to the same prudential inspection and regulatory reporting requirements as Cyprus-incorporated banks. No differences exist in the regulatory regime for Cyprus-incorporated banks and Cyprus branches/subsidiaries of foreign-incorporated banks. However, branches of foreign banks are exempted from own capital and capital adequacy requirements; consequently, capital-based restrictions (e.g., large exposures limitations) are not applicable and are left to the home country supervisory authority to monitor.</p> <p>With regard to the licensing process as well as for ongoing supervision, applicant banks are required to submit to the CBC a "Letter of Authorization," which enables the CBC to approach and exchange information with the home supervisory or regulatory authority of the applicant's parent institution. In this respect, the CBC approaches the home country licensing and supervisory/regulatory authority of the applicant bank's parent institution directly and obtains, inter alia, its written consent authorizing the proposed establishment, as well as an undertaking that, in circumstances under which that authority is warranted to act as the group's consolidating supervisor/regulator, it will exercise consolidated supervision equivalent to that provided in the EU over the global activities of the parent institution, including the operations proposed to be carried out by the prospective subsidiary/branch in Cyprus.</p> <p>Section 27(1) of the BL permits the CBC to cooperate and exchange information with competent banking and/or insurance and/or securities markets supervisory authorities, whether in Cyprus or elsewhere, including member states of the EU, in order to assist these supervisory authorities in the discharge of their functions and responsibilities or to enable the effective exercise of their functions, including consolidated supervision. Section 27(4) prescribes that any exchange of information will only take place when the CBC is satisfied that the information provided is subject to the same confidentiality rules in the hands of the receiving competent supervisory authority as apply to the CBC. Section 27(5) prescribes that where the information received by the CBC originates in another member state of the EU, it may not be disclosed without the express agreement of the competent authorities that have disclosed it and, where appropriate, solely for the purposes for which those authorities gave their agreement.</p> <p>MOUs have already been signed or are in process of negotiation with a number of overseas supervisors. The MOUs include statements on the scope of information to be exchanged and stipulate details on the cooperation regarding on-site examinations in the host country and the confidentiality of the information received from the other supervisory authority. Consequently, the MOUs facilitate the close cooperation and exchange of information between the CBC and other overseas banking supervisory and regulatory authorities in the discharge of their functions and responsibilities, including the overall framework of supervision in which a banking group</p>

	operates, and, to the extent appropriate, concerning significant problems arising in the head office or in the group as a whole. In practice, there is close and frequent contact with home country supervisors. The CBC cooperates and exchanges information with all foreign supervisory authorities from jurisdictions whose banks operate subsidiaries and branches in Cyprus, regardless of their significance. The CBC permits home country supervisors of banks operating subsidiaries and branches in Cyprus to conduct on-site examinations and meets with the foreign supervisory authorities to discuss the examination results. Over the years, many home supervisory authorities have conducted on-site examinations of branches and subsidiaries in Cyprus pursuant to their primary or consolidated supervisory responsibility.
Assessment	Compliant.
Comments	None.

Table 2. Summary Compliance of the Basel Core Principles (CBC)

Core Principle	C ^{1/}	LC ^{2/}	MNC ^{3/}	NC ^{4/}	NA ^{5/}
1. Objectives, Autonomy, Powers, and Resources					
1.1 Objectives	X				
1.2 Independence		X			
1.3 Legal framework	X				
1.4 Enforcement Powers	X				
1.5 Legal Protection	X				
1.6 Information Sharing	X				
2. Permissible Activities	X				
3. Licensing Criteria	X				
4. Ownership	X				
5. Investment Criteria	X				
6. Capital Adequacy	X				
7. Credit Policies	X				
8. Loan Evaluation and Loan-Loss Provisioning		X			
9. Large Exposure Limits	X				
10. Connected Lending	X				
11. Country Risk		X			
12. Market Risks		X			
13. Other Risks	X				
14. Internal Control and Audit	X				
15. Money Laundering	X				
16. On-Site and Off-Site Supervision	X				
17. Bank Management Contact	X				
18. Off-Site Supervision	X				
19. Validation of Supervisory Information	X				
20. Consolidated Supervision	X				
21. Accounting Standards	X				
22. Remedial Measures	X				
23. Globally Consolidated Supervision	X				
24. Host Country Supervision	X				
25. Supervision Over Foreign Banks' Establishments	X				

^{1/} C: Compliant.

^{2/} LC: Largely compliant.

^{3/} MNC: Materially non-compliant.

^{4/} NC: Non-compliant.

^{5/} NA: Not applicable.

F. Recommended Action Plan and Authorities' Response to the Assessment

Recommended action plan

Table 3. Recommended Action Plan to Improve Compliance of the Basel Core Principles (CBC)

Reference Principle	Recommended Action
CP 1.2 Independence	Additional qualified supervision staff is needed.
CP 8 Loan Evaluating and Loan Loss Provisioning	Finalize implementation of the more stringent criteria for interest suspension. ⁶
CP 11 Country Risk	Establish formal guidance for a framework for country and transfer risk.
CP 12 Market Risks	Improve interest rate risk expertise expertise and supervision.

Authorities' response to the assessment

The CBC welcomes the assessors' recognition of the overall quality and effectiveness of Cyprus's banking regulatory and supervisory framework in place and the resulting very high degree of compliance with the Basel Core Principles.

Following is the CBC's Action Plan to address the specific recommendations cited in the report:

Reference Principle	Planned Action
CP 1.2 Independence	The CBC aims at taking all necessary steps to strengthen its Banking Supervision and Regulation Division in all aspects, in order to meet the increased demands emerging from Cyprus's accession to the EU and the development and innovation process of the banking sector.
CP 8 Loan Evaluating and Loan Loss Provisioning	The CBC has issued, in December 2005, a new "Directive on the suspension of interest and other income on non-performing credit facilities" which took effect on 1 st of January, 2006 and by which the 90-days rule has been applied in full conformity with international practice..
CP 11 Country Risk	The CBC shall proceed with the drafting of guidelines to banks for the management of country and transfer risk in the near future.

⁶ See Footnote 4.

Reference Principle	Planned Action
CP 12 Market Risks	Although the level of activities of banks in Cyprus which can generate market risk remains low, the CBC aims at enhancing the scope of its supervision to ensure that banks perform scenario analysis, stress testing and contingency planning, as appropriate, and periodic validation or testing of the internal systems/models used to measure market risk as provided in the EU Capital Requirements Directive, which shall come into force on the 1 st January, 2007. Market risk expertise shall be enhanced by additional training provided by the Financial Stability Institute of the Bank of International Settlements as well as the supervisory authorities of other EU countries such as the UK, France, Germany and the Netherlands, to specialised staff of the Banking Supervision and Regulation Division of the CBC.

G. Principle by Principle Assessment—Cooperative Societies’ Supervision and Development Authority

Table 4. Detailed Assessment of Compliance with the Basel Core Principles (CSSDA)

Principle 1.	<p>Objectives, Autonomy, Powers, and Resources</p> <p>An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to the authorization of banking establishments and their ongoing supervision; powers to address compliance with laws, as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.</p>
Principle 1(1)	An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks.
Description	<p>There are 358 cooperative credit institutions (“CCI”) with limited or unlimited liability and 104 non-credit limited liability cooperatives. They operate in various sectors (banking, consumer, trading of agricultural products and services), and are shareholders-members of the Cooperative Central Bank (CCB).</p> <p>The CCIs have as their main objective the extension of credit and the provision of services to their members in accordance with the cooperative principles of mutual help and assistance.</p> <p>The activities and supervision of the 358 CCIs are regulated according to the contents of the Cooperative Societies Laws of 1985 to 2004 (“CSL”), by their own supervisory authority—the Cooperative Societies Supervision and Development Authority (“CSSDA”).</p> <p>However, the CCB, being the apex of the cooperative movement (CM) in Cyprus, has a dual status for it is also a bank for the purposes of the Banking Law (“BL”) and is therefore supervised by the Central Bank of Cyprus (CBC), as well as the CSSDA. It acts as the banker to the CCIs by accepting their surplus funds as deposits, granting loans to those CCIs in need of liquidity and delivering general support services. The locus of lender-of-last-resort responsibilities of the CCB is generally governed by Article 26 of the CSL, and it will be regulated in detail by the Committee of the CSSDA according to Article 94 of the Cooperative Societies Rules of 1985 to 2004, that authorizes the committee to issue further detailed prudential instructions on the matter.</p>

	<p>According to article 41D of the CSL the Commissioner of the CSSDA is responsible for the supervision of the CCIs and the application of the CSL.</p> <p>Part VI A of the CSL provides a framework of minimum prudential standards addressing issues such as:</p> <ul style="list-style-type: none"> • licensing conditions; • minimum capital; • capital adequacy ratio; • organizational and management requirements (“four-eyes” principle, fit-and-proper character); • shareholder requirements; • exposure restrictions; • connected lending limits; • prudential reporting; • on-site examinations; • administrative sanctions; • remedial measures. <p>Section 44 of the CSL authorizes the commissioner to decide on the winding up of a CCI and to nominate a liquidator to that effect.</p> <p>The audit of the accounts and the financial management of the individual CCIs is performed by the Audit Office of Cooperative Societies (“AOCS”), which is an independent legal entity established by Section 19.1 of the CSL and whose audit costs are covered by the examined CCIs by means of annual fees. The AOCS, which also audits the other non-credit cooperative institutions is administered by a committee composed of five members appointed by the Council of Ministers for a term of three years. At present, usually, the committee is chaired by the Auditor General of Cyprus. The auditor general also audits the financial statements of the CBC and performs the audit of the CSSDA.</p> <p>The CCIs have been operating in a relatively stable social and economic environment. There has been no need for implementing major structural changes since the division of the CM (into Turkish-Cypriot and Greek-Cypriot CMs) by the then British-Colonial Authorities almost half a century ago. In 1987, the audit function for the CCIs was separated from the supervisory function with the establishment of the AOCS.</p> <p>However, the negotiations with the EU have introduced a process of change, which led to the harmonization of policies and legislation with the EU standards and Banking Directives (BD). A five-year transitional period as from January 1, 2003 has been agreed upon by the EU within which all CCIs will be compliant with the BD. In this context, the CSL has been modified in 2003 and 2004 in order to ensure full conformity with the <i>acquis communautaire</i>.</p> <p>A two-layered approach will be followed with a number of CCIs complying individually on a stand-alone basis with the remaining CCIs complying by becoming affiliates of the CCB (called the “Central Body”). However, any conforming CCI can also join the permanent affiliation arrangement if it so wishes. The Central Body arrangements will be introduced within the context of the permanent affiliation arrangements set out in Article 2, paragraph 5 of the BD 2000/12/EC where the CCB, as the “Central Body,” and the affiliated CCIs will have to satisfy the provisions on a consolidated basis.</p> <p>The supervisory framework of the affiliated CCIs will be as follows:</p> <ul style="list-style-type: none"> • the affiliated CCIs will be supervised by their own supervisory authority (the CSSDA) as stated in Section 41D of the CSL; • simultaneously, and according to Section 35 of the Banking Law (BL), the affiliated CCIs are subject to the provisions of the BL to the extent that this is considered necessary for the CBC to exercise supervision on a consolidated basis. Therefore, the CSSDA will have to provide the CBC with all the necessary data and information
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	<p>regarding affiliated CCIs and will participate in joint on-site examinations of the affiliated CCIs.</p> <p>On the other hand, the CCB, being the Central Body of the affiliated CCIs, is empowered to supervise these affiliated CCIs explicitly and only for the purposes of the permanent affiliation arrangements and in accordance with the provisions of the BD. The CCB/Central Body has no authority to perform prudential supervision but will have the power to monitor their solvency and liquidity as well as to issue compulsory instructions to the affiliated CCIs that would include concrete management issues covering administrative, organizational, and operational areas (e.g., internal audit, risk management, credit policy, etc.).</p> <p>These instructions to be issued by the Central Body to the affiliated CCIs will:</p> <ul style="list-style-type: none"> • lay down the main principles by applying generally accepted banking principles and procedures in order to ensure the financial stability and competitiveness of the affiliated CCIs; and • be general and be directed towards all CCIs except in cases where due to reasons relating to their size and/or other reasons it is considered necessary to issue specially-formulated or modified instructions. <p>On the other hand these instructions are not intended to:</p> <ul style="list-style-type: none"> • aim at full control of the CCIs nor will they cover routine operations (their routine operations will be conducted in accordance with the CCIs' internal control procedure manuals); • replace or reduce the role and authority of the CCIs' management but rather form the basis for a framework under which the Central Body will be offering support and conducting the required monitoring and control in specific areas and operations which are important; • alter the authority and powers of the CSSDA or their authority and independence; or • replace the supervisory and prudential instructions issued by the CSSDA. <p>Furthermore, the law requires that before such instructions are issued, the Central Body will have to consult the commissioner and collaborate with him in order to assure full conformity with the legal and regulatory framework of the CCIs. The CSSDA and the Central Body are also to collaborate systematically in order to resolve any pending issues and problems so as to meet their respective duties and obligations.</p> <p>A Memorandum of Understanding has been signed between the CBC and the CSSDA under which it was decided that the supervision of the CBC over the CCB has to take into account the permanent affiliation arrangements of the CCB as a Central Body with the affiliated CCIs. The arrangements for the CBC's supervision of the CCB and its affiliates on a consolidated basis are governed by the BL and Article 5A(3)(b) of the CSL.</p> <p>The CSSDA's annual report highlights the financial situation of the CCIs and informs the reader on regulatory developments. A new website in English is also under construction.</p>
Assessment	Materially Noncompliant.
Comments	<p>A comprehensive transitional regulatory and supervisory system has been set in place that will require every CCI to conform to the EU-banking directives before the end of 2007.</p> <p>During this transitional period, the CCIs are allowed to continue their existing business within Cyprus under the CSL without any restrictions or conditions, with the result that the cooperative credit sector will not be fully compliant with the EU banking directives during that period.</p> <p>However, and pursuant to Section 2 of the transitional provisions of the CSL, the CCIs have been asked to inform the CSSDA on the measures they intend to take in order to comply with the upcoming prudential requirements. The CSSDA has also developed a monitoring system of</p>

	<p>a number of prudential issues for each CCI (e.g., “four-eyes” principle, capital, large exposures, connected lending, etc.).</p> <p>Although, prima facia, there is a basic framework of prudential standards in the law and supporting regulations, the arrangements for the transitional period that is currently progressing fundamentally restricts the full, proper enforcement of and supervision under them.</p> <p>The mission has been informed that a sample of CCIs representing different types of CCIs will probably decide without further delay on their affiliation. This will enable the CCB to start a pilot project in the second half of 2005, the benefits of which will then be extended to the rest of the CCIs that chose to affiliate with the CCB. It is therefore recommended that the ongoing efforts in order to accelerate the affiliation process be further stepped up, particularly the formulation of the rules governing the affiliation of the non-conforming cooperatives with the CCB.</p> <p>The mission has also been informed of the ongoing efforts of the CCB and the CSSDA to encourage mergers in the cooperative credit sector in order to enhance the critical mass and economies of scale that will be required in view of the upcoming regulatory and supervisory reinforcement.</p> <p>These dramatic regulatory changes and the many players involved also highlight the need to organize and manage the change process very closely. The mission therefore recommends that the work of the different working groups and committees be coordinated under the umbrella of a global change committee.</p>
Principle 1(2)	Each such agency should possess operational independence and adequate resources.
Description	<p>According to the CSL, the Minister of Commerce and Industry supervises the cooperative societies and is authorized to give instructions to the Commissioner of the CSSDA regarding the exercise of his powers.</p> <p>However, Section 3(2) explicitly exempts the CCIs from the application of this requirement and Section 41D (1) of the CSL confers the responsibility for supervising the CCIs to the commissioner.</p> <p>The commissioner is appointed by the Council of Ministers for a period of five years with the possibility of renewal. He is not allowed to hold any other position or public office in Cyprus or be employed against remuneration in the private sector. The commissioner is the presiding officer of the CSSDA. He chairs the Committee of the CSSDA, which is composed of the commissioner or his deputy (the senior director) and four other members appointed by the Council of Ministers for a term of five years. The committee is responsible for determining the strategy and policy of the CSSDA and for the regulation of CCIs according to specific provisions of the CSL.</p> <p>The operational services of the CSSDA are composed of a recently established Supervision Department (7 staff) and a Development Department (33 staff). This picture has to be completed by mentioning that staff of the development department are assuming tasks that are related to the supervisory area (e.g., continuous monitoring of CCI’s compliance with the CSL, validating prudential returns, input of data into the central data system).</p> <p>The supervision division of the CSSDA also profits to some extent in its supervisory function from the intense contacts of support staff with the CCIs which increases the staff’s understanding of the individual CCIs. The intelligence so acquired is subsequently used in the on-site supervisory process.</p> <p>However, the recent character of the Supervision Department and the limited number of its staff illustrate that in the past the activities of the CSSDA were mainly, if not exclusively, directed to support the great number of very small CCIs (50 CCIs out of 360 account for 75 percent of the assets of the sector). In the past, the activities of the CSSDA centered on monitoring of CCI’s</p>

	<p>compliance with the old CSL (before its harmonization with EU directives), as well as the development and support of the CCIs.</p> <p>However, against the backdrop of the dramatic regulatory and supervisory changes described under the assessment of Principle 1(1), which will have to materialize in the near future, the CSSDA has developed, in cooperation with the governmental personnel department, a transition plan providing for 17 additional staff. Fourteen will reinforce the supervisory staff, tripling the present supervisory resources. A number of these additional staff will fill existing vacancies and pending their entry the supervisor tends to hire nonpermanent experienced staff in order to meet the most urgent needs. The plans call for upgrading the salary levels of both officers and staff.</p> <p>The salary scales of the CSSDA are equivalent to government salary scales. However, the public sector salaries are considered to be higher than the private sector salaries, at least as far as the entry level is concerned. Therefore, hiring additional staff with adequate academic and professional background is reportedly not to be problematic.</p> <p>According to Section 4(6)(c) of the CSL, the commissioner shall have at his disposal the financial means necessary for the unobstructed and immediate exercise of the duties imposed upon him by the CSL regarding the supervision and control of the CCIs.</p> <p>In view of the future regulatory and supervisory changes the CSSDA liaises intensively with the CBC. A six-month training program has been organized during which four CCIs have been submitted to joint on-site examinations. The CSSDA also combines its efforts with the CBC and the CCB in preparing for the new supervisory and regulatory environment. Also, the establishment of the affiliation arrangements will allow the progressive transfer of a great deal of the support efforts of the CSSDA to the Central Body (the CCB). The latter process will also allow CSSDA staff involved in the development area to switch to the supervisory sector.</p> <p>An Administrative Co-operation Program between Cyprus and the European Union has been set up in order to provide for technical assistance for the effective supervision of co-operative credit institutions (Twinning Light Project). The project will cover a period of five months and should start no later than September 2005. The specific objectives aim at strengthening the administrative capacity of the CSSDA for effective on-site and off-site supervision, including the enhancement of electronic monitoring, based on the relevant <i>acquis communautaire</i> as well as on the supervisory principles of the Basel Committee, taking into account the common position agreed upon with the EU.</p> <p>The Commissioner may also contract or hire lawyers, auditors or other professional experts related to the execution of its legal duties. However, the Commissioner has not yet done this.</p> <p>The Commissioner's mandate may only be terminated by the Council of Ministers when he no longer fulfills the conditions required for the execution of his duties or when he has committed a serious offence.</p>
Assessment	Materially Noncompliant.
Comments	<p>The annual budget of the CSSDA is prepared by the Committee and then forwarded to the Council of Ministers through the Ministry of Finance and, finally, submitted to and approved by the House of Representatives. This may raise questions and doubts about the financial independency of the supervisory authority.</p> <p>The matter is especially sensitive since the supervisory capacity of the CSSDA must be developed in a very substantial way in order to cope with the new regulatory environment. The number of required additional staff is testimony to that.</p> <p>The mission therefore recommends that the government proceed without further delay with the execution of the various plans in order to strengthen the supervisory capacity of the CSSDA.</p>
Principle 1(3)	A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.

Description	<p>As stated above, the CSL confers the responsibility for supervising the CCIs to the commissioner and gives him the power to grant or revoke the license.</p> <p>Article 41J of the CSL allows the Council of Ministers to set prudential rules and also to delegate this power to the Committee of the CSSDA. By Regulative Administrative Act N°110/2004, published in the Official Gazette on February 27, 2004, the Council has delegated this power to the Committee. The committee has made an extensive use of this power in the past and continues to do so as is shown in the descriptions of other principles.</p> <p>Also, article 41G of the CSL empowers the committee to make additional rules for the CCIs.</p> <p>Article 41JC(1) of the law gives the commissioner the power to demand and collect information useful for the exercise of his power pursuant to the cooperative law (see also Principle 16).</p>
Assessment	Compliant.
Comments	None.
Principle 1(4)	A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws, as well as safety and soundness concerns.
Description	<p>Article 41D of the CSL enables the commissioner to address compliance with the CSL and the safety and soundness of the CCIs.</p> <p>The commissioner is allowed to exercise qualitative judgment in the forming of his/her opinion.</p> <p>The commissioner has also the right to conduct audits and collect information [Article 41D (2)(b)].</p> <p>The Commissioner also has the power to take prompt remedial measures or impose sanction, including the revocation of the license when a CCI is not complying with laws and regulations or is engaged in unsafe or unsound practices [Articles 41F (3) and 4 and 41JH].</p>
Assessment	Compliant.
Comments	None.
Principle 1(5)	A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.
Description	<p>According to Section 4(5) of the CSL, the commissioner and the supervisory staff are exempt from any civil liability regarding any action or omission in exercising their duties and powers unless it is proven that the action or omission was performed in bad faith involved serious negligence.</p> <p>The defense of CSSDA staff against lawsuits rests with the Office of the Attorney General and all legal expenses incurred are covered by the Cyprus government.</p>
Assessment	Compliant.
Comments	None.
Principle 1(6)	Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Description	<p>According to Section 41D (1)(c), the commissioner is allowed to cooperate and share information with other local or foreign agencies, provided that this information is treated as confidential by the receiving agency.</p> <p>A Memorandum of Understanding has been signed between the CBC, the Cyprus Securities and Exchange Commission, the Insurance Companies' Control Service, and the CSSDA. The memorandum came into effect on January 1, 2003.</p> <p>This Memorandum is based on the application of Articles 41D(1)(c) and 41H of the CSL, which allows the competent supervisory authorities of the financial sector to cooperate and exchange information between them and/or with other supervisory authorities, whether in Cyprus or elsewhere, with a view of discharging their functions and responsibilities in a more effective manner. Any exchange of information will only take place when the CSSDA is satisfied that the</p>

	<p>information provided is subject to the same confidentiality rules in the hands of the receiving competent supervisory authority as apply to the CSSDA.</p> <p>The information exchange between the competent supervisory authorities is exclusively used in the discharge of their functions and responsibilities and is subject to confidentiality rules in the hands of the receiving supervisory authority as applied to the supervisory authority which provides the information on the basis of legislation in force from time to time. Confidential information exchanged between the competent supervisory authorities on the basis of the legislation in force may not be disclosed without the expressed agreement of the competent supervisory authority which disclosed it and, where appropriate, solely for the purposes for which this authority gave its agreement.</p> <p>As stated above, in view of the future regulatory and supervisory changes, the CSSDA liaises intensively with the CBC. A six-month program has been organized during which four CCIs have been submitted to joint on-site examinations. The CSSDA also combines its efforts with the CCB in preparing for the new supervisory and regulatory environment. Also, the establishment of the affiliation arrangements will allow the progressive transfer of a great deal of the support efforts of the CSSDA to the Central Body (the CCB). The latter process will also allow CSSDA staff involved in the development area to switch to the supervisory section.</p> <p>According to Section 41H (1), the Commissioner, the Committee, and the staff of the CSSDA are to preserve the confidentiality of the information in their possession and may only use this information within the exercise of their duties.</p>
Assessment	Compliant.
Comments	None.
Principle 2.	Permissible Activities
	The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word “bank” in names should be controlled as far as possible.
Description	<p>Article 1 of the CSL defines a CCI as a society whose business it is to receive deposits or other repayable funds from the public, to grant credit for its own account, or to provide electronic money services. The CSL further stipulates (Section 41A 1) that only licensed cooperative credit institutions established in Cyprus or in an EU member state or a third country may carry out the business of accepting deposits.</p> <p>The Committee of the CSSDA is mandated to define the services or activities that the CCIs are allowed to offer or exercise. The CSSDA plans to issue a Regulatory Decision on this.</p> <p>The licensed CCI is required to mention at a distinct point near its name, on its stationary and on any other document used in receiving money, on its annual accounts, on leaflets of provided services, or on internet websites, whether it operates as a stand-alone CCI or as a CCI affiliated with the “Central Body.”</p> <p>The use of the phrase “cooperative credit institution” is not currently protected, but the protection of the word “cooperative” which is part of that phrase may provide protection.</p> <p>According to Section 55.1, the use of any name of which the word “cooperative” forms part is also prohibited without the sanction of the Council of Ministers. Contravening this provision represents a criminal offense.</p>
Assessment	Materially Noncompliant.
Comments	The Committee should complete the issuance of its Regulatory Decision defining the services or activities that the CCIs are allowed to offer or exercise.
Principle 3.	Licensing Criteria
	The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organization’s ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent organization is a

foreign bank, the prior consent of its home country supervisor should be obtained.	
Description	<p>Article 41F (1) of the CSL authorizes the CSSDA to set criteria for licensing the CCIs. These criteria are set in the CSL [Article 41B (1)].</p> <p>According to Section 41E, these criteria are to be complied with on a continuous basis. The commissioner retains the right to reject a license application. He also has the authority to amend or withdraw any imposed terms or to impose any new terms on an existing license (Article 41F).</p> <p>The commissioner verifies the organizational structure, and he satisfies himself that the CCI provides all the necessary guarantees or conditions for the execution of an effective supervision [Article 41B(1) (ii)].</p> <p>The shareholders-members of the CCIs are individuals. The CCIs are non-profit motivated organizations governed by the one-member–one vote principle with each entity having its own committee elected from among the members.</p> <p>Article 41B (1)(a)(iii) of the CSL also stipulates that the license shall only be granted if the CSSDA is satisfied with the fit-and-proper character of members that hold a percentage of capital that exceeds 10 percent. In practice, this situation does not exist, and as stated above the cooperative system is based on the one- member,-one-vote principle.</p> <p>A minimum initial amount of capital in Cyprus pounds of an equivalent of one million Euros is required by Article 41B (i).</p> <p>The CSL also requires the CCI to be directed by at least two persons with the necessary expertise and skills in order to effectively define the orientation of the activities, a good administrative and accounting organization, and a proper internal control system [Article 41B(ii)].</p> <p>According to Article 41B(iv) the applicant CCI shall also have to satisfy the commissioner that it shall have prior to the commencement of its activity the requisite financial capacity and liquidity to achieve the proposed program of activities that is submitted with its application.</p> <p>A CCI of a EU-member state has the right to exercise its activities in Cyprus, defined in the Appendix of the CSL, either by establishing a branch or via cross-border services, if the following conditions are met:</p> <ul style="list-style-type: none"> • for a branch: (e.g.,) licensed by the home-member state, the activities that will be undertaken are compatible with the home license and contact is to be taken with the home supervisor; • for cross-border provision of services: the presence of a home license and the intended activities should be consistent with the intended license. <p>CCIs from third countries (i.e., nonEU member states) have the right to exercise activities in Cyprus if the conditions of article 41B(1) are met.</p> <p>The commissioner has the right to withdraw a license at any time if it is established that the license has been obtained on false statements or by concealed substantial evidence [Article 41F(4)].</p>
Assessment	Compliant.
Comments	Currently, the necessary regulatory framework is in place. Existing CCIs have a transition period in which to decide whether to affiliate with the Central Body or continue to stand-alone.
Principle 4.	Ownership Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.
Description	According to the Cooperative Laws (Articles 6 and 7), each Cooperative Credit Institution (CCI), which may have either limited or unlimited liability, is independent and self-governing.

	<p>Where the liability of the members of a Cooperative Credit Institution is limited by shares, no member, other than a registered cooperative society, shall hold a portion of the share capital of the institution which exceeds the maximum limit prescribed by the CSL, which in percentage shall not exceed one-fifth of the share capital of the institution.</p> <p>Irrespective of the liability or the shareholdings of a CCI, each member holds only one vote. It is apparent that under the present legal framework the subsidiary status based on controlling interest cannot exist.</p> <p>As stated above, Section 41B(1)(a)(iii) of the CSL also stipulates that the license shall only be granted if the CSSDA is satisfied with the fit-and-proper character of members that hold a percentage of capital that exceeds 10 percent. In practice, this situation does not exist, and, as stated above, the cooperative system is based on the one- member,one-vote principle.</p> <p>According to Section 41E, these criteria are to be complied with on a continuous basis.</p>
Assessment	Not applicable.
Comments	Given the existing legal framework, controlling interests cannot exist for CCIs.
Principle 5.	Investment Criteria Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Description	<p>Under Article 40(a) of the CSL, with the approval of the Commissioner, each CCI is allowed to use its funds for the purchase of immovable or movable property necessary for the execution of the purposes for which the society was incorporated.</p> <p>Under article 41J(e) of the CSL, the Council of Ministers, within the framework of the European Community's Acts, may define the limits of the participation in other enterprises of the CCI that applies for or holds a license. The Council of Ministers has duly delegated this authority to the committee.</p> <p>Against the general backdrop of the ongoing implementation of the EU regulations, it is the committee's firm intention to issue a Regulatory Decision according to the above article to adopt the relevant provisions of Directive 2000/12/EC in 2005, with regard to the limits of participation in other enterprises. A participation in a company outside the financial sector, exceeding 10 percent of the capital of that company will be considered as a qualifying holding, which should not exceed 15 percent of the own funds of the CCI. The aggregate portfolio of qualifying participations in nonfinancial-sector companies must not exceed 60 percent of the own funds of each CCI.</p> <p>The mission has been informed that the introduction of these limits will not present a problem for the CCIs. At present, few CCIs hold qualified participations in non-financial institutions. However, these participations are well below the 15 percent limit that will be introduced in the future.</p>
Assessment	Largely Compliant.
Comments	<p>The committee should complete the issuance of its Regulatory Decision regarding participation in other enterprises. This decision should incorporate the provisions of Directive 2000/12/EC with respect to participations outside the financial sector.</p> <p>Before granting its approval for any new acquisition by a CCI, the CSSDA will require that any new acquisitions and investments do not expose the CCI to undue risks or hinder effective supervision. The CCI will have to demonstrate that it has, from the outset, adequate financial and organizational resources to handle the acquisition/investment.</p>
Principle 6.	Capital Adequacy Banking supervisors must set minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. For internationally active banks, these requirements must not be

less than those established in the Basel Capital Accord.	
Description	<p>Following the accession of Cyprus to the EU, the Regulative Directive 58/2005 of the CSSDA's Committee introduced a risk-based capital requirement regime applicable to CCIs based on the provisions of Directive 2000/12/EC (Official Gazette February 11, 2005). This directive was drafted in cooperation with the CBC and the CCB.</p> <p>The CSSDA Directive is comparable with the CBC's Directive. However, the following differences are to be mentioned:</p> <ol style="list-style-type: none"> the minimum ratio requirement is set at 8 percent, based on the EU Directive 200/12/EC minimum requirements (compared to 10 percent for the banking sector); Tier 2 capital includes two additional items, i.e., members reserve liability and uncalled capital based on Article 36 of the EU Directive 2000/12/EC; Tier 1 capital includes an item regarding reserves for general banking risks, and Tier 2 does not include an item regarding general provisions for bad debts (approach based on the EU Directive mentioned above). <p>The mission was also informed that the committee has approved a new Regulative Directive introducing CAD II. This decision was published in the Official Gazette in April 2005 (Regulative Administrative Act No. 195/2005).</p> <p>This directive tends to fully harmonize the CSSDA's capital requirements with EU Directives 93/6/EEC as amended by Directives 98/31/EC, 98/33/EC, 2002/87/EC and 2004/39/39. It has also been drafted in collaboration with the CBC. Again, the CSSDA has followed the same approach as the CBC with the same differences as for CAD I (a, b, and c) as described above.</p> <p>The risk profile of the CCIs is determined by their main function, which is the acceptance of deposits and granting of loans to the members of the cooperative system in their particular area of operations. The total membership of the cooperatives covering the multiple activities in Cyprus has exceeded 500,000, whereas membership of CCIs totals around 358,000.</p> <p>Should a licensee's capital fall below the minimum capital ratio, Article 41D empowers the commissioner to impose the necessary measures.</p>
Assessment	Largely Compliant.
Comments	The CSSDA should require reporting on CCIs' capital ratios and their components at least semi-annually. Current reporting is only on an annual basis.
Principle 7.	Credit Policies An essential part of any supervisory system is the independent evaluation of a bank's policies, practices, and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios.
Description	<p>The assets created in the normal course of the business of CCIs are generally limited to home mortgage loans, personal/consumer loans, and small business/professional loans granted mainly to their members, mostly on a collateralized or guaranteed basis. Pursuant to Article 37 of the CSL Societies Law, loans to any non-members of any CCI must be approved by the commissioner. Individual CCIs do not normally make investments directly. Article 40(a) of the CSL requires that each CCC invest its excess funds in government securities or deposit the excess funds in the Cooperative Central Bank, which is regulated and supervised by the Central Bank of Cyprus and the CSSDA, or, with the consent of the commissioner, in any other bank. Consequently, credit risk for CCIs is limited and investment risk is moderated.</p> <p>Article 41JA of the CSL sets maximum limitations and controls for large exposures and exposures to connected parties. According to Rules 58(2), internal maximum lending limits must be included in the CCIs by-laws. By-laws are approved by the general meeting of the members and are subject to the approval of the commissioner.</p> <p>The Commissioner's Directives 3-01 and 3-02, regarding the basic principles for the internal procedures and internal control systems of CCIs, require that CCIs have established well-documented credit policies, practices, and procedures. CSSDA supervisors determine whether</p>

	<p>these directives are implemented by each CCI. The CSSDA reviews and evaluates compliance with pertinent legal and prudential requirements through both off-site supervision/monitoring and on-site examination.</p> <p>In the course of on-site examinations, the CSSDA examiners review extensively the credit procedures, practices, and administration policies of the CCI. These include the appraisal and authorization of individual credit exposures, procedures for identification of substandard lending, and provisioning policy. The examinations also include evaluation of internal systems and procedures for record keeping and control. The CSSDA monthly and annually collects and analyzes information on loans, by sector of economic activity, interest rate duration, and security, as well as overdue and excess exposures.</p>
Assessment	Materially Noncompliant.
Comments	<p>Within 2004 and 2005, the CSSDA's on-site examination program has covered only a fraction of the large number of CCIs, although the examined CCIs account for 17 percent of the total loan portfolio of the sector. The program's implementation has been limited by the small number of current staff and the need for further training. CSSDA's management in cooperation with the government personnel department, has developed plans for augmenting supervision staff and training has already begun. The continuous monitoring of the CCIs that is exercised by the Development Division supplements the work of the Supervision Division and the findings of the independent AOCS assist the CSSDA's on-site work, but do not mitigate the need for completion of planned expansion and development of staff.</p>
Principle 8.	<p>Loan Evaluation and Loan-Loss Provisioning</p> <p>Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices, and procedures for evaluating the quality of assets and the adequacy of loan-loss provisions and reserves.</p>
Description	<p>As stated above, the assets created in the normal course of business of CCIs are generally limited to home mortgage loans, personal/professional loans, and small business/professional loans granted to their members, mostly on a collateralized or guaranteed basis. Pursuant to Article 37 of the CSL, loans to any nonmembers of any CCI must be approved by the commissioner. Individual CCIs do not normally make investments directly. Article 40(a) of the CSL requires that each CCC invest its excess funds in government securities or deposit the excess funds in the Cooperative Central Bank, which is regulated and supervised by the Central Bank of Cyprus and the CSSDA, or, with the consent of the Commissioner, in any other bank. Consequently, credit risk for CCIs is limited and investment risk is moderated.</p> <p>The Commissioner's Directives 3-01 and 3-02, regarding the basic principles for the internal procedures and internal control systems of CCIs, require that CCIs have established well-documented credit policies, practices, and procedures. CSSDA supervisors determine whether these directives are implemented by each CCI during on-site examinations. One of the prime objectives of these examinations is to assess the quality of the assets of the CCIs. In the course of an on-site examination, the CBC examiners review extensively the bank's lending practices, its credit granting standards, and the level and adequacy of provisions. CCIs themselves are required to review individual credits, asset classifications, and provisioning, including those for both on- and off-balance sheet exposures, at least annually. In addition, the external AOCS, when conducting the annual audit of each CCI's financial statements and management/performance, reviews its provisioning policies and adequacy.</p> <p>During the course of on-site examinations, the CSSDA examiners assess the quality of assets individually, especially major loan accounts, and the level and adequacy of provisions and compare their results with those of the CCI under examination. CSSDA examiners review a sample of at least 30 percent of the balance sheet value of CSI credit exposures; the sample selected is biased towards large or problematic loans and includes both on- and off-balance sheet exposures. Each borrower selected is individually assessed, together with connected persons, by account, collateral held, financial condition, and other pertinent factors. Then, according to the risk entailed, each account is classified on the basis of CSSDA's established asset quality classification criteria. These classifications are Pass, Special Mention, Substandard, and Doubtful; the definition of the characteristics of each of these classifications is very comparable to the definitions of similar classifications that are used by other competent</p>

	supervisory authorities worldwide, as is the approach to evaluating the adequacy of provisioning.
Assessment	Materially Noncompliant.
Comments	<p>Within 2004 and 2005, the CSSDA's on-site examination program has covered only a fraction of the large number of CCIs, although the examined CCIs account for 17 percent of the total loan portfolio of the sector. The program's implementation has been limited by the small number of current staff and the need for further training. CSSDA's management in cooperation with the government personnel department, has developed plans for augmenting supervision staff and training has already begun. The continuous monitoring of the CCIs that is exercised by the Development Division supplements the work of the Supervision Division and the findings of the independent AOCS assist the CSSDAs on-site work, but do not mitigate the need for completion of planned expansion and development of staff.</p> <p>The CSSDA should provide for additional regular reporting, in relevant detail, from CCIs on a broader range of credit-related matters (e.g., classification of credits and other assets, non-performing assets, provisioning, assets with suspended interest, etc.) and include such reporting in its ongoing analysis of each CCI.</p>
Principle 9.	<p>Large Exposure Limits Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.</p>
Description	<p>Pursuant to Article 41JA of the CSL:</p> <ol style="list-style-type: none"> 1) It is forbidden for a registered cooperative credit institution, with the exceptions of the institutions affiliated with the Central Body: <ol style="list-style-type: none"> (a) to allow the total value of exposures to a client or group of connected clients to exceed 25 percent of its own funds at any time or any other lower percentage that the CSSDA Committee may from time to time define, in general or in specific for a particular category of a cooperative credit institution; (b) to allow the total value of all large exposures to exceed the eightfold of its own funds at any time or any other lower percentage that the CSSDA Committee may from time to time define, in general or in specific for a particular category of a cooperative credit institution; or (c) to allow the total value of exposure without the guarantee of collateral security granted to the members of the committee or the board or the Supervisory Board, the secretary or the manager of the said cooperative credit institution or the legal persons, in which the aforesaid or their spouses or children or grandchildren hold a percentage bigger than 10 percent of the share capital, to exceed five percent of its own funds at any time or any other lower percentage that the CSSDA Committee may from time to time define, in general or in specific for a particular category of a cooperative credit institution. 2) During the ascertainment of the obligation for compliance with the provisions of subsection (1), the CSSDA Committee is authorized to exempt totally or partly any exposure, after taking into consideration the extreme low risk entailed by the said exposure, provided that such exemption does not violate any European Community Act enforced in Cyprus. <p>The terms "exposure," "large exposure," "exposure not guaranteed by collateral security," and "group of connected clients" are specifically defined in the law in a manner that is similar to the practice in other competent jurisdictions.</p> <p>In the course of on-site examinations, the CSSDA examiners verify that CCIs have management information systems to timely identify concentrations within the portfolio. In addition, the</p>

	CSSDA examiners assess the accuracy of management information with regard to concentrations. The CSSDA also annually collects information on large exposures and analyzes it for compliance with the law as part of its ongoing process of off-site supervision/monitoring. The CSSDA is currently revising and updating its return on large exposures.
Assessment	Materially Noncompliant.
Comments	Within 2004 and 2005, the CSSDA's on-site examination program has covered only a fraction of the large number of CCIs, although the examined CCIs account for 17 percent of the total loan portfolio of the sector. The program's implementation has been limited by the small number of current staff and the need for further training. CSSDA's management, in cooperation with the government personnel department, has developed plans for augmenting supervision staff and training has already begun. The continuous monitoring of the CCIs that is exercised by the Development Division supplements the work of the Supervision Division and the findings of the independent AOCS assist the CSSDA's on-site work, but do not mitigate the need for completion of planned expansion and development of staff.
Principle 10.	Connected Lending In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arm's-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.
Description	<p>Pursuant to Article 41JA of the CSL:</p> <ol style="list-style-type: none"> 1) It is forbidden for a registered cooperative credit institution, with the exceptions of the institutions affiliated with the Central Body: <ol style="list-style-type: none"> (c) to allow the total value of exposure without the guarantee of collateral security granted to the members of the committee or the board or the Supervisory Board, the secretary or the manager of the said cooperative credit institution or the legal persons, in which the aforesaid or their spouses or children or grandchildren hold a percentage bigger than 10 percent of the share capital, to exceed 5 percent of its own funds at any time or any other lower percentage that the Committee may from time to time define, in general or in specific for a particular category of a cooperative credit institution. 2) During the ascertainment of the obligation for compliance with the provisions of subsection (1), the CSSDA Committee is authorized to exempt totally or partly any exposure, after taking into consideration the extreme low risk entailed by the said exposure, provided that such exemption does not violate any European Community Act enforced in the Republic. <p>The terms "exposure" and "exposure not guaranteed by collateral security" are specifically defined in the law in a manner that is similar to the practice in other competent jurisdictions.</p> <p>Facilities to the members of the committee of the CCI and their connected persons are required to be approved by the CCI's Committee, irrespective of the amount, without the member concerned voting on the resolution. However, there is no apparent requirement that the facilities may not be granted on more favorable terms than corresponding loans to nonrelated counterparties. Article 43(2) does permit the commissioner to deal with problems arising in connected lending to the Committee of a CCI and its related persons. Although Article 43(2) gives the commissioner general authority to deal with problems, the law should more explicitly prohibit loans to be granted on more favorable terms than corresponding loans to non-related counterparties.</p> <p>Following delegation of the relevant power by the Council of Ministers, Article 41J(a) of the CSL empowers the Committee of the CSSDA to regulate the computation of the capital of a CCI, but regulations do not currently provide for the deduction of connected lending exposures.</p> <p>CCIs are required to submit, on a semi-annual basis, a return showing all their loans related to the members of their committee or the board or the Supervisory Board, the secretary, or the</p>

	<p>manager. These are analyzed for compliance with the law as part of the off-site supervision/monitoring program. The CSSDA is currently testing a revised return on the monitoring and control of credit facilities to CCIs' Committee members and their connected persons.</p> <p>In the course of on-site examinations, the CSSDA examiners verify that CCIs have management information systems to timely identify exposures to connected parties assess their accuracy.</p>
Assessment	Materially Noncompliant.
Comments	<p>The CSSDA should specifically require that the facilities granted to connected persons of CCIs may not be granted on more favorable terms than corresponding loans to nonrelated counterparties.</p> <p>Within 2004 and 2005, the CSSDA's on-site examination program has covered only a fraction of the large number of CCIs, although the examined CCIs account for 17 percent of the total loan portfolio of the sector. The program's implementation has been limited by the small number of current staff and the need for further training. CSSDA's management, in cooperation with the government personnel department, has developed plans for augmenting supervision staff and training has already begun. The continuous monitoring of the CCIs that is exercised by the Development Division supplements the work of the Supervision Division and the findings of the independent AOCS assist the CSSDAs on-site work, but do not mitigate the need for completion of planned expansion and development of staff.</p>
Principle 11.	<p>Country Risk Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring, and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risks.</p>
Description	Currently, CCIs do not engage in cross-border lending and investment activities.
Assessment	Not Applicable.
Comments	However, the CSSDA has issued its Regulative Decision regarding Cross-Border Credit Transfers, pursuant to its authority under Article 41G(2) of the CSL to define the terms, conditions, and any other item that requires definition as regards the conduct of business by the credit cooperatives institutions.
Principle 12.	<p>Market Risks Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor, and adequately control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposure, if warranted.</p>
Description	<p>As stated above, the mission has also been informed that the committee has approved a new Regulative Directive introducing CAD II. This decision is to be published in the Official Gazette in April 2005.</p> <p>This directive tends to fully harmonize the CSSDA's capital requirements with EU Directives 93/6/EEC as amended by Directives 98/31/EC, 98/33/EC, 2002/87/EC and 2004/39/39. It has also been drafted in collaboration with the CBC. Again, the CSSDA has followed the same approach as the CBC with the same differences as for CAD I (a, b, and c) as described above.</p> <p>Article 40(a) of the CSL requires that each CCC invest its excess funds in government securities or deposit the excess funds in the Cooperative Central Bank, which is regulated and supervised by the Central Bank of Cyprus and the CSSDA, or, with the consent of the commissioner, in any other bank.</p> <p>However, the CCIs are not currently authorized foreign exchange dealers (except when acting as agents of the CCB) and do not offer foreign exchange services. These services are offered to the individual CCIs by the CCB, which is also supervised by the CBC. This allows the members to execute their international dealings and business through the CCB at special rates.</p>
Assessment	Largely Compliant.
Comments	The mission has been informed that the CSSDA intends to issue a directive that will specify the

	<p>rules and conditions required in order to obtain a license for foreign exchange operations. These rules and conditions will address such issues as, e.g., the required organizational structure and the necessary staff and expertise.</p> <p>The mission recommends that the supervisor adjust and develop the necessary expertise in order to supervise the new risks that will be assumed by the CCIs in this context.</p>
Principle 13.	<p>Other Risks</p> <p>Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor, and control all other material risks and, where appropriate, to hold capital against these risks.</p>
Description	<p>The commissioner has issued Directives 3-01 and 3-02 regarding the requirements for the basic principles for the internal operating procedures and internal control systems for CCIs. These provide a detailed instructional manual for the establishment of such systems by CCIs that can vary significantly in size and complexity of operations. The scope of the annual audit of each CCI that is conducted by the independent AOCS includes coverage of internal operations management systems and controls, as does the scope of the CSSDA's on-site examination function.</p> <p>The commissioner has issued a Directive on the Liquidity Ratio. The minimum acceptable liquidity ratio level has been set at 25 percent. Article 41F of the CSL provides the commissioner with the authority to address failure to comply with this requirement, protecting the interest of depositors. CCIs provide monthly returns on their liquidity to the CSSDA. The CSSDA is currently testing a revised and updated prudential liquidity return.</p> <p>For all CCIs that are connected electronically to the central server of the Cooperative Computer Society (currently 220 CCIs, including all of the larger institutions), a computerized gap analysis system exists to provide for the ongoing monitoring and evaluation of the effects of interest rate fluctuations. This information is currently available to the management of the CCIs; the CSSDA supervisors will not have direct access until the end of 2005. The CSSDA is currently testing a return on the monitoring of interest rate risk.</p> <p>For all CCIs that are connected electronically to the central server of the Cooperative Computer Society (currently 220 CCIs, including all of the larger institutions), a back-up of record keeping is provided to protect against possible operational problems created by general business interruption, disaster, or accident.</p>
Assessment	Materially Noncompliant.
Comments	<p>Within 2004 and 2005, the CSSDA's on-site examination program has covered only a fraction of the large number of CCIs, although the examined CCIs account for 17 percent of the total loan portfolio of the sector. The program's implementation has been limited by the small number of current staff and the need for further training. CSSDA's management in cooperation with the government personnel department, has developed plans for augmenting supervision staff and training has already begun. The continuous monitoring of the CCIs that is exercised by the Development Division supplements the work of the Supervision Division and the findings of the independent AOCS assist the CSSDAs on-site work, but do not mitigate the need for completion of planned expansion and development of staff.</p> <p>The CSSDA should enhance its ability to regularly acquire and analyze information on interest rate risk in the CCIs, either directly from the CCIs or through accelerated access to the reporting system of the Cooperative Computer Society.</p>
Principle 14.	<p>Internal Control and Audit</p> <p>Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls, as well as</p>

applicable laws and regulations.	
Description	<p>Article 41B(1)(a)(ii) of the Cooperatives Societies Law requires that a registered society be "...directed by at least two persons who have the necessary honesty and requisite experience to effectively define the orientation of the society's activities and with good administrative and accounting organization and proper internal control systems." Article 41F(3)(e) authorizes the Commissioner to demand the removal or alteration of the duties of any CCI officer or employee and Article 43 describes the circumstances when, including situations where the CCI is not properly managed, and authorizes the commissioner to dismiss the committee of a CCI.</p> <p>The commissioner has issued Directives 3-01 and 3-02 regarding the requirements for the basic principles for the internal operating procedures and internal control systems for CCIs. These provide a detailed instructional manual for the establishment of such systems by CCIs that can vary significantly in size and complexity of operations. The CSSDA is also planning to issue a future directive on the broader principles of internal control. In the course of its on-site examinations, the CSSDA determines whether the directives are implemented or other relevant internal controls are adopted; reviews the adequacy and efficiency of the institution's organizational structure; evaluates the effectiveness of its internal control system, including internal auditors where they exist; and makes recommendations as necessary. In the course of the on-site examination, the reports to the institution's committee from its internal auditor, where they exist, are reviewed by the examiners.</p> <p>The scope of the annual audit conducted in each CCI by the independent AOCS addresses the management of the CCIs, including an evaluation of the society's internal control systems' operations. CSSDA officers have access to the reports on these audits, participate in meetings with the management of the CCI regarding them, and provide support for the CCI's actions to address identified deficiencies, as necessary.</p>
Assessment	Largely Compliant.
Comments	<p>Due to the limited size of their management and staff, many small cooperative societies lack the ability to employ an internal audit function and/or operate under effective internal controls and segregation of duties. The absence of proper, effective internal control systems in a CCI will be a material factor in its decision on possible affiliation with the Central Body, subsequent to the expiration of the ongoing transitional period that ends on December 31, 2007.</p> <p>Within 2004 and 2005, the CSSDA's on-site examination program has covered only a fraction of the large number of CCIs, although the examined CCIs account for 17 percent of the total loan portfolio of the sector. The program's implementation has been limited by the small number of current staff and the need for further training. CSSDA's management in cooperation with the government personnel department, has developed plans for augmenting supervision staff and training has already begun. The continuous monitoring of the CCIs that is exercised by the Development Division supplements the work of the Supervision Division and the findings of the independent AOCS assist the CSSDA's on-site work, but do not mitigate the need for completion of planned expansion and development of staff.</p>
Principle 15.	Money Laundering Banking supervisors must determine that banks have adequate policies, practices, and procedures in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.
Description	<p>The Prevention and Suppression of Money Laundering Activities Laws of 1996 to 2004, (hereafter referred to as the "PSMLAL"), establish a solid framework that covers the various aspects of money laundering and the role of the financial system in this regard.</p> <p>The salient features of the PSMLAL are as follows:</p> <ul style="list-style-type: none"> • It defines and criminalizes laundering of proceeds from serious criminal offenses. • It provides for the confiscation of proceeds from serious crime.

	<ul style="list-style-type: none"> • It empowers courts to issue freezing and restraint orders in respect of such proceeds. • It requires suspicion of money laundering to be reported to the Unit for Combating Money Laundering (UCML) without this being treated as a breach of confidentiality. • It empowers the courts to order the disclosure and production of information held by natural or legal persons, including banks, related to money laundering investigations. • It requires all persons carrying on relevant financial business to maintain procedures in relation to customer identification, record keeping, internal control, and communication and staff training in the recognition and handling of suspicious transactions. • It enables the registration and enforcement of foreign orders for the freezing and confiscation of proceeds. <p>The Commissioner's Directives dated July 30, 1999, August 9, 2000, and November 7, 2000, address the prevention and suppression of money laundering by the CCIs. These directives are identical to the Guidance Notes and Supplements/Amendments issued by the Central Bank of Cyprus (CBC) prior to its November 2004 Guidance Note that takes into account:</p> <ul style="list-style-type: none"> (i) the harmonization of Cyprus's legislation with the EU Directive 2001/97EC; (ii) the revised recommendations for combating money laundering issued by the Financial Action Task Force (FATF) on money in June 2003; and (iii) the recommendations included in the paper on "Customer Due Diligence for Banks" issued in October 2001, by the Basel Committee on Banking Supervision. <p>The provisions of these Directives include the following:</p> <ul style="list-style-type: none"> a) prohibition of secret, anonymous, and numbered accounts as well as fictitious names; b) obligation to obtain data file for its customers; c) the appointment of a conforming officer that will act as the intermediary link between the CCI and the Financial Intelligence Unit (MOKAS). <p>The conforming officer is required to advise and direct other employees regarding the procedures required for money laundering, and has to decide whether employees need to participate in specialized seminars.</p> <p>In the course of on-site supervision, the examiners verify and control the policies and practices followed by the CCIs with regard to "Know-Your-Customer" rules.</p> <p>A comprehensive new Commissioner's Directive will soon revise the existing one and it will be issued based on the November 2004 Guidance Notes of the CBC mentioned above. At this stage, the said directive is in draft form subject to the commissioner's approval and will thereafter be circulated to the CCIs.</p>
Assessment	Largely Compliant.
Comments	<p>The CSSDA should complete the issuance of the new Guidance Note.</p> <p>In assessing compliance with this principle, it has to be noted that the activities of the CCIs, although important in volume and market share, are still of a very basic nature and are mainly confined to their members, which introduces an amount of social control into the system.</p>
Principle 16.	<p>On-Site and Off-Site Supervision An effective banking supervisory system should consist of some form of both on-site and off-site supervision.</p>
Description	<p>Pursuant to Article 41D of the CSL, the commissioner is responsible for supervising compliance with that law. Article 41JD empowers the commissioner or a person authorized by him "...to conduct investigations necessary for the carrying out of his competences or for a possible violation of the provided obligations in virtue of the Cooperative Law and for the</p>

	<p>purpose of this he may:</p> <ol style="list-style-type: none"> a) check the records, the books, the accounts and any other documents and data stored in computers at each cooperative credit institution or in the possession of any person for whom there is reasonable suspicion that he holds information of the Cooperative Credit Institution that may assist the commissioner in his investigation, and to take copies or extracts from them; and b) to enter the office and professional premises of the persons under investigation. <p>Also, pursuant to article 3(5), "... the Commissioner ... has the power to inspect the books, accounts, and documents of a registered society and every officer of such society shall provide the necessary facilitations and all of the requested information for such inspection." Article 41JC empowers the Commissioner "... to demand and collect information useful for exercising his powers pursuant to the cooperative law, and to demand through a written request the submission of this information within the set deadline, from registered co-operative credit institutions, their subsidiary companies, members of their Committee or their Board or the members of their Supervisory Board."</p> <p>Supervision is carried out through on-site examination and of-site monitoring. The Supervision Division of the CSSDA has two subdivisions: on-site supervision and off-site supervision and regulation. Currently, there are only seven officers and staff members in the division; however, plans and budgets have been prepared and are awaiting government approval for increasing the total number of the CSSDA's staff to 57, out of whom initially 21 will be allocated to the Supervision Division. The work of the Supervision Division is, inter alia, supported by the 33 officers and staff of the Development Division of the CSSDA, who also support the operations of the CCI's by working with them on supervisory, regulatory, and operational/administrative matters. Supervisory findings from the on- and off-site supervision processes are also used by the Development Division to assist the CCIs in enhancing their operations.</p> <p>The CSSDA's off-site supervision/monitoring and on-site examination functions benefit from their ongoing relationship with the independent Audit Office for Cooperatives Societies and the results of its annual audits of each CCI. These audits cover both financial and overall management/performance issues. CSSDA officers take part in the meetings with CCI management on results of the audit following each audit; they provide support for management's efforts to address any deficiencies identified in the audit.</p> <p>The CSSDA's on-site examination process began as a separate function within the CSSDA in November 2003; prior to that, the supervision and development functions were one group. A total of 16 examinations, including 4 that were conducted with the assistance of the Central Bank of Cyprus as part of a training exercise, have been conducted since the inception of the program. Examinations have included all sizes and complexity of CCIs, including the largest of these institutions. The CCI is normally notified in advance of a planned examination, but the CSSDA does, on occasion, conduct ad hoc examinations without prior notice.</p> <p>On-site examinations are planned using a basic risk-based approach, concentrating on those institutions that present the higher risks to the system, and using the findings of the off-site supervision/monitoring system, the findings of the independent external audit, and the knowledge about the CCI from the CSSDA's development officers as a base of knowledge on each institution. The CSSDA's goal is to conduct an annual examination of all CCIs that remain unaffiliated after the formation of the Central Body, as well as an annual examination of the Central Body and its affiliates, on a consolidated basis.</p> <p>The CSSDA's on-site supervision examines whether:</p> <ul style="list-style-type: none"> • the CCI complies with the CSL, by-laws, and regulations; • the organizational structure and the management is proper and effective; • the administrative and accounting procedures are adequate and effective; • the books and records are properly kept;
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	<ul style="list-style-type: none"> • the computerization as well as the internal control systems are adequate; • there are sufficient measures to prevent fraud and irregularities as well as money laundering; • the CCI has adopted and follows adequate loan evaluation and authorization procedures in order to minimize risk exposure; • the credit policies are followed, the loan portfolio is of good quality, and provisioning is adequate; • the loans in arrears are monitored; • adequate levels of liquidity are maintained; • the CCI's profitability is adequate; • the CCI's assets are properly safeguarded; and • the overall soundness and solvency of the institution is achieved. <p>In the course of the on-site examination, the reports to the institution's committee from their internal auditor, where they exist, are reviewed by the examiners.</p> <p>The findings of the on-site examination are provided to and discussed with the management of the CCI. Plans for corrective action, as necessary, are required from the institutions.</p> <p>Information on a wide variety of matters related to each CCI's activities is provided to the CSSDA through a series of periodic returns. Article 41JC(7) of the CSL states that such information provided is confidential, and Article 41H provides for the obligation of confidentiality for management and staff of the CSSDA and for sharing of such information for supervisory purposes. Article 41JC(1) gives the commissioner the power to demand and collect information useful for the exercise of his power pursuant to the co-operative law. Off-site supervision/monitoring involves the examination and analysis of these periodic returns, such as those relating to, inter alia, monthly statistical data, annual balance sheet and profit and loss accounts, the level of own funds, solvency ratio, large exposures, and credit facilities to staff and committee members. This monitoring covers the following:</p> <ul style="list-style-type: none"> • the level of deposits and their distribution per time duration and per interest rate; • the level of loans and whether they are within the set limits; • the distribution of loans per time duration and per sector of economic activity; • the level of loan excesses and arrears; • the level of liquid assets; • the liquidity ratio; and • returns, regarding the prudential requirements of Directive 2000/12/EC, such as Own Funds, Solvency Ratio, and Large Exposures. <p>Also, for all CCIs that are connected electronically to the central server of the Cooperative Computer Society (currently 220 CCIs, including all of the larger institutions), a uniform computerized recordkeeping and reporting system is in place that enables the supervisors to have effective and efficient access to ongoing financial information of the CCIs.</p> <p>Findings emerging during off-site supervision are analyzed, trended, and compared with other institutions and are verified during on-site supervision.</p> <p>Currently, the CSSDA is evaluating a comprehensive questionnaire that has been submitted by the CCIs regarding each institution's current overall condition (soundness, profitability, liquidity, etc.), as well as presenting a timetable scheme for compliance with the conditions for obtaining an ongoing operating license, as part of the program to harmonize the credit cooperative system in Cyprus with the requirements of the EU.</p>
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Assessment	Materially Noncompliant.
Comments	<p>Within 2004 and 2005, the CSSDA's on-site examination program has covered only a fraction of the large number of CCIs, although the examined CCIs account for 17 percent of the total loan portfolio of the sector. The program's implementation has been limited by the small number of current staff and the need for further training. CSSDA's management, in cooperation with the Government Personnel Department, has developed plans for augmenting supervision staff and training has already begun. The continuous monitoring of the CCIs that is exercised by the Development Division supplements the work of the Supervision Division and the findings of the independent AOCS assist the CSSDA's on-site work, but do not mitigate the need for completion of planned expansion and development of staff.</p> <p>Also, the CSSDA's ability to perform off-site supervision/monitoring is materially impacted by the limited size of the staff in the Supervision Division. Currently, this deficiency is somewhat mitigated by the oversight work performed by the Development Division; but, for the longer-term, Supervision Division staff should be augmented permanently.</p>
Principle 17.	<p>Bank Management Contact Banking supervisors must have regular contact with bank management and a thorough understanding of the institution's operations.</p>
Description	<p>The AOCS (which is responsible for performing the annual audit of the institutions' accounts) submits to the Commissioner the audited annual report for each institution. The CSSDA's officers hold meetings with the institution's Committee and the external auditors to discuss the results of their work and to agree on the action/measures for corrective action.</p> <p>The CSSDA's officers hold meetings (e.g., during and after on-site examinations) with the institution's committee members, department managers, and internal auditors, as well as senior management, to discuss matters relevant to the assessment of specific problems, the overall condition of the institution, and future prospects. Officers of CSSDA's Development Division have regular contact in performing their function to support the institution's supervisory, regulatory, and operational/administrative needs.</p> <p>The regular contact of the officers of the CSSDA's Development Division with the CCIs for which they have specific oversight and support responsibilities provides the CSSDA with an ongoing ability to maintain current knowledge of each institution's activities. The CSSDA's off-site supervision/monitoring program also provides an ongoing ability to understand the institution's activities and condition.</p> <p>Pursuant to Articles 12(2) and (3) of the CSL, no amendment of the by-laws (including material changes in their activities) of a registered society will be valid until the amendment has been registered under the CSL, for which purpose two copies of the amendment will be forwarded to the commissioner. If the commissioner is satisfied that any amendment of the by-laws is not contrary to the CSL or to the rules and the cooperative principles, takes into account the proper operation and financial position of the society in connection with the Cooperatives Societies general interest, registers the amendment.</p> <p>Also, pursuant to article 41Z(1)(b), the CSSDA's cCommittee has the power to define, regulate, and amend with a regulative decision: the accounts, the figures, or the information that have to be submitted periodically, or on certain occasions by the CCIs that apply to obtain or hold an operating license, as well as the form, the type, and the timeframes within which these must be submitted. The issuing of a regulative decision, based on the transitional provisions of the CSL, referring to the CSI's obligation to conform at least to their existing prudential levels and to notify the CSSDA of any material adverse developments regarding those prudential levels, is underway.</p>
Assessment	Largely Compliant.
Comments	The CSSDA should complete the issuance of its planned Regulative Decision to specifically require that each CCI notify it in a timely manner of any material changes in its activities and any adverse developments.

Principle 18.	<p>Off-Site Supervision Banking supervisors must have a means of collecting, reviewing, and analyzing prudential reports and statistical returns from banks on a solo and consolidated basis.</p>
Description	<p>Pursuant to Article 3(5) of the CSL, "... the Commissioner ... has the power to inspect the books, accounts, and documents of a registered society and every officer of such society shall provide the necessary facilitations and all of the requested information for such inspection." Article 41JC empowers the Commissioner "... to demand and collect information useful for exercising his powers pursuant to the cooperative law, and to demand through a written request the submission of this information within the set deadline, from registered cooperative credit institutions, their subsidiary companies, members of their committee or their board or the members of their Supervisory Board." This article also provides administrative sanctions for failure to comply with such requests or to fail to supply complete and accurate information or within prescribed timeframes. Information requested covers only the CCIs themselves, since they have no subsidiaries or affiliated companies.</p> <p>Supervision is carried out through off-site monitoring and on-site examination. Off-site supervision/monitoring is conducted and information is collected only on a solo basis, since cooperative societies do not currently have subsidiaries or affiliated companies. This monitoring covers the following:</p> <ul style="list-style-type: none"> • the level of deposits and their distribution per time duration and per interest rate; • the level of loans and whether they are within the set limits; • the distribution of loans per time duration and per sector of economic activity; • the level of loan excesses and arrears; • the level of liquid assets; • the liquidity ratio; and • returns, regarding the prudential requirements of Directive 2000/12/EC, such as own funds, solvency ratio, and large exposures. <p>The CSSDA requires the cooperative societies to submit, inter alia, the following periodic returns to facilitate its supervisory process:</p> <ul style="list-style-type: none"> • statistical data (monthly and annually) on: deposits by type and interest rate; loans by sector and interest rate; overdue and excess loans; maximum levels of lending and accepting of deposits; liquidity; share capital and reserves; and general expenses and revenues; • balance sheet accounts (annually); • profit and loss account (annually); • credit facilities to the CCI's committee members (semi-annually); • loans to legal entities (quarterly); • prudential requirements (own funds, solvency ration, large exposures, qualifying holdings outside the financial sector) (annually); and • balance sheet information on the CCIs that are connected to the CSSDA central processing system (220 CCIs) (monthly). <p>A range of additional detailed statistical and administrative information can be obtained from the CSSDA central processing system. All of these reports can be analyzed by CSSDA supervisory officers by individual CCI, by sector (e.g., region/geographic area), and by the entire industry. These analyses are used in the ongoing off-site monitoring, as well as in the planning and conduct of on-site examinations, of CCI's.</p> <p>Findings emerging during off-site supervision are analyzed, trended, and compared with other institutions and are verified during on-site supervision.</p>

	The CCIs also supply statistical information to the Central Bank of Cyprus, the Cooperative Central Bank, and the Statistics Service. A series of new and redesigned prudential and statistical reports are being developed by the CSSDA that will be in better harmony with EU requirements.
Assessment	Materially Noncompliant
Comments	<p>To date, the CSSDA’s off-site supervision/monitoring has been limited by the small number of current staff, although the Supervision Division staff is supplemented in some monitoring functions by CSSDA’s Development Division staff. CSSDA management has developed plans for augmenting overall supervision staff. There is a pressing need for the completion of planned expansion and development of supervision staff.</p> <p>The CSSDA is working to design and build new automated analytical/monitoring and early-warning systems that will use information provided by those CCIs that are and will be connected through the central server of the Cooperative Computer Society. Currently, the analysis uses information from existing returns and from the existing computer system. The CSSDA should proceed in a timely manner to establish a complete direct connection in order to facilitate its access to the central server.</p>
Principle 19.	<p>Validation of Supervisory Information</p> <p>Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.</p>
Description	<p>Pursuant to article 41D of the CSL, the commissioner is responsible for supervising compliance with that law. Article 41JD empowers the commissioner or a person authorized by him “...to conduct investigations necessary for the carrying out of his competences or for a possible violation of the provided obligations in virtue of the Cooperative Law and for the purpose of this he may:</p> <p>a) check the records, the books, the accounts and any other documents and data stored in computers at each cooperative credit institution or in the possession of any person for whom there is reasonable suspicion that he holds information of the Cooperative Credit Institution that may assist the Commissioner in his investigation, and to take copies or extracts from them; and</p> <p>b) to enter the office and professional premises of the persons under investigation.</p> <p>Also, pursuant to Article 3(5), “... the Commissioner ... has the power to inspect the books, accounts, and documents of a registered society and every officer of such society shall provide the necessary facilitations and all of the requested information for such inspection.”</p> <p>Article 41JC empowers the Commissioner “... to demand and collect information useful for exercising his powers pursuant to the cooperative law, and to demand through a written request the submission of this information within the set deadline, from registered co-operative credit institutions, their subsidiary companies, members of their Committee or their Board or the members of their Supervisory Board.”</p> <p>The scope of the both the CSSDAs on- and off-site supervisory activities includes the regular validation of the periodic supervisory information from the CCIs by the CSSDA’s Development Division, as well as its ongoing review and analysis by the Supervision/Monitoring Division. The CSSDA’s process for planning the scope and conducting on-site examinations includes assessing the results of the independent external audit and the prudential and statistical information provided by the CCIs through their periodic supervisory returns. Meetings are held following each examination to discuss the results and initiate corrective actions, as necessary.</p> <p>Article 19 of the CSL provides for the establishment and operation of the Inspections Service of Cooperative Societies (the independent AOCS). The Council of Ministers has issued the Cooperative Societies Audit Service Regulations (174/89, 14/92, 328/91, 115/98). The accounts of all CCIs are audited annually by the independent Audit Office of Cooperative Societies, a group within the Office of Auditor General of Cyprus. These audits are both financial audits</p>

	and overall management/performance audits. They address credit/compliance/ operational/ funding risk, as well as the financial audit of the society's financial statements. CSSDA officers participate in the independent AOCS' meetings with CCI management following each audit and provide support for the CCI's actions to correct identified deficiencies.
Assessment	Largely Compliant.
Comments	Within 2004 and 2005, the CSSDA's on-site examination program has covered only a fraction of the large number of CCIs, although the examined CCIs account for seventeen percent of the total loan portfolio of the sector. The program's implementation has been limited by the small number of current staff and the need for further training. CSSDA's, management in cooperation with the government personnel department, has developed plans for augmenting supervision staff and training has already begun. The continuous monitoring of the CCIs that is exercised by the Development Division supplements the work of the Supervision Division and the findings of the independent AOCS assist the CSSDA's on-site work, but do not mitigate the need for completion of planned expansion and development of staff.
Principle 20.	Consolidated Supervision An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.
Description	Currently, CCIs do not have subsidiaries or affiliated companies.
Assessment	Not Applicable.
Comments	However, pursuant to Article 41D(1)(e) of the CSL, the commissioner is responsible for supervising the compliance of the registered societies that will become affiliated to the Central Body with the provisions of the CSL, for the purposes of consolidated supervision.
Principle 21.	Accounting Standards Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly reflect its condition.
Description	<p>Articles 53(jb), (jc), and (jd) empower the Council of Ministers to issue rules for the better application of the provisions of the CSL and for the determination of every issue where determination is necessary. Such rules may:</p> <ul style="list-style-type: none"> • prescribe the accounts and books to be kept by a registered society, and provides for the periodical publication of a balance sheet showing the assets and liabilities of a registered society; • provide for the audit of the accounts of registered societies and for the charges, if any, to be paid for such an audit; and • prescribe the returns to be submitted by registered societies to the commissioner and the persons by whom and the form in which the same shall be submitted. <p>Article 19, which provides for the establishment and operation of the Inspections Service of Cooperative Societies (the independent Audit Office of Cooperative Societies), also provides for the annual audit of every CCI by it and requires that the accounts of the CCIs must be ready for audit within one month from the end of its economic year. The audit report must be provided to the CCI and to the commissioner upon its completion. The CCI provides information on the results of the audits to its management and members. Regulative Decision 59/2005 regarding the publishing of the annual accounts of CCIs states that accounts must be prepared and audited to establish a "true and fair view," in accordance with international auditing and accounting standards.</p> <p>Article 41JC empowers the commissioner to demand and collect information useful for exercising his powers pursuant to the CSL, and to demand through a written request the submission of this information within a set deadline, from registered cooperative credit institutions, their subsidiary companies, members of their committee or their board or the members of their supervisory board.</p>

Assessment	Compliant.
Comments	None.
Principle 22.	Remedial Measures Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking license or recommend its revocation.
Description	Article 41D(1)(d) of the CSL empowers the commissioner "... to take remedial measures, to cease the Committee or any officer, and to appoint a liquidator of registered societies that carry out the activities of a cooperative credit institution." Article 41(D)(2)(a) authorizes the commissioner to suspend or withdraw operating licenses and articles 41D(2)(c) and 41JE both authorize the imposition of administrative sanctions. Article 41F(3) and (4) empower the commissioner to withdraw the license of a CCI when anyone associated with the CCI fails to comply with the law, of any rule, order, or decision, or the terms of the license, or when the liquidity or solvency are diminished, or when the depositors or creditors' interests must be secured, as well as a range of other formal and informal remedial measures. Article 41F(3)(e) authorizes the commissioner to demand the removal or alteration of the duties of any CCI officer or employee and Article 43 describes the circumstances when and authorizes the commissioner to dismiss the committee of a CCI. The range of remedial measures available can be used in a timely manner commensurate with the severity of the issues involved. Actions may be taken against the institution, as well as against the individuals involved in the management and direction of it.
Assessment	Compliant.
Comments	None.
Principle 23.	Globally Consolidated Supervision Banking supervisors must practice global consolidated supervision over their internationally active banking organizations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organizations worldwide, primarily at their foreign branches, joint ventures, and subsidiaries.
Description	Currently, CCIs do not have overseas activities, joint ventures, or foreign branches or subsidiaries.
Assessment	Not Applicable.
Comments	However, pursuant to article 41G(1)(d) of the CSL, the committee of the CSSDA has the power to define, regulate, or amend, within the framework of the EU's acts that are in force in Cyprus, the conditions or terms of the operations of the branches or of the provision of cross-border services by registered societies that carry out the business of a cooperative credit institution in a member state or a third country.
Principle 24.	Host Country Supervision A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.
Description	Currently, CCIs do not have overseas activities, joint ventures, or foreign branches or subsidiaries.
Assessment	Not Applicable.
Comments	However, pursuant to Article 41D(1)(c) of the CSL, the Commissioner is responsible for "... the cooperation, exchange of information, verification of data, assigning or undertaking of the responsibility of prudential supervision of the co-operative credit institutions or of their subsidiaries or of other societies that appertain to the Commissioner's powers, with other competent supervisory authorities of a member state or of a third country, provided that the communicated information is covered, as regards to the professional secrecy, by guaranteed liabilities."
Principle 25.	Supervision Over Foreign Banks' Establishments Banking supervisors must require the local operations of foreign banks to be conducted with the same high standards as are required of domestic institutions and must have powers to

	share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.
Description	Currently, there are no branches or subsidiaries of foreign credit cooperative societies in Cyprus.
Assessment	Not Applicable.
Comments	However, pursuant to Articles 41(D)(b) and (c) of the Cooperatives Societies Law, the commissioner is responsible for "... the cooperative credit institutions that have established a branch or that provide cross-border services to the Republic, the control of liquidity, the market risk, as well as the abiding by these to the principles set from time to time as to the monetary policy..." and "... the cooperation, exchange of information, verification of data, assigning or undertaking of the responsibility of prudential supervision of the cooperative credit institutions or of their subsidiaries or of other societies that appertain to the Commissioner's powers, with other competent supervisory authorities of a member state or of a third country, provided that the communicated information is covered, as regards to the professional secrecy, by guaranteed liabilities."

Table 5. Summary Compliance of the Basel Core Principles (CSSDA)

Core Principle	C ^{1/}	LC ^{2/}	MNC ^{3/}	NC ^{4/}	NA ^{5/}
1. Objectives, Autonomy, Powers, and Resources					
1.1 Objectives			X		
1.2 Independence			X		
1.3 Legal framework	X				
1.4 Enforcement powers	X				
1.5 Legal protection	X				
1.6 Information sharing	X				
2. Permissible Activities			X		
3. Licensing Criteria	X				
4. Ownership					X
5. Investment Criteria		X			
6. Capital Adequacy		X			
7. Credit Policies			X		
8. Loan Evaluation and Loan-Loss Provisioning			X		
9. Large Exposure Limits			X		
10. Connected Lending			X		
11. Country Risk					X
12. Market Risks		X			
13. Other Risks			X		
14. Internal Control and Audit		X			
15. Money Laundering		X			
16. On-Site and Off-Site Supervision			X		
17. Bank Management Contact		X			
18. Off-Site Supervision			X		
19. Validation of Supervisory Information		X			
20. Consolidated Supervision					X
21. Accounting Standards	X				
22. Remedial Measures	X				
23. Globally Consolidated Supervision					X
24. Host Country Supervision					X
25. Supervision Over Foreign Banks' Establishments					X

^{1/} C: Compliant.^{2/} LC: Largely compliant.^{3/} MNC: Materially non-compliant. ^{4/} NC: Non-compliant.^{5/} NA: Not applicable.

H. Recommended Action Plan and Authorities' Response to the Assessment

Recommended action plan

Table 6. Recommended Action Plan to Improve Compliance of the Basel Core Principles (CSSDA)

Reference Principle	Recommended Action
CP 1.1 Objectives	Manage changes during the transitional period through a global change committee.
CP 1.2 Independence	Full government support of supervisory strengthening capacity.
CP 2 Permissible Activities	Finalize regulatory decision defining permissible services and activities. Make provision that the term "Cooperative Credit Institution" or any derivative of this term cannot be used without the approval of the CSSDA.
CP 5 Investment Criteria	Finalize regulatory decision regarding participation in other enterprises.
CP 6 Capital Adequacy	Mandatory semi-annual reporting on each CCI's compliance with capital requirements regime.
CP 7 Credit Policies	Strengthen supervisory capacity. Enhance the supervisors' capacity to evaluate loan policies.
CP 8 Loan Evaluation	Strengthen supervisory capacity. Provide for additional prudential reporting.
CP 9 Large Exposure Limits	Strengthen supervisory capacity.
CP 10 Connected Lending	Strengthen supervisory capacity. Facilities to connected persons should not be granted on terms more favorable than those used in the normal course of business.
CP 12 Market Risks	Adjust and develop expertise to supervise new risks.
CP 13 Other Risks	Strengthen supervisory capacity. Organize accelerated access to centralized reporting system regarding interest rate risk.
CP 14 Internal Controls	Strengthen supervisory capacity. Undertake efforts to encourage mergers favoring critical mass and organizational capabilities of CCIs.
CP 15 Money Laundering	Update guidance note.
CP 16 On-site and Off-site Supervision	Strengthen supervisory capacity.
CP 17 Bank Management Contact	Impose mandatory and timely communication of material changes in activities and adverse developments.
CP 18 Off-site Supervision	Strengthen supervisory capacity. Accelerate direct connection to central data server.
CP 19 Validation of Supervisory Information	Strengthen supervisory capacity.

Authorities' response to the assessment

Recommended Actions	Planned Action
<p>CP 1.1 Objectives: Manage changes during the transitional period through a global change committee.</p>	<p>Changes during the transitional period are managed through strong cooperation between the CSSDA, the Cooperative Central Bank, the Pancyprian Cooperative Confederation and the Audit Office of Cooperative Societies.</p>
<p>CP 1.2 Independence Full government support of supervisory strengthening capacity</p>	<p>The Parliament has approved the enhancement of CSSDA (Official Gazette July 2005). The scheme provides for 17 additional staff and the upgrading of the salary levels of the officers. Fourteen officers from the additional staff will reinforce the supervisory staff, tripling the present supervisory resources.</p>
<p>CP 2 Permissible Activities Finalize regulatory decision defining permissible services and activities. Make provision that the term "Cooperative Credit Institution" or any derivative of this term cannot be used without the approval of the CSSDA</p>	<p>A Regulatory Decision will be issued as soon as possible.</p>
<p>CP 5 Investment Criteria Finalize regulatory decision regarding participation in other enterprises.</p>	<p>A Regulatory Decision will be issued as soon as possible.</p>
<p>CP 6 Capital Adequacy Mandatory semi-annual reporting on each CCI's compliance with capital requirements regime.</p>	<p>The Committee has approved a new Regulative Directive introducing CAD II. This decision was published in the Official Gazette in April 2005. Based to the above, a Commissioner's Directive is going to be issued regarding the mandatory semi-annual reporting on each CCI's compliance with capital requirements regime.</p>
<p>CP 7 Credit Policies Strengthen supervisory capacity. Enhance the supervisors' capacity to evaluate loan policies.</p>	<p>Recruitment of additional staff (see CP 1.2 above). Further relevant training will be undertaken.</p>
<p>CP 8 Loan Evaluation Strengthen supervisory capacity. Provide for additional prudential reporting</p>	<p>The CSSDA is working to design and build new automated analytical monitoring and early-warning systems that will use information provided by those CCIs that are and will be connected through the central server of the Cooperative Computer Society. Additional Prudential reporting for loan loss provisions will be required.</p>
<p>CP 9 Large Exposure Limits Strengthen supervisory capacity.</p>	<p>The CSSDA is currently revising and updating its return on large exposures. A Regulatory Decision will be issued as soon as possible.</p>
<p>CP 10 Connected Lending Strengthen supervisory capacity. Facilities to connected persons should not be granted on terms more favorable than those used in the normal course of business.</p>	<p>An amendment of the Law in order to explicitly provide for that, will take place</p>
<p>CP 12 Market Risks Adjust and develop expertise to supervise new risks.</p>	<p>Relevant training will be undertaken.</p>

Recommended Actions	Planned Action
<p>CP 13 Other Risks Strengthen supervisory capacity. Organize accelerated access to centralized reporting system regarding interest rate risk.</p>	<p>This information is currently available to the management of the CCIs. The CSSDA supervisors will have direct access when the project of prudential reporting is completed.</p>
<p>CP 14 Internal Controls Strengthen supervisory capacity. Undertake efforts to encourage mergers favoring critical mass and organizational capabilities of CCIs</p>	<p>Due to the ongoing efforts to encourage mergers in the Cooperative Credit Sector we have already reached promising results. In the first half of this year the number of Cooperative Credit Institution's due to the merging procedure has decreased from 358 to 348.</p>
<p>CP 15 Money Laundering Update guidance note.</p>	<p>Guidance notes by CSSDA have been finalized and issued on 16/05/2005.</p>
<p>CP 16 On-site and Off-site Supervision Strengthen supervisory capacity.</p>	<p>Recruitment of additional staff (see CP 1.2 above) and Continuous Training.</p>
<p>CP 17 Bank Management Contact Impose mandatory and timely communication of material changes in activities and adverse developments.</p>	<p>Relevant Regulatory Decision will be issued as soon as possible</p>
<p>CP 18 Off-site Supervision Strengthen supervisory capacity. Accelerate direct connection to central data server.</p>	<p>The CSSDA has accelerated direct connection to the central data server and use information provided by those CCIs that are and will be connected through the central server of the Cooperative Computer Society.</p>
<p>CP 19 Validation of Supervisory Information Strengthen supervisory capacity.</p>	<p>Recruitment of additional staff (see CP 1.2 above).</p>

II. DETAILED ASSESSMENT OF OBSERVANCE OF THE IAIS INSURANCE CORE PRINCIPLES

A. General

21. With the agreement of the supervisor of insurance, the mission assessed the observance of the IAIS Core Principles using the October 2003 Core Principles Methodology. The assessments were undertaken in the context of the Offshore Financial Center (OFC) Assessment Program.

B. Information and Methodology used for Assessment

22. The assessment was based on discussions held with the superintendent of insurance and her deputy, the staff of the Insurance Company Control Service (ICCS), representatives from domestic insurance companies, the Insurance Association of Cyprus, an auditor, and the Association of Actuaries of Cyprus. The assessment was carried out by Henning Göbel. The assessment considered several documents:

- Law on Insurance Services and other related Issues of 2002 (LIS);
- Amendments I to V to the LIS;
- Guidance for the submission of an application to carry on Insurance business;
- Guidance notes on the completion of the annual returns under the LIS;
- Orders concerning the format and contents of annual accounts;
- Report on Insurance in Cyprus for the years 1983–2002; and
- The Audit of Insurers in Cyprus, published by the Institute of Certified Public Accountants of Cyprus.

23. Cyprus joined the EU in May 2004. The assessment therefore gave particular attention to the insurance-specific directives in Cypriot law. A technical assistance report providing advice on how to address some of the issues identified by the assessment was also provided to the authorities.

C. Institutional and Macprudential Setting—Overview

24. There are currently 44 companies being supervised under the powers of the SI. The total gross written premiums (GWP) of those companies are £C 415.7 million. The total underwriting results are £C 12.6 million. (All figures in the text are based on results at December 2003, as annual returns at Dec 2004 had not been returned to the SI at the time of the mission).

25. The following table ranks Cyprus according to the Sigma Report on world insurance markets for 2003:

Table 7. Cyprus: Market Share as Rank of World Market and European Markets

Line of Business	World Market Rank	European Market Rank (of 34 countries)
Total Market	56	28
Life Insurance	51	25
General Lines	67	31

26. With a penetration of slightly below 6 percent of GDP and less than \$1,000 premiums per capita, Cyprus ranks at the lowest end of the 25 EU countries; only Malta and Greece have lower premiums per capita.

27. Life insurance was the dominant line of business from 1994 until 2003. During that period, the market share of life insurance grew steadily from 50.1 percent to 54.4 percent in 1998. It peaked in 1999 with a market share of 77.6 percent, when life premiums more than tripled from £C 111,149 to £C 338,723. Since then, the market share has dropped from 67.3 percent in 2000 down to 50.2 percent in 2003 with a stable total premium of £C 154 million.

The very specific characteristic of the Cypriot life insurance market is the enormously high market share of unit-linked products. Currently, their market share is approximately 75 percent. According to SwissRe's Sigma Report No. 3/2003, unit-linked products had a 35 percent share of the Western European market. The high share is due to two factors. First, the development of the Cypriot insurance market follows closely the trends in the U.K. market. Second, private customers had no access to mutual funds until 2003. Unit-linked life insurance products were therefore in high demand as a savings vehicle in which to invest at the time of a booming stock market.

28. The increase in life insurance premiums was primarily generated by single premium policies. The underlying growth rate was between 12 percent and 18 percent for 1997 to 2000.

29. General lines insurance has regained its share in the Cypriot market and in 2003 accounted for £C 105 million of GWP, with an increase of almost 13 percent in 2004 according to the Insurance Association of Cyprus based on unconfirmed preliminary results. This increase is due to rate increases, particularly in motor insurance, and the development of the fire and property classes.

30. The following tables list the supervised companies for general lines and core data for them received during the assessment mission:

Table 8. Domestic Non-Life Insurance Market by Company, 2003 and 2004

Company name	Company Status	Gross Written Premium	Net Earned Premium	Assets	Equity	Technical Reserve	Underwriting result	Domestic Market share	Cumulative market share
		(in thousands of Cyprus pounds)						(percentage)	
Laiki Insurance Co. Ltd	Not listed								
	2003	23,384	13,026	40,671	5,811	29,578	617	22.2	22.2
	2004	26,034	15,014	47,948	6,848	33,286	1,390	20.8	20.8
General Insurance Cyprus Ltd	Not listed								
	2003	19,067	8,322	35,074	8,321	20,940	901	18.1	40.4
	2004	22,905	10,940	41,961	9,667	24,902	3,808	18.3	39.0
Pancyprian Insurance Ltd.	Not listed								
	2003	11,534	5,964	22,560	3,545	12,293	-432	11.0	51.3
	2004	13,248	7,555	23,895	4,315	13,342	230	10.6	49.6
Atlantic Insurance Co. Ltd	Listed								
	2003	7,985	6,094	15,296	9,100	6,265	938	7.6	58.9
	2004	9,466	6,978	18,209	10,731	7,535	1,009	7.5	57.1
American Home Assurance Company	Not listed								
	2003	7,359	2,079	14,340	3,801	8,749	-177	7.0	65.9
	2004	6,492	2,175	13,925	4,673	7,893	869	5.2	62.3
Commercial Union Assurance Cy	Not listed								
	2003	7,044	5,078	17,638	8,451	7,151	-505	6.7	72.6
	2004	8,548	6,424	19,475	9,126	8,254	66	6.8	69.1
Cosmos Insurance Co. Ltd	Listed								
	2003	6,275	4,716	8,943	3,153	4,598	385	6.0	78.6
	2004	9,527	7,957	11,756	3,543	6,228	160	7.6	76.7
Eurosure Insurance Co. Ltd	Not listed								
	2003	4,934	3,417	5,814	928	3,904	-9	4.7	83.3
	2004	5,477	3,705	7,207	1,478	4,688	-258	4.4	81.1
Royal Crown Insurance Co. Ltd	Not listed								
	2003	4,755	2,642	8,291	1,401	4,808	220	4.5	87.8
	2004	5,371	3,024	8,840	2,040	4,810	652	4.3	85.4
Ethniki General Ins. Cyprus Ltd	Not listed								
	2003	3,246	1,514	5,333	1,134	3,111	-164	3.1	90.9
	2004	3,450	2,121	6,219	1,325	3,851	196	2.8	88.1
Kentriki Ins. Co. Ltd	Not listed								
	2003	2,658	1,695	4,148	1,395	1,796	136	2.5	93.4
	2004	2,857	1,791	4,578	1,526	1,982	131	2.3	90.4
Progressive Ins. Co. Ltd	Not listed								
	2003	2,336	992	5,335	1,387	3,227	132	2.2	95.6
	2004	1,951	1,143	6,103	1,457	3,844	161	1.6	91.9
Hydra Insurance Co. Ltd	Not listed								
	2003	2,011	1,818	3,155	1,137	1,505	3	1.9	97.6
	2004	3,813	2,782	4,055	1,163	2,287	42	3.0	95.0
Gan Direct Insurance Ltd	Not listed								
	2003	1,056	901	1,790	502	557	122	1.0	98.6
	2004	1,927	1,090	2,822	816	713	231	1.5	96.5
Olympic Insurance Co. Ltd	Not listed								
	2003	796	553	1,920	947	758	186	0.8	99.3
	2004	2,035	531	2,122	1,057	818	127	1.6	98.1
Ydrogios Insurance Co (Cyprus) Ltd	Not listed								
	2003	505	32	1,530	855	390	-280	0.5	99.8
	2004	2,245	1,010	2,349	1,065	1,223	160	1.8	99.9
Ledra Insurance Ltd	Not listed								
	2003	145	533	2,003	775	911	-102	0.1	99.9
	2004	80	29	1,742	855	745	69	0.1	100.0
Hermes Insurance Ltd	Not listed								
	2003	67	10	5,385	5,291	33	25	0.1	100.0
	2004	19	3	5,360	5,360	24	5	0.0	100.0
Total									
	2003	105,157	59,386	199,226	57,934	110,574	1,996	100	--
	2004	125,445	74,272	228,566	67,045	126,425	9,048	100	--

Source: Insurance Companies Control Service

Table 9. International Non-Life Insurance Companies, 2003 and 2004

Company name	Company Status	Gross Written Premium	Net Earned Premium	Assets	Equity	Technical Reserve	Under-writing result
(in thousands of Cyprus pounds)							
Alliance International Reinsurance Co. Ltd.	Listed						
	2003	18,315	13,703	41,147	25,055	13,786	546
	2004	16,137	13,944	41,433	25,595	13,910	962
Mol Reinsurance Co Ltd	Not listed						
	2003	8,659	4,110	7,017	6,567	12	3,698
	2004	9,061	2,926	8,806	7,013	8,539	932
Ami Alpha Marine Ins. Co. Ltd	Not listed						
	2003	5,655	520	2,877	1,825	505	748
	2004	6,988	736	4,943	2,787	6,118	950
Hellenic Hull Mutual	Not listed						
	2003	5,540	3,814	6,637	-1,009	5,235	-170
	2004	3,902	2,982	4,296	-381	4,274	-267
Trust Int' Nal Ins.Co(Bahrain) Ltd (Non-Eu Branch)	Not listed						
	2003	5,178	1,956	12,971	1,369	7,385	106
	2004	5,292	2,941	9,633	1,355	5,446	16
Arab German Insurance Co Ltd (Non-Eu Branch)	Not listed						
	2003	4,248	1,713	3,934	-7	3,576	-153
	2004	3,034	1,823	3,584	306	1,987	218
Trust Int' Nal Ins.Co(Cyprus) Ltd	Not listed						
	2003	4,163	69	20,983	14,903	3,452	-358
	2004	3,821	73	23,352	18,688	3,838	1,095
Raets Insurance Company	Not listed						
	2003	2,837	2,433	3,148	437	1,096	-556
	2004	...	...	...	...	...	...
Berytus Marine Ins. Co. Ltd	Not listed						
	2003	1,942	913	3,025	619	1,915	285
	2004	1,546	679	2,765	776	1,558	-137
B&B Marine Insurance Ltd	Not listed						
	2003	316	316	2,140	2,123	0	240
	2004	884	884	2,279	2,271	884	320
V.T.I Insurance Co. Ltd	Not listed						
	2003	31	-24	358	331	19	-24
	2004	...	...	...	...	...	...
CP Reinsurance	Not listed						
	2003	...	...	...	...	...	...
	2004	113,223	113,223	100,336	34,216	61,920	28,304
Total							
	2003	56,884	29,523	104,237	52,213	36,981	4,362
	2004	163,888	140,211	201,427	92,626	108,474	32,393

Source: Insurance Companies Control Service

31. The following tables list the supervised life companies and core data for them received during the assessment mission:

Table 10. Domestic Life Market by Company, 2003 and 2004

Company name	Listed	Gross Written Premium	Net Earned Premium	Assets	Equity	Technical Reserve	Under-writing result	Market share in percentage	Cumulative market share in percentage
		(in thousands of Cyprus pounds)						(percentage)	
Laiki Cyprialife Ltd	Not listed								
	2003	43,023	38,317	210,409	16,906	185,330	1,784	28.4	28.4
	2004	41,846	36,598	219,989	19,406	194,564	3,027	27.6	55.8
Eurolife	Not listed								
	2003	41,867	37,964	209,756	15,301	184,632	5,202	27.6	56.1
	2004	42,725	37,973	217,080	15,522	192,175	3,101	28.2	28.2
Universal Life Insurance Co. Ltd	Not listed								
	2003	37,495	32,796	233,134	6,536	211,145	-177	24.8	80.8
	2004	36,558	31,678	227,121	6,508	201,345	2,441	24.1	79.9
American Life Insurance Co.	Not listed								
	2003	18,085	15,688	104,219	11,758	87,490	-219	11.9	92.8
	2004	18,294	15,667	115,549	13,863	96,486	1,438	12.1	92.0
Liberty Life Insurance Public Co Ltd	Listed								
	2003	5,111	4,967	18,285	1,982	12,865	-509	3.4	96.1
	2004	5,007	4,879	17,281	2,205	11,642	609	3.3	95.3
Aspis Pronia Ltd	Not listed								
	2003	2,364	1,917	5,966	873	4,914	340	1.6	97.7
	2004	2,324	1,869	6,823	880	5,629	-208	1.5	98.5
Ethniki Insurance (Cyprus) Ltd	Not listed								
	2003	2,155	1,818	10,994	3,938	6,572	-127	1.4	99.1
	2004	2,574	2,107	11,412	3,856	7,317	-77	1.7	97.0
Hellenic Alico Life Co. Ltd	Not listed								
	2003	1,318	846	2,488	1,196	212	320	0.9	100.0
	2004	2,250	1,610	4,164	1,673	613	497	1.5	100.0
Total									
	2003	151,418	134,313	795,251	58,490	693,160	6,614	100	--
	2004	151,578	132,381	819,419	63,913	709,771	10,828	100	--

Source: Insurance Companies Control Service

Table 11. International Life Insurance Companies, 2003 and 2004

Company name	Listed	Gross Written Premium	Net Earned Premium	Assets	Equity	Technical Reserve	Under-writing result
(in thousands of Cyprus pounds)							
Akelius Insurance Co. Ltd	Not listed						
	2003	44,469	44,468	320,643	5,707	314,831	-2,274
	2004	23,361	23,361	262,649	12,936	226,985	6,998
Medlife Insurance Ltd	Not listed						
	2003	22,807	21,176	107,532	9,312	81,960	796
	2004	24,625	22,954	112,583	14,355	81,263	1,729
Axioma Insurance Co. Ltd	Not listed						
	2003	774	708	2,891	669	2,158	27
	2004	865	755	3,321	666	2,602	48
Total							
	2003	68,050	66,352	431,066	15,688	398,949	-1,451
	2004	48,851	47,070	378,553	27,957	310,850	8,775

Source: Insurance Companies Control Service

32. The following table lists the supervised composite companies and core data for them received during the assessment:

Table 12. Composite Companies, 2003 and 2004

Company name	Company status	Gross Written Premium	Net Earned Premium	Assets	Equity	Technical Reserve	Underwriting result
(in thousands of Cyprus pounds)							
Domestic							
Interlife Insurance Co. Ltd	Not listed						
	2003	10,928	9,376	20,484	1,762	16,185	-683
	2004	12,342	10,600	25,356	2,242	20,576	-371
Minerva Insurance Company Ltd	Listed						
	2003	10,595	8,969	38,928	12,394	21,385	-387
	2004	10,994	9,764	37,659	10,211	22,328	-435
Alpha Insurance Ltd	Not listed						
	2003	8,425	5,934	16,876	1,905	12,461	181
	2004	9,643	6,734	19,707	2,157	14,577	310
Total							
	2003	29,948	24,279	76,288	16,061	50,031	-889
	2004	32,979	27,098	82,722	14,610	57,481	-496
Transacting business outside of Cyprus							
Grawe Reinsurance Ltd	Not listed						
	2003	4,239	6,826	30,443	20,969	9,426	1,981
	2004	9,156	9,058	33,668	22,724	10,985	2,484

Source: Insurance Companies Control Service

33. The following tables show the total premiums by core line of business for both domestic companies and those doing business outside of Cyprus, as received during the assessment mission:

Table 13. Domestic Premiums by Line of Bussiness, 2003 and 2004

	Gross Written Premium	Net Earned Premium	Assets	Equity	Technical Reserve	Under- writing Result
(in thousands of Cyprus pounds)						
Non-Life						
2003	105,157	59,386	199,226	57,934	109,221	1,996
2004	125,445	74,272	228,566	67,045	126,425	9,048
Life						
2003	151,418	150,340	795,251	58,490	693,160	6,614
2004	151,578	132,381	819,419	63,913	709,771	10,828
Composite						
2003	29,948	24,279	76,288	16,061	50,031	-889
2004	32,979	27,098	82,722	14,610	57,481	-496
Total Market						
2003	286,523	234,005	1,070,765	132,485	852,412	7,721
2004	310,002	233,751	1,130,707	145,568	893,677	19,380

Source: Insurance Companies Control Service

Table 14. Premium by Line of Business for Companies Transacting Business Outside of Cyprus, 2003 and 2004

	Gross Written Premium	Net Earned Premium	Assets	Equity	Technical Reserve	Under- writing Result
(in thousands of Cyprus pounds)						
Non-Life						
2003	56,884	29,523	104,237	52,213	36,981	4,362
2004	163,888	140,211	197,843	92,320	108,474	32,393
Life						
2003	68,050	67,983	431,066	15,688	398,949	-1,451
2004	48,851	47,070	378,553	27,957	310,850	8,775
Composite						
2003	4,239	6,826	30,443	20,969	9,426	1,981
2004	9,156	9,058	33,668	22,724	10,985	2,484
Total						
2003	129,173	104,332	565,746	88,870	445,356	4,892
2004	221,895	196,339	610,064	143,001	430,309	43,652

Source: Insurance Companies Control Service

D. Principle-by-Principle Assessment

34. The assessment of the insurance supervision has been based on the Insurance Core Principles of the IAIS. The assessment was conducted against the essential criteria for all principles.

35. There were no differences in the supervision of companies conducting domestic business, and those acting as offshore companies. As part of the assessment, one company conducting business solely with customers outside Cyprus was visited.

Table 15. Detailed Assessment of Observance of the IAIS Insurance Core Principles

Conditions for Effective Insurance Supervision	
Principle 1.	Conditions for effective insurance supervision - Insurance supervision relies upon -a policy, institutional and legal framework for financial sector supervision -a well developed and effective financial market infrastructure efficient financial markets.
Description	Financial sector policy framework The government has established a policy statement aimed at ensuring financial stability, including the provision of effective insurance supervision. The institutional and legal framework—comprising public institutions, laws and regulations—exists for financial sector issues, including those pertaining to insurance, and system-wide issues. This framework is well defined and publicly disclosed.

	<p>The Law on Insurance Services and other Related Issues of 2002 (LIS) sets out the legal framework under which insurance companies are allowed to operate in Cyprus. The administrative supervision of the application of the provisions of this law is assigned under s4 to a Superintendent of Insurance (SI) and one Assistant SI. The appointment is made by the Council of Ministers. The SI can make use of a service to perform his duties. This service is established as the Insurance Companies Control Service (ICCS).</p> <p>The law does not specify a reporting relationship between SI and the MoF. However, the MoF is in almost all cases the institution for an appeal. According to the SI, the MoF has not exercised a veto so far.</p> <p>The SI also chairs an Insurance Advisory Committee (IAC) which is composed of the SI, her deputy and four individuals appointed by the MoF after consultation with the Insurance Association of Cyprus. Terms of reference for this IAC are set out in s9.</p> <p>Regulations, other than the LIS, have not been issued to provide clear instructions to companies on how to comply with the law. The ICCS should at least define minimum requirements for insurance undertakings to set clear expectations as to how the LIS has to be applied.</p> <p>Financial market infrastructure</p> <p>The judicial infrastructure is reliable and decisions are enforceable. In the absence of a developed national GAAP, Cyprus applied IAS and for insurance specific application U.K.-GAAP. Accounting, actuarial, and auditing standards are comprehensive, documented, transparent, and consistent with international standards. Therefore, the transformation to IFRS4 will be based on similar evaluation rules.</p> <p>The Institute of Certified Public Accountants of Cyprus (ICPAC) sets standards for the auditing of insurance undertakings through technical circulars which provide technical guidance. These standards are accessible. It has to be stated that the ICCS is not consulted and does not require consultation prior to the issue of these circulars, nor does the ICCS provide regulation in addition to the provisions set out in the LIS. There is also basic statistical information available to the public, included in the information provided by the MoF and—with a two-year delay—and through the “Report on Insurance in Cyprus” issued by the ICCS.</p> <p>There was no evidence to doubt the existence of an appropriate infrastructure which would allow insurance companies to make firm investment decisions and to ensure that investments are secured within the jurisdiction.</p>
Assessment	Largely observed.
Comments	Regulation has to be defined to set a frame in which insurance undertakings can operate and in order to create clear expectations from a supervisory standpoint towards the companies.
The Supervisory System	
Principle 2.	<p>Supervisory objectives</p> <p>The principal objectives of insurance supervision are clearly defined.</p>
Description	<p>The supervisory objectives are stated in the LIS. They are broad and general but cover all relevant areas. The objectives of the SI—apart from enforcing the LIS—are not clearly defined. The LIS refers in s5(2) to administrative functions only: “The functions of the Superintendent are the granting and the withdrawal of the licence to carry on insurance business, the taking of measures prescribed by the Law in the event of violation of the legislation in force and the exercise of preventive or suppressive control, in relation to the provisions in Part XIII of the Law.”</p> <p>There is no specific law or administrative act which defines objectives or powers of the SI in addition to the rather vague description set out in the LIS.</p> <p>There is also no regular report on activities of the ICCS to the public. Neither the SI nor the staff of the ICCS have received precise performance indicators.</p> <p>Priorities are set by the SI for the ICCS and comprise mainly the transposition of European</p>

	directives into national legislation.
Assessment	Largely observed.
Comments	Clear objectives and measures should be defined for the SI. The SI should issue a report on its activities and achievements on a regular basis. Moreover, the SI should issue regulations to inform the industry how it wants the LIS to be applied.
Principle 3.	<p>Supervisory authority</p> <p>The supervisory authority:</p> <ul style="list-style-type: none"> – has adequate powers, legal protection and financial resources to exercise its functions and powers; – is operationally independent and accountable in the exercise of its functions and powers; – hires, trains and maintains sufficient staff with high professional standards; and – treats confidential information appropriately.
Description	<p>Legal framework</p> <p>The LIS identifies the SI as responsible for the supervision of insurance entities. It also gives the SI power to issue and enforce rules by administrative means.</p> <p>The SI is entitled to issue circulars and further regulation although the ICCS has not made significant use of this power. There is a draft entitled “Orders for insurance companies to set and maintain prudential standards”. These standards, however, have been in draft since 2002. The standards should be further developed and should be published as the definition of sound insurance principles according to LIS, s21(1)(e).</p> <p>The SI is the principal addressee of any lawsuit and is a civil servant; there is a principal discharge of responsibilities to third parties.</p> <p>Independence and accountability</p> <p>As the LIS names the SI alone as the principle authority to carry out the supervision of insurance undertakings, a governance structure of the supervisory authority is not clearly defined. Internal governance procedures necessary to ensure the integrity of supervisory operations, including internal audit arrangements, are in place to a limited extent.</p> <p>The institutional relationships between the SI and executive and the judiciary branches are clearly defined and transparent. Circumstances where executive overrides are allowed are specified. The SI and its staff are free from undue political, governmental, and industry interference in the performance of supervisory responsibilities. However, almost all sanctions imposed by the SI can be appealed to the MoF. S.43, s96(2) and s202(5) basically entitle the MoF to overrule well-founded decisions by the SI. Moreover, s43 lays out the procedure for an appeal but does not provide a clear indication as to whether the decision subjected to appeal should stay in force during the appeal process. It is fair to state that the executive branch can overrule almost every sanction imposed by the SI.</p> <p>The SI and ICCS are not financed in a proper manner and that undermines the supervisor’s independence from political, governmental, or industry bodies. Although the supervisory authority has discretion to allocate its resources in accordance with its mandate and objectives, and the risks it perceives, it suffers from having no control over a budget and being entirely dependent on financial decisions of the MoF. The ability to perform its duties is thus undermined. The SI cannot react appropriately to emerging situations. Due to budgetary constraints, the SI was unable to receive the support of external auditing firms in the conduct of on-site inspections.</p> <p>In the absence of further established regulation, the decision-making process is very individualized and therefore difficult for the insurance undertakings to predict. All material changes to the insurance legislation and supervisory practices have been subject to prior consultations with market participants and the transposition of European directives has been the subject of consultation with industry and distribution associations.</p> <p>Currently, there is no regular and structured way of communicating with the interested public about supervisory actions taken.</p>

	<p>Powers</p> <p>Adequate powers would require that the SI be able to take immediate action to achieve its objectives, especially to protect policyholders' interests. Based on the LIS, s41, the SI does have appropriate legal powers to react immediately to a given situation where a significant violation of the LIS has taken place. An immediate withdrawal of a license is possible, even if an appeal to the MoF will be made subsequently.</p> <p>Financial resources</p> <p>None of the criteria is met. The ICCS has no budget or control over financial resources to perform its duties independently. Given the current processes and priorities set by the SI, the ICCS appears understaffed and has no access to an appropriate recruitment process. There is no budgetary responsibility and the recruitment process is not influenced by the SI. Recent postings of vacancies have taken more than 1.5 years and did not lead to recruitment. On-site inspections with support from third parties such as auditors or actuaries have not been carried out for the last three years.</p> <p>As a result of its lack of financial independence, the SI does not publish audited financial statements on a regular basis.</p> <p>Human resources and legal protection</p> <p>The criteria are not met. Moreover, the composition of staff within the ICCS does not reflect appropriate skills. The expertise on actuarial expertise is outsourced to the Governmental Actuarial Services Department (GaD). Due to the absence of qualified actuaries or mathematicians, responses from the GaD cannot be challenged by the ICCS. The current ICCS structure as laid out by the SI consists of the SI, an Assistant SI, and Senior Accounting Officer, four accounting officers, and one economic officer..</p> <p>Confidentiality</p> <p>The supervisory authority maintains appropriate safeguards for the protection of confidential information in its possession. Other than when required by law or when requested by another supervisor who has a legitimate supervisory interest, the SI would deny requests for the disclosure of confidential information. Also, third parties contracted by the SI are subject to the same confidentiality and code of conduct requirements as the staff of the supervisory authority. The LIS provides (in s7 and s8) appropriate measures to ensure confidentiality. No breaches have been reported during interviews conducted for this assessment.</p>
Assessment	Partially observed.
Comments	The SI has to be granted a budget in order to perform the duties laid out in the LIS. Also, the SI should be charged with producing a plan setting out the priorities for a given period of at least a year. Those plans would set clear expectations for the council of ministers and for the staff of the ICCS. Most importantly, there is an urgent need to assess the composition of skills required to exercise the powers of the LIS. Whether all the skills identified will have to be allocated within the ICCS remains to be seen. At the time this assessment was carried out, the SI was not provided with adequate resources to perform insurance supervision, which is able to respond to critical situations.
Principle 4.	<p>Supervisory process</p> <p>The supervisory authority conducts its functions in a transparent and accountable manner.</p>
Description	<p>Transparency and accountability</p> <p>The supervisory authority has not adopted clear, transparent, and consistent regulatory and supervisory processes. The supervisory authority applies all regulations and administrative procedures consistently, but supervisory actions are based on individual decisions. Hence, any decisions take the company's specific situation into account. Thus, the process of decision making is extremely individualized. This is not necessarily in contradiction with the ICPs. Its disadvantage is that decisions cannot be predicted by the companies.</p> <p>The administrative decisions of the supervisory authority can be subject to substantive judicial review. Moreover, as the decisions can be appealed to the MoF, some actions unduly impede the</p>

	<p>ability of the SI to make timely interventions in order to protect policyholders' interests.</p> <p>Given the organisational size of the ICCS, the decision-making lines of the supervisory authority are so structured that action can be taken immediately in an emergency situation</p> <p>As stated under ICP 3, the process for appealing supervisory decisions is specified but unbalanced, and potentially undermines supervisory independence and effectiveness.</p> <p>The supervisory authority makes little or no information on its role publicly available. The supervisory authority publishes a regular report but with a delay of more than two years. This report does not include statements about the conduct of its policy, does not explain its objectives or describe its performance in pursuing its objectives.</p> <p>Also, the absence of clear regulation requires that the ICCS intervene to enforce compliance with the LIS. If regulatory rules and administrative acts were in place, the companies would receive clearer guidance and non-compliance would be determined through that set of rules rather than through decisions of the ICCS.</p>
Assessment	Largely observed.
Comments	<p>"Largely observed" is an appropriate assessment as long as the decision-making process is consistent and supports a stable market. However, given the very limited resources of the ICCS, a more efficient way of conducting ongoing supervision would free up capacity for more structural supervisory involvement.</p> <p>The internal procedures should be standardized to operate more efficiently. In addition, publications should be made available to the public.</p>
Principle 5.	Supervisory cooperation and information sharing
	The supervisory authority cooperates and shares information with other relevant supervisors subject to confidentiality requirements.
Description	<p>The existence of a formal agreement with another supervisor is not a prerequisite for information sharing. Also, the supervisory authority, at its discretion, can enter into agreements or understandings with any other financial sector supervisor ("another supervisor") to share relevant supervisory information or to otherwise work together.</p> <p>There are formal agreements for information sharing in place within the jurisdiction as well as with relevant authorities of the EU. The ICCS has signed the Helsinki and Siena protocol, which lay out the process for cooperation in the light of the concept of home/host supervisors. The SI attends the quarterly meeting of CEIOPS and remains informed about ongoing activities within the EU. Every chapter of the LIS contains clauses indicating how the regulation is applicable to non-Cypriot companies and their supervisors.</p>
Assessment	Observed.
Comments	There has been no substantial information sharing since Cyprus joined the EU in May 2004. In 2005, the SI should contact the home supervisors to identify how many of the companies under the freedom of services (FoS) have actually started business activities.
The Supervised Entity	
Principle 6.	Licensing
	An insurer must be licensed before it can operate within a jurisdiction. The requirements for licensing are clear, objective and public.
Description	<p>The licensing process is clearly defined in Part III of the LIS. The law provides a full set of requirements prior to the granting of a license as well as rules for intervention during the application process if a license is granted.</p> <p>There is also a guide available documenting the procedures for the licensing process. The licensing procedures—as far as other member states of the EU are concerned—are met. During the last 24 months, there were two licenses granted.</p>

	<p>As necessary, after an insurer has been licensed, the supervisory authority continues to evaluate and monitor the degree to which the insurer satisfies the relevant licensing principles and requirements of the jurisdiction.</p> <p>The LIS includes a definition of insurers; requires licensing of insurers, and prohibits unauthorized insurance activities; defines the permissible legal forms of insurers, and identifies the SI as the responsible institution for issuing licenses.</p> <p>The licensing criteria require the applicant's board, and the applicant's significant owners to be suitable and the applicant to hold the required capital.</p> <p>There are no specific requirements for the applicant's risk-management systems, internal control systems, information technology systems, policies, and procedures to be adequate for the nature and scale of the business in question. However, adequate reinsurance arrangements are required as part of the licensing procedure.</p> <p>The applicant's business plan must reflect the business lines and risk profile and give details of projected setting-up costs, capital requirements, projected development of business, solvency margins, and reinsurance arrangements.</p> <p>The LIS sets provisions to avoid domestic or foreign insurance establishment escaping supervision. Insurance establishments of international groups and international insurers are subject to effective supervision. The creation of a cross-border establishment is subject to consultation between the host and home supervisor. It also determines the method by which a foreign insurer can carry on business in the jurisdiction, either by way of a local branch or subsidiary or on a services basis only.</p> <p>As necessary, after an insurer has been licensed, the supervisory authority continues to evaluate and monitor the degree to which the insurer satisfies the relevant licensing principles and requirements of the jurisdiction.</p>
Assessment	Observed.
Comments	None.
Principle 7.	Suitability of persons
	<p>The significant owners, board members, senior management, auditors and actuaries of an insurer are fit and proper to fulfill their roles. This requires that they possess the appropriate integrity, competency, experience and qualifications.</p>
Description	<p>The suitability criteria for persons involved in the management of an insurance undertaking are defined in Part IV of the LIS and are sufficient. A standardized process for obtaining CVs and documents of a criminal record are established.</p> <p>The LIS identifies which key functionaries must meet fit-and-proper requirements. In cases where significant owners no longer meet fit-and-proper requirements, the SI takes appropriate action, including requiring that the owners dispose of their interests. Participation in insurance undertakings is subject to the approval of the SI and regulated in s 143–s150.</p> <p>The SI disqualifies the appointment of key functionaries including auditors and actuaries of insurers that do not comply with fit-and-proper requirements. Insurers are required to demonstrate to the SI the fitness and propriety of key functionaries by submitting documentation illustrating their knowledge, experience, skills and integrity upon request, or where there are changes in key functionaries. Appointment of any person to two positions in an insurance undertaking which could result in a material conflict would not be approved.</p> <p>Copies of criminal records and CVs were seen during the assessment. There were at least five cases where the suitability of a person was challenged by the ICCS.</p>
Assessment	Observed.
Comments	None.

<p>Principle 8. Changes in control and portfolio transfers</p> <p>The supervisory authority approves or rejects proposals to acquire significant ownership or any other interest in an insurer that results in that person, directly or indirectly, alone or with an associate, exercising control over the insurer.</p> <p>The supervisory authority approves the portfolio transfer or merger of insurance business.</p>	
Description	<p>The threshold for a notification of ownership is set in the LIS, Part X, and amounts to 10 percent. The execution of voting rights can also be restricted. The LIS grants sufficient power to appoint or remove directors to the board and other executive committees. Section 145 sets out the procedure under which potential controlling owners apply for approval for the acquisition, or change in control, of the insurers. It also entitles the SI to disapprove any change in control if those changes would conflict with the supervision of the relevant undertaking.</p> <p>The SI has the authority to approve any significant increase in shareholdings above the predetermined control levels in an insurer by legal or natural persons, whether obtained individually or in association with others. This also applies to any other interest in that insurer or its intermediate or ultimate beneficial owners.</p> <p>When processing applications for changes in control, the SI also considers the requirements in ICP 7—Suitability of Persons—which apply to prospective owners with control of insurers.</p> <p>The SI can reject applications of proposed owners with controlling interest if facts exist from which it can be deduced that their ownership will be unduly prejudicial to policyholders. In the past 24 months, there has been one application for change in control.</p> <p>The process for transferring a portfolio is set out in Part VIII of the LIS and contains sufficient rules for life and non-life business in the relevant chapters. There are also relevant forms to support the standardized process. The regulation is in line with the requirements of the EU. Changes in control over an insurance undertaking have to be notified in advance to the SI according to s143ff of the LIS.</p> <p>In accordance with that section, the SI requires insurers to get approval before they transfer all or any part of their insurance business. To facilitate this, the SI has established criteria for use as a basis by which to assess insurers' applications to transfer all or any part of their insurance business.</p>
Assessment	Observed.
Comments	None.
<p>Principle 9. Corporate governance</p> <p>The corporate governance framework recognizes and protects rights of all interested parties. The supervisory authority requires compliance with all applicable corporate governance standards.</p>	
Description	<p>The corporate governance rules apply to those insurance companies listed on the Cyprus SE or part of a listed Cypriot Bank. Such businesses account for approx. 60 percent of the market.</p> <p>The LIS however, does not require insurance undertakings to follow corporate governance standards. In practice, more than two thirds of the companies are either family owned or established and managed as very small businesses. A balance of powers and control, risk-management and internal control procedures cannot be expected to be in place.</p> <p>The most essential requirements are that the LIS requires and verifies that the insurer complies with applicable corporate governance principles. Specific requirements should also ensure that the board of directors sets out its responsibilities in accepting and committing to the specific corporate governance principles for its undertaking. Regulations on corporate governance should be covered in general company law and/or insurance law. These regulations should take account of the size, nature, and complexity of the insurer. The senior management should be held responsible for overseeing the operations of the insurer and providing direction to it on a day-to-day basis subject to the objectives and policies set out by the board of directors as well as to legislation.</p>

Assessment	Partially observed.
Comments	Since the number of small and family-owned businesses is substantial, the required control and balance mechanisms are not met for the sector as a whole, even though the corporate governance rules apply to listed companies. Nor is the application of corporate governance supervised or checked. There should be a joint effort to develop governing rules for undertakings in the financial sector. These rules should be developed by all three supervisory authorities.
Principle 10.	Internal control
	The supervisory authority requires insurers to have in place internal controls that are adequate for the nature and scale of the business. The oversight and reporting systems allow the board and management to monitor and control the operations.
Description	<p>The application of the principle has to be seen in light of the size and nature of the business conducted in Cyprus. There are currently no specific requirements for insurance undertakings to establish internal control mechanisms. The LIS states however, that the auditing firm has to report any irregularities it becomes aware of to the SI. Minimum requirements on internal control, however, will have to be an essential part of the sound insurance principles to be developed. Through the establishment of rules for internal control the ICCS can ensure that standards will be audited and preventive measures are in place to avoid most of the potential failures. The implementation of rules for internal control has to be seen as an essential part of supervisory activity as it sets the standard of how the business will be conducted and administered within the insurance undertakings.</p> <p>The SI holds the board of directors ultimately responsible for an effective internal control system but does not insist on the establishment and maintenance of such a system. A framework for internal control should include internal and external audit, actuarial, and compliance functions.</p> <p>The SI should also require the board of directors to provide suitable prudential oversight and establish a risk management system that includes setting and monitoring policies.</p> <p>As part of internal control, the SI should require the insurer to have an ongoing internal audit function of a nature and scope appropriate to the business. This includes ensuring compliance with all applicable policies and procedures and reviewing whether the insurer's policies, practices, and controls remain sufficient and appropriate for its business.</p> <p>The SI should also have access to reports of the internal audit function.</p>
Assessment	Partially observed.
Comments	Define standards on internal control as an essential part of sound insurance principles and enforce those standards through reporting and auditing requirements. Internal control procedures should also cover initial procedures for investment decisions and operational risk as it relates to contingency planning.
Ongoing Supervision	
Principle 11.	Market analysis
	Making use of all available sources, the supervisory authority monitors and analyses all factors that may have an impact on insurers and insurance markets. It draws the conclusions and takes action as appropriate.
Description	The SI has the right to require all data necessary to aggregate into market data to perform an analysis. During the assessment, there was no indication that any data other than those provided by insurance undertakings is considered of importance as part of the market analysis undertaken by the SI. There was no data about the investment market nor socio-demographic data nor on trends which could have a potential impact on the insurance market. Although the ICCS does not have the resources to conduct such an in-depth analysis, it should align itself with other relevant sources in the public service to ensure that timely information which could be of interest to the insurance sector is collected elsewhere and could be provided to the ICCS. The SI should use market analysis on a regular basis to identify trends and possible future scenarios and issues.

Assessment	Partly observed.
Comments	The SI should identify the information about the insurance sector that is required or of interest to other public services. The SI should also define all information necessary to undertake a market analysis for the insurance sector and determine the process through which this information will be received and updated.
Principle 12.	Reporting to supervisors and off-site monitoring The supervisory authority receives necessary information to conduct effective off-site monitoring and to evaluate the condition of each insurer as well as the insurance market.
Description	The SI has the right to require all data necessary to perform an analysis. The forms to be used for companies are well defined. Since the forms were introduced only in 2003, there are still misunderstandings as to how they should be utilized. The amount of information received is quite comprehensive; there is some delay until erroneous reporting is identified. As there are relatively long periods allowed before companies have to report on the recent business period, which is six months after closing, only data as per December 2003 was available. A large number of smaller companies is not even able to meet this requirement. Received data is not consolidated regularly and has to be aggregated on an as-needs basis to respond to individual requests. During the assessment, it took a considerable time to receive market data which could serve as a basis for in-depth analysis.
Assessment	Partially observed.
Comments	Company data should be stored electronically once received. Also companies should be required to submit the relevant forms in signed hardcopies and in electronic form in prescribed formats. That would allow the ICCS to have updated information on request without long delays and manual efforts. Also, there should be a procedure to imply some degree of plausibility testing of received data.
Principle 13.	On-site inspection The supervisory authority carries out on-site inspections to examine the business of an insurer and its compliance with legislation and supervisory requirements.
Description	Although the SI possesses the right to perform on-site inspections, it hardly makes use of it. If on-site inspections are carried out, they are performed by staff of the ICCS. Inspections are only conducted if there is severe evidence of wrong doing by the respective undertakings. There is no agreed process to contract external sources to perform inspections, neither in cases where an inspection is known to be necessary, nor for random inspections. There were only four on-site inspections carried out during the last 24 months. None of those inspections was conducted on a random basis but was considered necessary due to information received. By law, the supervisory authority has wide-ranging powers to conduct on-site inspections and gather information deemed necessary to perform its duties.
Assessment	Not observed.
Comments	Gain agreement from the MoF to obtain the right to contract third parties to support the carrying out of on-site inspections. Also develop a plan to perform regular on-site inspections regardless of clear evidence that an inspection is deemed to be necessary.
Principle 14.	Preventive and corrective measures The supervisory authority takes preventive and corrective measures that are timely, suitable and necessary to achieve the objectives of insurance supervision.
Description	The LIS allows for sanctions either through withdrawal of license, disapproval of individuals, or administrative fines. Preventive measures are not explicitly allowed for in the LIS. All provisions in the law, the processes within the ICCS, are geared to correct rather than to prevent. One exception is the requirement for insurance undertakings to provide in a timely manner information about existing reinsurance cover for the existing business period. Further preventive measures would require that more precise regulation be issued by the ICCS. The ICP requires a progressive escalation of action or remedial measures if the problems become worse or if management of the insurer ignores more informal requests from the supervisory authority to take corrective action. This progressive escalation could be further developed.
Assessment	Largely observed.

Comments	The ICCS should develop a set of regulatory rules designed to prevent compliance failure instead of deciding on corrective measures after the event. Although the emphasis will clearly be on corrective measures, the ICCS should consider whether the development of preventive measures could also contribute to a more efficient allocation of resources within the ICCS.
Principle 15.	Enforcement or sanctions
	The supervisory authority enforces corrective action and, where needed, imposes sanctions based on clear and objective criteria that are publicly disclosed.
Description	<p>The biggest challenge for the ICCS is to become aware of situations where sanctions and enforcement would be applicable. The legal provisions to issue sanctions and to enforce the law are satisfactory.</p> <p>The SI can issue formal directions to companies to take particular actions or to desist from taking particular actions. Failure to comply with a formal direction issued by the supervisory authority has serious consequences.</p> <p>The SI can also require capital levels to be increased, restrict, or suspend dividend or other payments to shareholders, restrict asset transfers and restrict an insurer's purchase of its own shares. It can also initiate action to restrict the ownership or activities of a subsidiary where, in its opinion, such activities jeopardize the financial situation of the insurer.</p> <p>The LIS provides for sanctions by way of fines against individuals and insurers where the provisions of the legislation are breached and provides for sanctions against individuals who withhold information from the supervisory authority, provide information that is intended to mislead the supervisory authority, or fail to provide information to the supervisory authority in a timely fashion. In addition, previously fined individuals can be refused permission to hold key positions in an insurance company.</p> <p>As to the issuing of sanctions, there have been 13 withdrawals of licenses since 1995, 5 cases of administrative fines in 2004 and 5 requests to increase reserves in 2003 and 2004. All were imposed on insurance companies as part of, or through, sanctions.</p>
Assessment	Largely observed.
Comments	As indicated in ICP 3, the MoF should take steps to improve the independence and credibility of the SI and should therefore review the number of cases in which an appeal is possible. The variety of such cases should be reduced considerably to avoid delays arising from legal disputes over supervisory sanctions.
Principle 16.	Winding-up and exit from the market
	The legal and regulatory framework defines a range of options for the orderly exit of insurers from the marketplace. It defines insolvency and establishes the criteria and procedure for dealing with insolvency. In the event of winding-up proceedings, the legal framework gives priority to the protection of policyholders.
Description	<p>A high legal priority is given to the protection of the rights and entitlements of policyholders and other policy beneficiaries in the event of an insurer becoming insolvent and winding-up. This priority ensures that, as far as is practical, there is limited disruption to the provision of benefits to policyholders.</p> <p>The LIS has been amended to incorporate the 2001/17/EC on reorganization and winding up. All provisions necessary to ensure a process with safeguards are in place. There have been two withdrawals of licenses, but neither has resulted in a winding up. Prior to the amendment of the LIS, there were several cases where companies had been wound up.</p>
Assessment	Largely observed.
Comments	As s157 requires the SI to appoint a liquidator, the ICCS should have a short list of potential candidates in order to shorten the appointment process. That list should be part of the process of withdrawing a license.

Principle 17. Group-wide supervision	
The supervisory authority supervises its insurers on a solo and a group-wide basis.	
Description	<p>The Cyprus Insurance Laws have been harmonized with the provisions of relevant directives, especially the Financial Conglomerates Directive.</p> <p>In the case of an insurance group, an adjusted solvency margin must be calculated. For a financial conglomerate, the supplementary capital adequacy requirements of the regulated entities must be calculated at the end of each financial year based on the technical principles and methods set out in the Cyprus Insurance Laws.</p> <p>In order to ensure proper supplementary supervision of the regulated entities in a financial conglomerate, the law allows for a single coordinator, responsible for coordination and exercise of supplementary supervision, to be appointed from among the competent authorities concerned. No appointments have been made so far.</p> <p>Persons who effectively direct the business of an insurance holding company must be of sufficiently good repute and must have sufficient experience to perform their duties.</p> <p>In the case of an insurance group, every Cypriot insurance company must notify the Superintendent of Insurance annually, of any significant transactions in which it has engaged with other undertakings within the insurance group.</p> <p>In the case of a financial conglomerate, regulated entities are required to have in place, at the level of the financial conglomerate, adequate risk management processes and internal control mechanisms, including sound administrative and accounting procedures.</p> <p>Regulated entities in a financial conglomerate must report annually to the coordinator any significant risk concentration at the level of the financial conglomerate and all the significant intra-group transactions of the regulated entities within a financial conglomerate, in accordance with the rules laid down in the Insurance Laws.</p> <p>Moreover, in the Insurance Laws and Orders, there are, inter alia, provisions regarding the cooperation and exchange of information between the competent authorities, access to information and verification of the information concerning the entities.</p> <p>However, this process is not covered by the MOU signed in 2002 by the Central Bank, Securities Commission and SI but should be incorporated at one of the next meetings. Finally, it should be noted that the law on the supplementary supervision of insurance groups came into effect as from 1/5/2004, and the law on the supplementary supervision of financial conglomerates came into effect as from 1/1/2005, so there is no real practical experience in the area of group wide supervision. However, the SI participates appropriately in the bank supervisor-led supervision of bank-headed conglomerates and has prepared for the possible eventuality of supervising an insurance-dominated conglomerate.</p>
Assessment	Observed.
Comments	Incorporate relevant information exchange processes and terms of reference for the coordinator into the mentioned MOU.
Prudential Requirements	
Principle 18. Risk assessment and management	
The supervisory authority requires insurers to recognize the range of risks that they face and to assess and manage them effectively.	
Description	The ICP requires risk management policies and risk control systems to be appropriate to the complexity, size, and nature of the insurer's business. The insurer should establish an appropriate tolerance level or risk limit for material sources of risk. As the businesses in the Cypriot market vary from very small to medium size, there is no common approach to risk assessment and management. Most insurance companies benefit from existing relationships with reinsurers who tend to create a form of awareness when insurance companies are entering

	business terrain where more advanced risk awareness is needed to conduct the business in a safe manner. However, such an approach is not required by the SI.
Assessment	Partially observed.
Comments	Initial steps toward risk management should be considered when internal control procedures as laid out in principle 10 are sufficiently regulated and recommendations are implemented through the establishment of sound insurance principles.
Principle 19. Insurance activity	
Since insurance is a risk taking activity, the supervisory authority requires insurers to evaluate and manage the risks that they underwrite, in particular through reinsurance, and to have the tools to establish an adequate level of premiums.	
Description	<p>The SI reviews reinsurance arrangements to check that they are adequate and that the claims held by insurers on their reinsurers are recoverable. This review includes checking that the reinsurance program provides coverage appropriate to the level of capital of the insurer and the profile of the risks it underwrites</p> <p>The ICCS requires insurance undertakings to disclose the existing reinsurance covers. Through the off-site inspection of those programs, it is established that all companies operating in the market have their underwriting policies also checked by reinsurance companies. As the net retention rate is 59.1 percent, it can be regarded as an appropriate provision made by the ICCS.</p> <p>The SI requires insurers to have in place strategic underwriting and pricing policies. Insurers are required to evaluate the risks that they underwrite and establish and maintain an adequate level of premiums. This requirement does not go so far as to ask insurers to have systems in place to control their expenses related to premiums and claims, including claims handling and administration expenses.</p>
Assessment	Largely observed.
Comments	The ICCS should ask the supervised companies to provide a risk profile stating the introduction of new products, availability of rating factors and changes in its attitude to insurance risks.
Principle 20. Liabilities	
The supervisory authority requires insurers to comply with standards for establishing adequate technical provisions and other liabilities, and making allowance for reinsurance recoverables. The supervisory authority has both the authority and the ability to assess the adequacy of the technical provisions and to require that these provisions be increased, if necessary.	
Description	<p>The LIS has provisions in place for establishing adequate technical provisions and other liabilities based on sound accounting and actuarial principles. The SI prescribes or agrees to standards for establishing technical provisions and other liabilities.</p> <p>Although the ICCS does not investigate appropriateness of reserves on-site, it has issued clear instruction on how reserves have to be established. Also, the LIS does provide clear regulation regarding what is to be included as a liability and methods and assumptions for assessing, on a reliable, objective, transparent and prudent basis, technical provisions to cover all expected and some unexpected claims and expenses.</p> <p>However, structured approaches to reserving in General Lines, such as chain ladders and claims triangles, have been introduced only recently. To determine whether companies have reserved adequately is very time consuming or, in cases where the actuarial service is supplied, happens with long time delays. At the time of the assessment, there were 5 insurance companies operating in the market with suboptimal reserving levels; the authorities noted that they had been required to increase their reserves.</p>
Assessment	Partially observed.
Comments	The determination of appropriate reserves requires the ICCS to have both the ability to contract external resources and recruit further adequately skilled staff. It is therefore referred to the relevant recommendations on Principles 1 and 3.

Principle 21. Investments	
The supervisory authority requires insurers to comply with standards on investment activities. These standards include requirements on investment policy, asset mix, valuation, diversification, asset-liability matching, and risk management.	
Description	<p>Clear instructions are in place on what is regarded as qualified assets and the assets that are eligible to cover technical reserves. The reporting forms on investments are sufficient and have to be submitted to the ICCS on a quarterly basis. Investments are valued according to a method prescribed by or acceptable to the supervisory authority. The SI requires that insurers have in place effective procedures for monitoring and managing their asset/liability position to ensure that their investment activities and asset positions are appropriate to their liability and risk profiles</p> <p>The board of directors is held responsible for the investments, and there is no requirement to establish a specific investment policy. One of the biggest undertakings in life insurance almost lost its license in 2004 due to an assessment made by the actuarial service (GaD). The financial position of this company was restored in a very short time, and, according to the company, the process was well managed by the SI.</p>
Assessment	Largely observed.
Comments	The investment policy should be part of a risk profile which every insurance company should submit to the ICCS on a regular basis.
Principle 22. Derivatives and similar commitments	
The supervisory authority requires insurers to comply with standards on the use of derivatives and similar commitments. These standards address restrictions in their use and disclosure requirements, as well as internal controls and monitoring of the related positions.	
Description	Derivatives are rarely used and, if so, only within the largest life insurance companies. Those companies buy these financial instruments on the basis of internal restrictions or on the advice of the parent company. However, in practice, the use of derivatives by undertakings has so far been the subject of prior approval by the Superintendent. The approval was based on the condition that undertakings should meet the criteria set by the SI, namely that the risk-management systems must cover the market, credit, liquidity and failure risks associated with investment activities that might affect the coverage of technical provisions and/or solvency margins (capital). The SI also requires those companies utilizing derivatives to have in place effective procedures for monitoring and managing their asset/liability positions to ensure that their investment activities and asset positions are appropriate to their liability and risk profiles.
Assessment	Largely observed.
Comments	None.
Principle 23. Capital adequacy and solvency	
The supervisory authority requires insurers to comply with the prescribed solvency regime. This regime includes capital adequacy requirements and requires suitable forms of capital that enable the insurer to absorb significant unforeseen losses.	
Description	<p>Solvency requirements are in place in accordance with the EU. The application of Solvency I is required for all companies as a condition for granting a license. The existing businesses however have been given until March 2007 to meet Solvency I and therefore remain within the prior solvency regime and have to meet lower capital requirements. A specific problem arises from the fact that premium receivables are accepted as assets for solvency purposes. Insurance undertakings use that possibility although it is very questionable whether the assets can be fully realized when needed. There are attempts to apply an ageing structure and to insist on writing-off procedures. Based on audited statements depreciation takes place but does not include questionable assets to the necessary extent.</p> <p>As the Solvency I requirements define significantly higher minimum guaranteed funds, it must be expected that a larger proportion of the smaller companies will experience difficulties in providing adequate capital in 2007. There is currently no supervisory strategy in place to address this problem. The fact that at least four companies are currently unable to meet existing</p>

	<p>capital demonstrates the seriousness of the situation.</p> <p>As concerns the development of a strategy for full implementation of Solvency I, a possible draft outline of an approach to the problem was provided at the time of this assessment</p>
Assessment	Partially observed.
Comments	<p>Monitoring of the collection of premiums paid in cash should be an essential part of the internal control procedures. Premium receivables would not then be recorded at the high existing levels and would, therefore, not be a substantial issue.</p> <p>The solvency capital should be reported to the ICCS on a quarterly basis in order to avoid current delays. There should be an awareness that it is unacceptable for companies to continue their operations if they are unable to meet the minimum requirements. There is also evidence that the Solvency I requirements, which will be enforced in March 2007 for existing businesses, will create difficulties for some of the smaller companies, mainly in General Lines. This problem is addressed in a technical assistance report.</p>
Markets and consumers	
Principle 24. Intermediaries	
<p>The supervisory authority sets requirements, directly or through the supervision of insurers, for the conduct of intermediaries.</p>	
Description	<p>The SI requires intermediaries to be licensed or registered in accordance with the European directive on insurance intermediaries, and requires intermediaries to have adequate general, commercial, and professional knowledge and ability as well as a good reputation. The SI can take corrective action, directly or through insurers, and can cancel the intermediary's license or registration, when appropriate.</p> <p>Currently, there are about 1,600 intermediaries, mostly tied agents, actively in the market. Prior to the implementation of the intermediary directive, there were also a register and professional qualification requirements in place.</p>
Assessment	Observed.
Comments	Given the range of tasks undertaken by the supervisor, the planned allocation of resources, including those devoted to intermediary supervision, could be reviewed.
Principle 25. Consumer protection	
<p>The supervisory authority sets minimum requirements for insurers and intermediaries in dealing with consumers in its jurisdiction, including foreign insurers selling products on a cross-border basis. The requirements include provision of timely, complete and relevant information to consumers both before a contract is entered into through to the point at which all obligations under a contract have been satisfied.</p>	
Description	<p>The SI's requirements that insurance mediation is in accordance with the European directive on insurance intermediation, as indicated in ICP 24 above, implies that requirements with regard to the skills, care, diligence and fair treatment of customers are in place, as well as requirements on adequately obtaining and providing information to customers.</p> <p>The SI receives customer complaints and refers them to the insurance undertakings. Through the receipt of those complaints, the ICCS becomes well aware of issues relating to sub-optimal customer service being provided by the insurance companies. Although the ICCS has no legal powers to resolve the issues on behalf of the customer, it does get involved informally and requests the companies to deal with claims and complaints effectively and fairly through a simple, easily accessible, and equitable process..</p> <p>There is no ombudsman for insurance matters.</p>
Assessment	Observed.
Comments	The SI could publish the frequency of complaints received on a company level to initiate further incentives for companies to react in a more customer-friendly fashion.

<p>Principle 26. Information, disclosure & transparency towards the market</p> <p>The supervisory authority requires insurers to disclose relevant information on a timely basis in order to give stakeholders a clear view of their business activities and financial position and to facilitate the understanding of the risks to which they are exposed.</p>	
Description	<p>Insurers are required to disclose information on their financial position and the risks to which they are subject. This information is mostly quantitative but some qualitative information is also required.</p> <p>The SI publishes trends and statistics about the insurance market every second year and is planning to produce an annual report. The current level of detail of this report reflects the sophistication of the market and can be seen as adequate. The qualitative information should increase and elaborate on trends and changes as well as on developments within the EU in relation to insurance. Also, quantitative information should be provided on a company level as this is not regarded as proprietary information.</p>
Assessment	Largely observed.
Comments	Improve content and frequency of market reports.
<p>Principle 27. Fraud</p> <p>The supervisory authority requires that insurers and intermediaries take the necessary measures to prevent, detect and remedy insurance fraud.</p>	
Description	<p>The SI has the power but lacks the resources to establish and enforce regulations and to communicate as widely as could be appropriate with enforcement authorities as well as with other supervisors to deter, detect, record, report, and remedy fraud in insurance.</p> <p>Legislation addresses insurer fraud and claims fraud is a punishable offence. The SI requires insurers and intermediaries to ensure integrity of their business against fraud and also requires intermediaries to deter, detect, record, and report fraud to their companies and the SI. The SI is empowered to cooperate with other supervisory authorities in Cyprus and in other jurisdictions in countering fraud.</p> <p>Since structures are not very complex, a series of fraudulent attempts would be identified. The measures needed to reflect optimal market procedures should be improved through internal control.</p>
Assessment	Largely observed.
Comments	See ICP10 recommendations for further details.
<p>Anti-money laundering, combating the financing of terrorism</p>	
<p>Principle 28. Anti-money laundering, combating the financing of terrorism (AML/CFT)</p> <p>The supervisory authority requires insurers and intermediaries to take effective measures to deter, detect and report money laundering and the financing of terrorism.</p>	
Description	<p>The Prevention and Suppression of Money Laundering Activities Law (the “Law”) considers, among other activities, as relevant financial business (a) long-term insurance contracts whether or not linked with investment schemes (unit-linked and/or conventional policies); and (b) non-Life insurance contracts provided by companies registered in the Republic of Cyprus, in accordance with the Company Law, either as Cypriot or foreign companies, operating exclusively outside the Republic of Cyprus.</p> <p>The Council of Ministers, in accordance with Section 60 of the law, has designated the superintendent of insurance as the responsible supervisory authority for the assessment of the compliance of all insurance companies with the special provisions of the law.</p> <p>Under Section 60(3) of the law, the Superintendent has issued Guidance Notes to those insurance companies notifying them that their activities fall within the scope of the law in order to assist them in achieving compliance with the law.</p>

	<p>Furthermore, in accordance with the insurance legislation (Sections 91 and 99), each insurance undertaking providing life insurance contracts has to submit, together with its annual insurance accounts, a certificate certifying its compliance with the Guidance Notes issued by the superintendent. This certificate is signed by members of the Board of Directors, the chief executive officer, as well as the compliance officer who is appointed in accordance with the provision of Section 67 of the law. This certificate is part of the audit review process.</p> <p>As regards the application of AML/CFT measures on foreign branches and subsidiaries, there are only two Cypriot insurance companies which have branches or subsidiaries (one branch and one subsidiary), and these are in Greece (another EU member state).</p> <p>As regards the allocation of adequate resources to AML/CFT activities, due to lack of resources, there is not going to be a real improvement in the near future.</p>
Assessment	Partially observed.
Comments	A common approach should be identified. Also, resources to deal with suspicious transactions reports (STRs) should be provided on an as-needs-basis. During the assessment of the life market, interviewed managers stated that most of the single premiums paid into unit-linked contracts have not been withdrawn from other forms of saving vehicles but were provided either in cash or from other accounts. The source of those premiums and their provision to the life insurance companies have not, however, resulted in the submission of STRs to the SI.

Table 16. Summary Observance of IAIS Insurance Core Principles

Assessment Grade	Principles Grouped by Assessment Grade	
	Count	List
Observed	7	ICP 5, 6, 7, 8, 17, 24, 25
Largely observed	11	ICP 1, 2, 4, 14, 15, 16, 19, 21, 22, 26, 27
Partially observed	9	ICP 3, 9, 10, 11, 12, 18, 20, 23, 28
Non observed	1	ICP 13
Not applicable	0	

E. Recommended Action Plan and Authorities' Response to the Assessment

Recommended action plan

36. Recommended actions are outlined as part of the comments on each assessed principle. Specific attention should be given to the further development of specific regulation. The ability to issue sound insurance principles should be used to define the framework for the application of the LIS. The draft entitled "Orders for insurance to set and maintain prudential standards" should be used as a starting point. Further attention should be given to standards on internal control and operational risks.

Table 17. Recommended Action Plan to Improve Observance of IAIS Insurance Core Principles

Reference Principle	Recommended Action
Conditions for effective insurance supervision i.e., CP 1	Regulation has to be developed to set a framework in which insurance undertakings operate and in order to create clear expectations of a supervisory standpoint towards the companies.
Supervisory objectives i.e., CP 2	Clear objectives and measures should be defined for the ICCS. The ICCS should report on its achievements on a regular basis. Moreover, the ICCS should communicate through regulation how it wants the SIL to be applied.
Supervisory authority i.e., CP 3	The SI has to be granted a budget in order to perform the duties laid out in the LIS. Also, the SI should be charged with producing a plan laying out the priorities for a year. Those plans would set clear expectations for the council of ministers and for the staff of the ICCS. Most importantly, there is an urgent need to assess the composition of skills required to properly exercise the powers of the LIS. Whether all those skills identified will have to be allocated within the ICCS remains to be seen. At the time this assessment was carried out, the SI was not provided with resources adequate to perform insurance supervision which is able to respond to critical situations.
Supervisory process i.e., CP 4	Internal procedures of the supervisor should be standardized for more efficient operation. Also, publications should be made available to the public.
Supervisory cooperation and information sharing i.e., CP 5	There has not as yet been any information sharing since Cyprus joined the EU in May 2004. In 2005, the SI should contact the home supervisors to identify how many of the companies under the FoS have actually started business activities.
Licensing i.e., CP 6	None.
Suitability of persons i.e., CP 7	None.
Changes in control and portfolio transfers i.e., CP 8	None.
Corporate governance i.e., CP 9	There should be a joint effort to develop governing rules for undertakings in the financial sector. These rules should be developed by all three supervisory authorities.
Internal control i.e., CP 10	Define standards on internal control as an essential part of the sound insurance principles and enforce those standards through reporting and auditing requirements.

Reference Principle	Recommended Action
Market analysis i.e., CP 11	The SI should identify the information about the insurance sector that is required or of interest to other public services. She also should define all information necessary to prepare a market analysis for the insurance sector and determine the process through which this information will be received and updated.
Reporting to supervisors and off-site monitoring i.e., CP 12	Company data should be stored electronically once received. Also, companies should be required to submit the relevant forms in signed hard copies and in electronic files in prescribed formats. That would allow the ICCS to have updated information on request without long delays and manual efforts. There should be a procedure to imply some degree of plausibility testing of received data.
On-site inspection i.e., CP 13	Gain agreement from the MoF to obtain the right to contract third parties to support the carrying out of on-site inspection. Also, develop a plan to perform regular on-site inspections regardless of clear evidence that an inspection is deemed to be necessary.
Preventive and corrective measures i.e., CP 14	The ICCS should develop a set of regulatory rules which would enable it to prevent a breach in compliance instead of deciding on corrective measures subsequent to a breach. Although, the emphasis should clearly be on corrective measures, the ICCS should consider whether the development of preventive measures could also contribute to a more efficient allocation of resources within the ICCS.
Enforcement or sanctions i.e., CP 15	The MoF should review whether the variety of cases in which an appeal is possible should be reduced considerably.
Winding-up and exit from the market i.e., CP 16	As s157 requires the SI to appoint a liquidator, the ICCS should have a short list of potential candidates in order to shorten the appointment process. That list should be part of the process of withdrawing a license.
Group-wide supervision i.e., CP 17	Incorporate relevant information exchange processes and terms of reference for the coordinator of financial conglomerate supervision into the 2002 MOU among the supervisors..
Risk assessment and management i.e., CP 18	Initial steps toward risk management should be considered when internal control procedures as laid out in Principle 10 are sufficiently regulated and recommendations are implemented through the establishment of sound insurance principles.
Insurance activity i.e., CP 19	The ICCS should ask the supervised companies to provide a risk profile stating the introduction of new products, availability of rating factors, and changes in its attitude to insurance risks.
Liabilities i.e., CP 20	The determination of appropriate reserves requires that the ICCS both have the ability to contract external resources and recruit further adequately skilled staff. It is therefore referred to the relevant recommendations on Principles 1 and 3.

Reference Principle	Recommended Action
Investments i.e., CP 21	Company investment policy should be part of a risk profile which every insurance company should submit to the ICCS on a regular basis. Also, internal control procedures should cover initial procedures for investment decisions and on operational risk as it refers to contingency plans.
Derivatives and similar commitments i.e., CP 22	None.
Capital adequacy and solvency i.e., CP 23	Cash collection should be an essential part of the internal control procedures. Premium receivables would not then accumulate to the existing levels and, therefore, not be a substantial issue. Solvency capital should be reported to the ICCS on a quarterly basis in order to avoid currently existing delays. There should be an awareness that it is unacceptable for companies to continue their operation if they are unable to meet the minimum requirements.
Intermediaries i.e., CP 24	Given the range of tasks, the planned allocation of resource could be reviewed.
Consumer protection i.e., CP 25	The SI could publish frequency of complaints received on a company level to initiate further incentives for companies to react in a more customer-friendly fashion.
Information, disclosure & transparency towards the market i.e., CP 26	Improve contents and frequency of market report.
Fraud i.e., CP 27	See ICP10 recommendations for further details.
Anti-money laundering i.e., CP 28	A common approach should be identified. Also, resources to deal with STRs should be provided on an as-needs-basis. During the assessment of the life market, interviewed managers stated that most of the single premiums paid into unit-linked contracts had not been withdrawn from other forms of saving vehicles but had been provided either in cash or from other cash accounts. The source of those premiums and their provision to the life insurance companies, however, have not led to submission of STRs to the SI.

Authorities' response to the assessment

Reference Principle	Authority's Planned Action
Conditions for effective insurance supervision i.e., CP 1	Efforts are underway to outsource legal services for EU harmonization purposes. Within this context, legal services will also be sought for the implementation of the proposed recommended action.

Reference Principle	Authority's Planned Action
Supervisory objectives i.e., CP 2	Efforts will be made to upgrade the existing «Report in Insurance in Cyprus», by including a more detailed reference to the ICCS and publish it annually instead of once every two years.
Supervisory authority i.e., CP 3	This recommended action implies granting the ICCS full financial autonomy from the Government. This requires political decision which is currently under consideration by the Government with a view to rationalize the supervision of insurance and financial services in general. As regards the staffing of the ICCS, all the necessary procedures will be expedited in order to recruit the appropriate qualified staff the soonest.
Supervisory process i.e., CP 4	By the implementation of the previous three proposed recommended actions, a considerable improvement in the efficiency of operations is expected. However, at the same time a balance between efficiency and flexibility should be maintained. Also, the publications will gradually be made available to the public.
Supervisory cooperation and information sharing i.e., CP 5	The ICCS will send by the end of this year a letter to all EU home supervisory authorities in order to implement this recommended action.
Corporate governance i.e., CP 9	This recommendation has been discussed at the meeting of the heads of the supervisory authorities of the financial sector that took place on 11/10/2005. It has been decided that each supervisory authority will develop its own rules in close co-operation with each other.
Internal control i.e., CP 10	An initial discussion on this subject will take place within next year with the Institute of Certified Accountants followed by a further discussion with the Cyprus Association of Insurance Companies.
Market analysis i.e., CP 11	This is a subject directly linked to the adequate staffing of the ICCS. Comments under CP3 regarding staffing are relevant.
Reporting to supervisors and off-site monitoring i.e., CP 12	This is a subject directly linked to the computerization of the ICCS. Tender proposals have already been submitted for the development of the appropriate software from the private sector and they are currently under evaluation by a special committee appointed for this purpose. This procedure is expected to be completed by May 2006.
On-site inspection i.e., CP 13	The ICCS will submit specific proposals to the MoF for the appropriate funding for such services. A plan for regular on-site inspections is being prepared in parallel.

Reference Principle	Authority's Planned Action
Preventive and corrective measures i.e., CP 14	If the upgrading of the ICCS with qualified staff takes place within the next 2–3 years, then the implementation of this recommended action will also take place in parallel.
Enforcement or sanctions i.e., CP 15	Discussions are underway between the MoF and the ICCS for the review of the appeal process.
Winding-up and exit from the market i.e., CP 16	As liquidation of insurance companies does not take place very often, the provisional liquidator who is appointed by the Superintendent of Insurance, will be an officer from the Office of the Registrar of Companies and Official Receiver.
Group-wide supervision i.e., CP 17	It is expected that within the first semester of next year, the implementation of this recommendation will take place.
Risk assessment and management i.e., CP 18	This recommended action will be implemented in the future following the implementation of all the recommended relevant actions mentioned previously.
Insurance activity i.e., CP 19	A letter will be addressed in the near future by the ICCS to all insurance companies requesting them to submit this proposed information. It should be noted that assessment of the submitted information will require the possession of appropriate skills and knowledge within the ICCS. Therefore, the timing of the implementation of this proposed action is directly linked to the comments under CP3.
Liabilities i.e., CP 20	This recommended action is directly linked with the implementation of the recommended action under CP3, especially with regard to the adequate staffing of ICCS both in absolute numbers and in appropriate skills.
Investments i.e., CP 21	This recommended action is directly linked with the adequacy of the staffing of the ICCS both in absolute numbers and in appropriate skills. Comments under CP3 are relevant.
Capital adequacy and solvency i.e., CP 23	Early next year a letter will be addressed to all insurance companies in order to implement this recommended action.
Intermediaries i.e., CP 24	This recommended action will be reviewed with a view to reducing the planned allocation of resources for intermediaries.
Consumer protection i.e., CP 25	The ICCS does not have the legal right to examine complaints. In this respect a Bill has been drafted for the establishment of a Financial Ombudsman. In this context this recommended action could be implemented.
Information, disclosure & transparency towards the market i.e., CP 26	Efforts will be made to upgrade the existing «Report in Insurance in Cyprus» and publish it annually instead of once every two years.
Fraud i.e., CP 27	Please see comments under CP10.

Reference Principle	Authority's Planned Action
Anti-money laundering i.e., CP 28	The implementation of this recommended action is directly linked to the carrying out on site inspections. Comments under CP13 are relevant.

III. DETAILED ASSESSMENT ON THE IMPLEMENTATION OF THE IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

A. General

37. The assessment of observance of the IOSCO Objectives and Principles of Securities Regulation (IOSCO Principles) in Cyprus was undertaken as part of the offshore financial center (OFC) assessment program. The Cyprus Securities and Exchange Commission (CySEC) is the main authority responsible for the supervision of the securities market in Cyprus. The Central Bank supervises certain international financial services companies engaged in securities activities. Michael Deasy from the Central Bank of Ireland was the assessor.

B. Information and Methodology Used for the Assessment

38. The assessment was based on the IOSCO Assessment Methodology of October 2003 for evaluating the implementation of IOSCO's Objectives and Principles of Securities Regulation. The assessment was influenced by the structure of the securities market in Cyprus, including the existence of an international financial services sector. It was also influenced by the accession of Cyprus to the European Union in May 2004. Membership of the Union resulted in the transposition of many EU financial regulatory directives which has, and is continuing to have, a significant impact on the regulatory regime in Cyprus. For instance, Cyprus is in the process of introducing a domestic collective investments scheme regime based entirely on the EU UCITS Directives.

39. The assessment was based on a review of the relevant legislation and directives issued by CySEC and the Central Bank in their respective areas. It was also based on the self assessment completed by both CySEC and the Central Bank. This information was supplemented by information provided by both authorities and data available on the website. Detailed discussions were held with CySEC, the Central Bank, and the Stock Exchange as well as with relevant private sector companies, representative bodies, the accountancy supervisor, and accountancy firms.

40. Cooperation was freely given by all concerned.

C. Institutional and Macro Prudential Setting, Market Structure

41. In broad terms, the securities sector in Cyprus covers the Stock Exchange, market intermediaries, collective investment schemes (all except certain types of collective investment schemes supervised by CySEC), and certain international financial services companies (supervised by the Central Bank).

42. The Stock Exchange is state-owned, has a relatively small number of listed companies (18 main and 137 supplementary listings) and turnover is very modest—currently in the region of \$500,000 daily at end-April 2005, although it was in the region of \$1.8 million in the first 75 trading days of 2005. It deals mainly in equities and bonds. In 1999/2000, two years after it was established, the exchange witnessed a severe collapse in listed prices—its index fell from about 800 to 80 points in the course of a year and a half.

43. There are 47 authorized market intermediaries, generally offering a broad range of investments services. Thirty two of these intermediaries offer their services almost exclusively to nonresidents. The remaining 15 intermediaries offer their services locally; many of them are members of the Stock Exchange.

44. The collective investment schemes sector is in its infancy in Cyprus. Cyprus has just transposed into national law the recently adopted EU UCITS Directives but has not licensed any schemes to date.

45. There are two investment services activities regulated by the CBC (i) international collective investment schemes and (ii) independent financial advisory firms. Both offer their services almost exclusively to nonresidents.

D. Description of Regulatory Structures and Practices

46. With the exception of the international financial services companies engaged in securities business and supervised by the Central Bank, CySEC supervises all securities activities, including the Stock Exchange. There are no self regulatory organizations. There are difficulties in CySEC regulating the Stock Exchange in that both are public administrative bodies and one public administrative body cannot supervise another. The main pieces of legislation are The CySEC Law 2001–2004 establishing CySEC and the Stock Exchange Law 1993–2004 establishing the Stock Exchange.

E. General Preconditions for Effective Securities Supervision

47. The regulatory regime is highly influenced by Cyprus' membership of the European Union. Almost all of its regulatory framework is determined by European law. Company law is strongly influenced by U.K. legislation. A sound legal, taxation, and accounting framework appears to be in place in Cyprus.

F. Principle-by-Principle Assessment

48. The IOSCO Principles were assessed in accordance with the criteria set out in the Guidance Note, taking into account the particular circumstances of the Cypriot market.

49. A principle will be considered *implemented* whenever all assessment criteria are generally met without any materially deficiencies. The principles acknowledge that there are often several ways for countries to implement the principles. A principle will be considered to be *broadly implemented* whenever only minor shortcomings are found, which do not raise major concerns and when corrective actions to achieve full implementation with the principle are scheduled and are realistically achievable within a short period of time. A principle will be considered *partly implemented* whenever significant shortcomings are found, and the authorities have not implemented one or more assessment criteria. A principle will be considered *not implemented* whenever major and material shortcomings are found in adhering with the assessment criteria. A principle will be considered *not applicable* whenever it does not apply given the structural and institutional conditions.

G. Comments

50. **Regulator (Principles 1–5).** The regulatory responsibilities of CySEC are generally clearly set down in legislation and CySEC appears to apply them in a clear and consistent manner. One area that requires clarity, however, is the respective roles of CySEC and the Stock Exchange in the supervision of the issuers of securities (i.e., listed companies). CySEC's competency in this area has recently been questioned by the courts and an appeal is pending. CySEC is also seeking an amendment to the Stock Exchange Law to put its regulatory role beyond doubt.⁷ Currently staff numbers appear adequate but extra resources will be required in the near future to deal with extra responsibilities which CySEC will be required to assume, e.g., implementation of recently adopted EU directives. Current staff appear to have the requisite skill-sets and competencies to carry out the responsibilities of CySEC.

51. **Self-regulatory organizations (Principles 6–7).** Apart from the limited self-regulatory functions of the Stock Exchange, there are no self-regulatory organizations in the securities sector in Cyprus.

52. **Inspections, investigations, and enforcement (Principles 8–10).** CySEC has wide powers of inspection, investigation, and enforcement. However, for constitutional and legal reasons, it cannot supervise the Stock Exchange effectively (see below Principles 25–30 Principles for the Secondary Market).

53. **Information Sharing and cooperation (Principles 11–13).** There is provision in the law allowing for the sharing of information with both domestic regulators and foreign regulators. However, CySEC cannot collect information and carry out investigations on behalf of foreign regulators unless it has an independent interest in the matter being investigated. CySEC has experienced difficulties in obtaining information identifying the beneficial owners of shares from lawyers acting as nominees. However, a forthcoming bill is expected to correct this.

54. **Issuers (Principles 14–16).** The public offering law, stock exchange law and company law provide for accurate and timely disclosure of financial results and adequate safeguards in the fair and equitable treatment of shareholders and there is no reason to believe that these laws are not being implemented effectively. Accounting and auditing standards are in line with best international practice. Cyprus has adopted International Financial Reporting Standards (IFRSs) for accounting purposes.

55. **Collective Investment Schemes (Principles 17–20).** There are two distinct collective investment scheme regimes in Cyprus. One is supervised by CySEC and is based on the EU UCITS Directives. These are targeted at the retail market and can be marketed to Cyprus and non-Cyprus residents alike. The relevant UCITS legislation has just been adopted in Cyprus and to date no Cyprus UCITS has been authorized. The legislation is comprehensive, but CySEC needs to introduce specific rules for the valuing

⁷ The authorities have indicated that the planned amendment to the Stock Exchange Act was enacted in September 2005.

of assets other than shares in publicly quoted companies held by UCITS. CySEC intends to issue such guidelines before a Cyprus UCITS is authorized.

56. The second type—international collective investment schemes—are not marketed to the public and are largely targeted at nonresidents. Fifteen such schemes have been authorized to date with a total net asset value of about \$400 million. There are two types of schemes: (i) those marketed to experienced investors and carrying a minimum investor subscription of \$50,000 and (ii) private schemes which restrict the number of investors to 100.

57. **Market Intermediaries (Principles 21–24).** All market intermediaries with the exception of investment advisors (investment advisors give advice only, they do not, for instance, receive or execute orders, hold client assets, or manage investment portfolios) must be authorized by CySEC. Following the transposition of the recently adopted EU *Markets in Financial Instruments Directive*, which recognizes investment advice as an investment service for the first time, investment advisors, of which none currently exist in the domestic market, will fall to be supervised as an investment intermediary by CySEC.

58. There are 47 market intermediaries authorized by CySEC, generally offering a broad range of services. Thirty-two of these intermediaries offer their services almost exclusively to nonresidents and were previously categorized as international financial intermediaries supervised by the Central Bank. The remaining 15 intermediaries generally offer their services locally; many provide stockbroking services. The Central Bank supervises the international financial services companies whose activities have been restricted to the offering of investment advice. These companies almost exclusively offer their services to nonresidents. There are about 40 of these and following the transposition of the EU Directive referred to above these will fall to be supervised by CySEC.

59. The legislative regime for the supervision of market intermediaries and its implementation appear effective.

60. **Principles for the Secondary Market (Principles 25–30).** CySEC is charged with the supervision of the Stock Exchange. However, it faces a particular difficulty in carrying out this function. CySEC, like the Stock Exchange, is a public administrative body and one public administrative body cannot supervise another public administrative body. Consequently, it cannot legally apply a whole range of regulatory tools, such as the imposition of conditions or restrictions, nor has it ever carried out an inspection of the Exchange because of these constitutional difficulties. It could, in extreme circumstances, through a circuitous route involving the Council of Ministers, order the temporary suspension of the exchange. In practice, the CySEC and the exchange appear to have a satisfactory supervisor/supervisee relationship, for example, CySEC monitors trading on the exchange on a real time and daily basis.

61. The Stock Exchange is the only securities exchange in Cyprus. It has exclusive rights to undertake stock market transactions in movable securities in Cyprus. This is for political and historical reasons related to the nongovernment controlled areas issue and not to restrict new entrants into the market. In any event, Cyprus will be required to establish exchange authorization criteria when the recently adopted EU markets in Financial Instrument Directive is transposed into Cyprus law.

Table 18. Detailed Assessment of Observance of the IOSCO Objectives and Principles of Securities Regulation

Principles Relating to the Regulator	
Principle 1.	The responsibilities of the regulator should be clear and objectively stated.
Description	<p>The development of the securities market in Cyprus is of relatively recent origin. The Stock Exchange was established in 1996 in accordance with the “Law to provide for the development of the Securities Market in the Republic, the Establishment and operation of a Cyprus Stock Exchange, the Establishment of a Stock Exchange Council and Other Related Matters of 1993–2004” (The Stock Exchange Law). The Securities and Exchange Commission (CySEC)—the securities regulator—was established in 2001 in accordance with the “Law Governing the Establishment, Structure, Responsibilities, Powers, Organisation of the Securities and Other Related Issues of 2001–2004” (The CySEC Law). CySEC replaced the Securities and Exchange Commission which had been established in 1996 under the Stock Exchange Law. The CySEC Law and subsequent related laws nominated the CySEC as the authority responsible for the supervision of the Stock Exchange, collective investments schemes, investment intermediaries, issuers of securities on the Stock Exchange, etc.</p> <p>It should be noted that the Central Bank of Cyprus is responsible for the supervision of international financial services companies (see Principle 21), International Collective Investment Schemes (see Principle 17) which are regulated under the provisions of the International Collective Investment Schemes Law of 1999, as well as International Trustee Services Companies. These international entities have their origin in Cyprus Exchange Control Law, under which the Central Bank had the power to issue Exchange Control Law permits to nonresidents, allowing them to become shareholders in companies incorporated in Cyprus, including investment intermediaries and collective investment schemes. These companies were allowed to offer their services to nonresidents only and in currencies other than Cyprus pounds. In May 2004, when Cyprus became a member of the European Union, the Exchange Control Law was abolished so that the distinction between resident and nonresident ceased to exist. Membership of the European Union also saw a change in the regulation of investment intermediaries so that all such intermediaries (other than those offering investment advice only—investment advice is not a core investment service at present under European Union law) became subject to the supervision of CySEC. International advisory firms continue to be supervised by the Central Bank; new legislation is being prepared by CySEC; however, that will result in their being regulated by CySEC in the same way as other investment intermediaries. International collective schemes (these are not marketed to the public) will continue to exist and will be supervised by the Central Bank. Their units will be available both domestically and abroad. Collective investment schemes based on EU legislation (i.e., UCITS), which are open to the public, will be supervised by CySEC.</p> <p>The regulation of collective investment schemes is very much evolving in Cyprus and given that the respective remits of the Central Bank and CySEC in this area are very different, there is currently no significant duplication of functions.</p> <p>The regulatory regime applied by the CySEC is based on relevant EU Directives and, in common with its fellow member states of the EU, that regulatory regime is in a state of flux as the CySEC seeks to transpose into national law several EU Regulatory Directives, e.g., Markets in Financial Instruments Directive, Market Abuse Directive, Prospectus Directive, Transparency Directive. (Following the assessment mission, in September 2005, the EU Market Abuse and Prospectus Directives were transposed into domestic law.)</p> <p>While the legislative framework is generally comprehensive and transparent, one aspect of its application is lacking in clarity. This relates to an overlap of responsibilities between CySEC and the Stock Exchange in the supervision of issuers of securities. A recent High Court decision questioned the competency of CySEC in this area, overturning a previous High Court Decision in favor of CySEC. The most recent decision has been appealed, and in the meantime, a bill amending the Stock Exchange Law designed to bring clarity to the respective roles of CySEC and the Stock Exchange has been submitted by the Attorney General's Office to Parliament.</p>

Assessment	Partly implemented.
Comments	<p>The uncertainty surrounding the respective responsibilities of CySEC and the Stock Exchange should be addressed as a matter of urgency, particularly in light of the serious collapse in stock market prices in 1999/2000 when public confidence in the exchange was seriously dented.⁸</p> <p>As regards the regulation of CIS, while there is currently no duplication of function between the Central Bank and CySEC, in the longer term as the system develops there would be merit in exploring the possibility of greater cooperation and, ultimately, the consolidation of regulation.</p>
Principle 2.	The regulator should be operationally independent and accountable in the exercise of its functions and powers.
Description	<p>CySEC appears to operate without any external political interference or interference from commercial or other sectoral interests in the taking of day-to-day decisions.</p> <p>The CySEC Law provides for the appointment of directors to CySEC by the Council of Ministers. It sets down objective criteria for the appointment, terms of office, and removal from office of directors.</p> <p>Members of the board of CySEC and any person who acts as a consultant or by order of the board bears no personal responsibility for his actions and omissions during the exercise of his responsibilities, unless the omission is proven to have been made intentionally.</p> <p>CySEC is accountable to the minister of finance and to the parliament on an ongoing basis. It is required by law to submit to the minister and to parliament on a yearly basis a report of activities and financial statements of the previous financial year. Further, CySEC board and staff are required to appear before the legislature from time to time.</p> <p>CySEC's funding is based on revenues from fees and annual subscriptions of investment firms and mutual funds, the reviewing of prospectuses, a fixed amount of £C 75,000 per annum payable by the Stock Exchange and a fixed (£C1.0 million) as well as a variable amount payable by the government. The variable amount is determined by the level of other revenues and the responsibilities allocated to CySEC. In 2005, for the first time ever, a variable amount—£C500,000—was approved.. This was to meet the increased responsibilities of CySEC. (In 2006 the approved variable amount was increased to £C 1.020 million). In general, the level of funding does not appear to be an issue for CySEC—an indication of this is that there appear to be adequate levels of staff currently in the organization.</p> <p>In dealing with natural or legal persons adversely affected by its decisions, CySEC is bound by the Public Administration Act which provides that such decisions must be founded on the principles of natural justice, fair play, impartiality, etc.</p> <p>One unusual feature of the CySEC Law is that CySEC must provide the minister of finance with any information that the minister may deem necessary for the benefit of the public interest. This provision has never been invoked, but it could be argued that in certain circumstances it could be open to abuse. It is understood that this provision will be revoked in forthcoming legislation.</p>
Assessment	Broadly implemented.
Comments	The section specifying that CySEC must provide the minister with any information he may deem necessary for the benefit of the public interest should be revoked to avoid any possibility of its being abused.

⁸ The authorities have indicated that the planned amendment to the Stock Exchange Law was enacted in September 2005. It is expected that this would have brought the necessary clarity to CySEC's role.

Principle 3.	The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.
Description	<p>The legislative framework for the effective supervision of the securities market by CySEC (and the residual supervisory role of the Central Bank in this area) appears adequate.</p> <p>However, CySEC faces a particular difficulty in relation to its supervision of the Stock Exchange. CySEC, like the Stock Exchange, is a public administrative body and one public administrative body cannot supervise another public administrative body. Accordingly, it cannot directly impose a range of actions such as restrictions or conditions on the exchange or withdraw its authorization. In a situation where it would want to take action against the exchange, it could notify the minister of finance of such; the minister could in turn recommend to the Council of Ministers that the exchange be ordered to suspend temporarily its operations. However, such an order can only be given in extraordinary circumstances justified by the public interest. In practice, CySEC and the exchange appear to have a satisfactory supervisor/supervisee relation, but clearly, the inability of the former to take action against the latter is unsustainable. The issue will have to be addressed at the latest with the transposition into national law in the coming year or so of the EU Directive on Markets in Financial Instruments, which specifies that the national regulator must regulate all market operators.</p> <p>On the question of adequate resources, CySEC currently appears to have adequate or near adequate levels of staff; but it will seriously have to consider expanding its staff numbers in the near future to cope with increased responsibilities, e.g., the transposition and implementation of the various EU Directives; the regulation of International Financial Advisors, etc.</p> <p>As regards funding, the CySEC Law provides for a combination of funding from the supervised sector and the government. The government pays a fixed annual sum of £C 1 million and a variable amount determined by the level of other revenues and the responsibilities allocated to CySEC. In 2005, for the first time ever, a variable amount—£C 200,000—was paid. This was to meet the cost of the increased responsibilities of CySEC.</p>
Assessment	Fully implemented.
Comments	<p>The inability of CySEC to regulate effectively the Stock Exchange merits a “Not implemented” assessment, and this is reflected in the assessment for Principle 26.</p> <p>While staff numbers appear adequate or near adequate at present, extra resources will be needed in the very near term to cope with clearly identifiable additional work.</p>
Principle 4.	The regulator should adopt clear and consistent regulatory processes.
Description	<p>The rules governing CySEC supervisory powers and processes, taken together with the provisions of the Cyprus Constitution, The Public Administration Act, and the court system, allow for a clear and consistent regulatory approach. There is no reason to believe that CySEC does not carry out its functions in an impartial and fair manner.</p> <p>An effective consultative process is in place with all interested parties regarding proposed legal or policy changes. CySEC discloses and explains its policies in announcements and circulars and on its internet page.</p> <p>All material decisions affecting third parties are subject to judicial review through an appeal to the High Court pursuant to Article 146 of the Constitution.</p>
Assessment	Fully implemented.
Comments	None.
Principle 5.	The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.
Description	<p>Under Section 13 of the CySEC Law, no board member (or spouse, relations, associated companies, etc.) may participate directly or indirectly for his personal benefit or for the benefit of third persons in any action or transaction or have professional interest which concerns an item under the control of CySEC and any breach of this provision, notwithstanding any criminal or disciplinary liability of the person responsible, will result in the revocation of his appointment. Obligations for disclosure of any interest which an employee has or may have exist in the Terms of</p>

	<p>Employment Regulation for employees of CySEC.</p> <p>On the question of confidentiality, under Section 31 of the CySEC Law, all employees are bound by the duty of confidentiality and observance of professional secrecy and are obliged to use this information exclusively for the exercise of their duties and must not disclose it except to the extent that such disclosure is necessary within the context of an administrative recourse to justice concerning the exercise of their duties, or in cases where it constitutes evidence for the commission of a criminal or disciplinary offense. Further, under the Terms of Employment Regulation, every oral or written information, which comes to the knowledge of an employee in the course of his duties is confidential and shall not be published to anyone, except in respect of the exercise of his duties.</p> <p>As regards observance by staff of procedural fairness in the performance of their functions, under the Terms of Employment Regulation (Part V), employees must perform their functions in a fair, objective, impartial, and impersonal manner.</p>
Assessment	Fully implemented.
Comments	None.
Principles of Self-Regulation	
Principle 6.	The regulatory regime should make appropriate use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, and to the extent appropriate to the size and complexity of the markets.
Description	The Stock Exchange has a limited self-regulatory role in respect of certain of its functions.
Assessment	Fully implemented.
Comments	None.
Principle 7.	SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.
Description	The Stock Exchange seeks to ensure the transparency of trading (see Principle 27) and oversees the systems for clearing and settlement of securities transactions (Principle 30). (CySEC monitors market abuse issues –Principle 28–and large exposure, default risk and unfair trading practices).
Assessment	Fully implemented
Comments	The inability of CySEC to regulate wholly the Stock Exchange is reflected in the assessment for Principle 26.
Principles for the Enforcement of Securities Regulation	
Principle 8.	The regulator should have comprehensive inspection, investigation and surveillance powers.
Description	<p>CySEC’s overall supervisory powers, including those relating to inspection, investigation, and surveillance powers, are ultimately derived from domestic legislation transposing relevant EU legislation, particularly the Investment Services Directive (soon to be replaced by the Markets in Financial Instruments Directive).</p> <p>CySEC, in accordance with the provisions of CySEC Law, has power to inspect the operations, books, and records of a regulated entity without having to give prior notice. It has also the power to obtain all data and information deemed necessary for the carrying out of its supervisory function. While it has difficulties in supervising the Stock Exchange for legal and constitutional reasons (see Principle 3), it does monitor trading on the exchange on a daily and real-time basis.</p> <p>CySEC has the ability to determine or have access to the identity of all customers of regulated entities.</p>
Assessment	Broadly implemented.
Comments	While Principle 26 carries a “Not implemented” in respect of the supervisory difficulties in connection with the Stock Exchange, a ”Broadly Implemented” rating is deemed appropriate here given that the Principle is specifically concerned with comprehensive powers of inspection, investigation and surveillance.
Principle 9.	The regulator should have comprehensive enforcement powers.
Description	Under both the CySEC Law and the Investment Firms (IF) Act 2002–2004, CySEC has broad enforcement powers. It can carry out inspections, obtain all relevant information as described under Principle 8, apply administrative fines (which in general terms appear adequate to act as a deterrent), and it can revoke authorizations. Under Section 23(6) of the regulations “Establishment and Operation of the Investor Compensation Fund of Clients of Investment Firms,” CySEC may

	<p>prohibit an investment firm from disposing of specific assets, with the objective of securing the interests of the clients or take, at its discretion, other appropriate measures for the attainment of this objective. (This would allow CySEC to freeze the assets of an investment firm).</p> <p>As regards obtaining information from other authorities in Cyprus where it itself is unable to obtain information, CySEC has the power under Section 29 of the CySEC Law to apply to the Registrar of Companies, the Stock Exchange, and to any public service for information necessary to an investigation, and these authorities are bound to give the CySEC all necessary information for the exercise of its responsibilities. Further, CySEC has entered an MOU with its fellow banking and insurance regulators in Cyprus regarding the exchange of information.</p>
Assessment	Fully implemented.
Comments	None.
Principle 10.	The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.
Description	<p>Under Section 26 of the CySEC Law, CySEC may carry out inspections in respect of investment firms, collective investment schemes, and related parties (e.g., managers of such schemes), companies the securities of which are listed on the Stock Exchange. It also has power to inspect the Stock Exchange, but, for legal and constitutional reasons, cannot do so (see Principle 3). Inspections are carried out on a risk-rated basis and from information obtained from CySEC and market participants there appears to be an active program of inspections.</p> <p>While there are difficulties in the supervision of the Stock Exchange per se, CySEC does monitor trading activity through its surveillance system based in its (CySEC) premises which is carried out on a daily and real-time basis. This system is also used to detect and investigate market abuse and insider dealing.</p> <p>CySEC oversees compliance with general supervisory requirements by means of examining regulatory reports submitted to it and through its inspection.</p> <p>Following an inspection, a report including the findings of the inspection is submitted to the CySEC Board. Following consideration by the board, the firm in question is notified of nonconformity, and the matter is followed up.</p> <p>As indicated under Principle 1, the Central Bank has a supervisory role in respect of residual international securities firms (i.e., financial advisors, supervision of which will transfer to CySEC in due course and non public collective investment schemes). The Central Bank has powers of inspection over these entities. It carries out inspections on an exceptional basis (i.e., if some issue of concern comes to its attention) but not on a routine basis. It relies on regulatory reporting, annual audited accounts, and annual meetings with each firm to effect supervision. It also relies on the cooperation of the Cyprus International Financial Services Association (CIFSA). CIFSA is a body established with the encouragement of the Central Bank to represent all Cyprus-based International Financial Services Companies (IFCs). It aims at promoting high ethical and professional standards among its members as well as acting as a conduit for investigation of investors' complaints. It also advises the Central Bank of the temporary or permanent presence in Cyprus of any entity which appears to be providing international financial services to the public, in or from within Cyprus, without proper authorization.</p>
Assessment	Fully implemented.
Comments	None.
Principles for Cooperation in Regulation	
Principle 11.	The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.
Description	<p>CySEC has entered into an MOU with its fellow banking and insurance regulators in Cyprus relating to the exchange of information. Also, under Section 29 of the CySEC Law, it has the power to apply to the Registrar of Companies, the Central Bank of Cyprus, the Board of the Stock Exchange, and to any public service, and these are bound to give to CySEC all necessary information, documents, and other data necessary for the exercise of its responsibilities.</p> <p>Under Section 30 of the CySEC Law, CySEC may cooperate with foreign regulators and exchange</p>

	with them information necessary for the exercise of their responsibilities. However, it cannot collect information and carry out investigations on behalf of foreign authorities unless CySEC has an independent interest in the matter. It is proposed to rectify this matter in forthcoming legislation.
Assessment	Not implemented.
Comments	The ability to share information without restriction and carry out investigations on behalf of foreign authorities is fundamental to regulatory cooperation. Its absence is of serious concern. It is noted, however, that the issue is to be addressed in forthcoming legislation.
Principle 12.	Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.
Description	<p>CySEC has the power to establish with both domestic and foreign regulators mechanisms for the sharing of information. Section 26 of the CySEC Law states that CySEC can collaborate with other public authorities in Cyprus in accordance with the provisions of the CySEC Law. As indicated under Principle 11, it has entered into an MOU with the banking and insurance regulators in Cyprus.</p> <p>Section 26 also provides that one of CySEC's responsibilities is to collaborate with competent authorities abroad. CySEC has entered into MOU with a number of foreign regulators. It is a signatory to the MOU sponsored by the EU Commission of European Securities Regulators (CESR). It is also a signatory to the IOSCO multilateral MOU (Appendix B). It is intended that following the introduction of the legislation referred to in Principle 11, CySEC will be in a position to sign Appendix A.</p>
Assessment	Fully implemented.
Comments	None.
Principle 13.	The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.
Description	<p>CySEC can generally provide effective and timely assistance to foreign regulators in securing compliance with laws and regulations, subject to the shortcomings identified under Principle 11, (the absence of the ability to collect information and carry out investigations on behalf of foreign authorities unless it has an independent interest in the matter). This assistance covers records for securities and derivatives transactions, insider dealing, market manipulation, registration, and issuance of securities, market intermediaries, etc.</p> <p>As regards information on the beneficial owners of international trusts set up under the laws of Cyprus, Section 11 of the International Trusts Law states "Subject to the terms of the Memorandum of Association of an international trust and provided the court does not issue an order for the provision of information in accordance with Section (2), the commissioner or any other person, including government officials and officers of the Central Bank of Cyprus, may not disclose to any person not authorized by law to know information or documents." CySEC is of the view that it may request and collect information from international trusts pursuant to Section 33 of the CySEC Law which states "The Commission shall have the power to request and collect information necessary for the exercise of its statutory responsibilities arising from this law and to demand in writing the provision of information within a specified time limit from issuers who have their share listed on the Stock Exchange, Members, underwriters investment consultants, investment firms, investments companies, as well as from all other natural or legal persons or organisations that the commission considers to be in a position to provide such information." By virtue of this provision CySEC is of the view that it is a person "authorized by law to know information or documents" leading to the identification of the beneficial owners of international trusts pursuant to section 11 of the International Trusts Law.</p> <p>CySEC has in the past managed to obtain information on the beneficial owners of international trusts and would, if requested, pass such information to the requesting authority.</p> <p>CySEC has encountered difficulties in respect to the identification of the beneficial owners of shares registered in the names of lawyers acting as nominees on behalf of the beneficial owners. The authorities are agreed that the legal professional privilege invoked by lawyers to refuse to provide the name of beneficial owners is based on a misconception as to the breadth of professional privilege, and are prepared to challenge the stance in court. However, CySEC has proposed amendments to the CySEC law to give CySEC clear authority to secure information on</p>

	the identity of beneficial owners of shares. The enactment of this bill is expected shortly.
Assessment	Broadly implemented.
Comments	It is important that CySEC confirm its ability to obtain the identity of beneficial owners of shares registered in the names of lawyers by passage of the planned amendment to legislation.
Principles for Issuers	
Principle 14.	There should be full, accurate and timely disclosure of financial results and other information that is material to investors' decisions.
Description	<p>Public offerings are governed by the Public Offer Law which in turn is governed by the EU Directive on the Drawing-up, Scrutiny and Distribution of the Prospectus to be Published when Transferable Securities are offered to the Public, 1989. The Public Offer Law sets out the conditions under which an offer of securities to the public can be made. Inter alia, it states that public offerings must be accompanied by a prospectus which has been previously approved by CySEC. The content of the prospectus must be verified by the issuer, each board member, and advisors/experts for the part of the prospectus that relates to their work. It must also be verified by the sponsoring broker. It is a criminal offense to knowingly make a statement which is false, misleading, or fraudulent with respect to a material aspect of the prospectus or conceal any material information.</p> <p>Issuers are required to publish their annual reports and audited financial statements within four months of their financial year end. They must also prepare and submit to the Stock Exchange for announcement half yearly accounts, preliminary statements of profits and losses, and any disclosures of material information.</p> <p>CySEC has a dedicated staff of five people to undertake its obligations in this area and all indications would suggest that these obligations are being adequately met.</p> <p>The CySEC and the Stock Exchange have the power to impose administrative fines if an issuer has breached any of its obligations imposed by law.</p>
Assessment	Fully implemented.
Comments	None.
Principle 15.	Holders of securities in a company should be treated in a fair and equitable manner.
Description	<p>The rights and equitable treatment of shareholders in public companies are set down in Cyprus company law (broadly based on U.K. company law) and on the Stock Exchange Law and regulations. Under these, all shareholders have the right to participate at general meetings and to vote for the election of directors. All shareholders holding shares of the same class should have the same voting rights. Provisions exist for the rights of minority shareholders. Certain corporate changes (e.g., increase in authorized share capital) require simple majority approval (i.e., 50 percent plus), whereas more fundamental changes require a 75 percent majority.</p> <p>In the case of a takeover bid, all shareholders of the same class of a targeted company must be treated equally and all shareholders must be given a reasonable time (i.e., between 30 and 45 days) to accept or reject the proposal.</p> <p>In September 2002, a Corporate Governance Code was introduced by the Stock Exchange, on a voluntary basis, for all public companies. In August 2004, it became mandatory for companies listed on its main market. Inter alia, it deals with the rights of shareholders.</p>
Assessment	Fully implemented.
Comments	None.

Principle 16.	Accounting and auditing standards should be of a high and internationally acceptable quality.
Description	<p>In accordance with the provisions of the Company Law and the Stock Exchange Law and Regulations, all financial statements are prepared in accordance with International Financial Reporting Standards (IFRSs). As indicated under Principle 14, all public companies are required to prepare comprehensive annual audited accounts.</p> <p>The Institute of Certified Public Accountants of Cyprus (ICPAC) is the regulatory body for accountants in Cyprus. It is a member of the International Federation of Accountants (IFAC). ICPAC has adopted the IFAC Code of Ethics for Professional Accountants as the ethical standard for all accountants in Cyprus. This code, which deals with the independence of external auditors among other matters, is mandatory for all members of ICPAC. Further, ICPAC has introduced a system of peer reviews which has enhanced the quality of audit in Cyprus.</p> <p>The "Big Four" accountancy firms are well represented in Cyprus and appear to be the auditors for almost all the major financial institutions.</p>
Assessment	Fully implemented.
Comments	None.

Principles for Collective Investment Schemes	
Principle 17.	The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.
Description	<p>There are two distinct collective investment scheme regimes in Cyprus. One is supervised by CySEC and is based on the EU UCITS Directives (CIS). The other—International Collective Investment Schemes (ICIS)—is supervised by the Central Bank. These are targeted at foreign investors and denominated in currencies other than Cyprus pounds.</p> <p>The CIS market in Cyprus is in its infancy. The first UCITS Law was enacted in March 2003. It was replaced by the UCITS Law which came into effect in July 2004 and reflects the two EU UCITS Directives of 2002. These directives lay down broad principles, and it is up to national regulators to issue detailed rules and regulations.</p> <p>To date, no CIS have been licensed by CySEC because market participants say that the tax regime in respect of UCITS is unfavorable. There are, however, about 50 UCITS licensed in other EU member states marketing their units in Cyprus under the so-called European passport and these are registered with CySEC.</p> <p>The UCITS Law lays down requirements which must be met by those proposing to launch CIS in Cyprus. These cover such issues as honesty and integrity of operators, competency, financial capability, operators' specific powers and duties, adequacy of internal management procedures, etc. These apply to both managers of CIS and CIS that are self managed.</p> <p>The law provides for the collection of data and the carrying out of on-site inspections necessary for the proper regulation of CIS.</p> <p>Section 4 of the UCITS Law provides for the drawing up by CySEC of a code of conduct. The broad intent of the code is that CIS operators should act in the best interests of unit holders in CIS and ensure the smooth operation of the market. The code should cover such issues as conflicts of interest, best execution, churning, related-party interests. To date, CySEC has not drawn up such a code but is in the course of doing so. It is strongly recommended that this be done as a matter of priority.</p> <p>Operators may delegate functions but not responsibilities to third parties. To do so, they need the approval of CySEC.</p> <p>It is premature to evaluate the practice of oversight of collective investment schemes as none has applied for authorization as yet and there appears to be no immediate prospect of any applications because of the tax situation referred to above. Currently, there are three staff members in this area who were involved in the transposition of the relevant EU Directive into Cypriot Law and would therefore have a good knowledge of the subject matter. As identified under Principle 3, should the funds industry develop in Cyprus, additional staff resources will be required.</p> <p>Those funds licensed by the Central Bank (i.e., ICIS) are governed by the The International Collective Investment Schemes Law, 1999. ICIS may take one of three forms: (i) those marketed to the general public; (ii) those marketed to experienced investors; and (iii) private international schemes. The latter two types are not targeted at the public. The same broad regulatory requirements apply to all three types, but some of the detailed requirements are disapplied to the latter two on the basis that they are not available to the general public. The regulatory requirements include: the operator of the scheme must be approved by the Central Bank and must meet the general requirements applied to CIS operators as described above. The operators and the schemes themselves must make regulatory reports to the Bank, and the Bank has the power to carry out on-site inspections. The Bank may, in accordance with the law, revoke the recognition of a scheme. It can also require the replacement of an operator or trustee.</p> <p>The first type of schemes, i.e., those marketed to the public, mirror the provisions of the previous EU UCITS Directive of 1985 in terms of investment restrictions, etc., but they cannot avail of the European passport. To date, no such fund has been authorized due to lack of demand, and the</p>

	<p>Central Bank has taken the decision not to authorize these funds in the future in the light of the introduction in Cyprus of UCITS. Consequently, the only CIS capable of being marketed to the public are those licensed by CySEC.</p> <p>The second type of scheme, i.e., those marketed to experienced investors entail a minimum initial investor subscription of \$50,000. Only two have been licensed to date, and, of these, only one has commenced operations. It has a net asset value of \$12.5 million.</p> <p>The third type—private—restricts the number of investors to 100 and is prohibited from marketing to the public. Thirteen such schemes exist with a total net asset value of \$380 million. The countries of origin of the operators include Greece, Russia, Hong Kong, Switzerland, and Egypt.</p> <p>Both the second and third type are not intended for the public and in many countries such schemes would not require authorization. The CBC monitors these schemes by an analysis of regulatory returns, audited annual accounts and by annual meetings with the operators; it also has the power of onsite inspection. In the case of the third type—private—the safeguards appear adequate to ensure that they are not marketed to the public, although there is a possibility, given that they can have up to 100 investors, that members of the public (although hard to define in this context) may find themselves included within the 100. However, these funds do not issue the offering memoranda that would permit sales to the public and their quarterly returns to the CBC indicate that none have more than 50 unitholders.</p> <p>The fact that there are currently two regulatory bodies charged with the regulation of collective investment schemes should not result in a duplication of functions in the immediate future, given the very different remits of the two bodies. In the light of developments, however, there may be a case in the future for the merging of these functions under one roof.</p>
Assessment	Fully implemented.
Comments	None.
Principle 18.	The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.
Description	<p>Under Section 10 of the UCITS Law, CIS may take one of two legal forms—contractual form of a common fund or that of a variable capital investment company.</p> <p>All CIS must prepare two prospectuses—full and simplified. Both must contain sufficient information to enable investors to make informed choices.</p> <p>The law provides that all material changes to the scheme's documentation must be approved in advance by CySEC.</p> <p>All CIS must have a depository for the safeguarding of the CIS assets and that depository must be independent of the management company.</p> <p>Section 114 of the law provides that an approved external auditor must audit the half yearly and annual reports of CIS.</p>
Assessment	Fully implemented.
Comments	None.
Principle 19.	Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.
Description	<p>The full and simplified prospectuses must disclose the valuation rules for all CIS assets and the method of calculation of net asset values.</p> <p>The law provides for full disclosure in the full and simplified prospectuses to enable investors to make informed decisions. This disclosure includes details of investment policies and objectives, rights of investors, methods of asset valuation, procedures for purchase, redemption and pricing of units, audited financial depository, etc.</p> <p>CySEC, when licensing a CIS, has the power to hold back the approval where the relevant</p>

	regulatory requirements have not been satisfied.
Assessment	Fully implemented.
Comments	None.
Principle 20.	Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.
Description	<p>Section 118 of the UCITS Law provides guidance on how the assets of the CIS must be valued, and CySEC has the power to issue directives to elaborate further on valuation methods.</p> <p>The accounts of CIS must be prepared in accordance with International Accounting Standards and these standards should be reflected in the calculation of the net asset values of CIS.</p> <p>The UCITS Law sets down specific requirements for the valuation of publicly quoted companies, but there are no specific rules for valuing other assets held by CIS. This is being addressed in a directive to be issued by CySEC.</p> <p>Under Section 55 of the UCITS Law, the depository is required to ensure that the valuation of the CIS is carried out in accordance with the law and the scheme's rules.</p> <p>Section 115 of the UCITS Law provides for the pricing upon redemption and subscription on a daily basis and in accordance with the valuation rules of the scheme. Section 115 also provides that the price of CIS must be made public one day after the date of its calculation.</p> <p>The law provides that the operator must obtain the prior approval of CySEC in the event of suspension of the issue or redemption of the units of CIS.</p> <p>Sections 134 and 145 of the UCITS Law provide that in the event of noncompliance with any provisions of the UCITS Law, CySEC has the power to revoke the license of the CIS or impose administrative fines.</p>
Assessment	Partly implemented.
Comments	Specific rules for the valuing of assets other than shares in publicly quoted companies should be introduced before any schemes are authorized.
Principles for Market Intermediaries	
Principle 21.	Regulation should provide for minimum entry standards for market intermediaries.
Description	<p>The Act governing the regulation of market intermediaries is the Investment Firm's Law of 2002–2004. ("IF Law"). Prior to that Act coming into effect, there were two categories of market intermediaries: (i) members of the Stock Exchange (i.e., stock brokers) who were authorized and supervised under Stock Exchange legislation and (ii) International Financial Intermediaries which were regulated by the Central Bank. These were intermediaries that could offer their services to nonresidents only.</p> <p>Following the coming into effect of the IF Law in 2002, which reflects EU law in this area, all intermediaries with the exception of investment advisors are required to be supervised in the same manner. Consequently, the international intermediaries regulated by the Central Bank are now regulated by CySEC with the exception of international financial advisors (see below). In theory, all intermediaries can now offer their services in Cyprus; in practice, however, the former so-called international intermediaries by and large continue to offer their services to nonresidents. One of the reasons why some continue to offer their services solely to nonresidents is because they have elected to continue to be taxed at the lower rate of 4.25 percent until end-2005.</p> <p>As of the date of this assessment, CySEC had authorized 47 intermediaries, 15 of which were "local" intermediaries (almost all members of the Stock Exchange). The remaining 32 were former international intermediaries, many of whom operate in Russia for Russian citizens.</p> <p>As indicated already, the IF Law reflects the provisions of the EU Investment Services Directive. There is a comprehensive authorization process for new entrants which covers such issues as probity and competence of the principals, initial capital, internal controls, and risk management systems, etc. Details of these requirements are available on CySEC's website.</p>

	<p>Section 10 of the law gives CySEC the power to refuse authorization if authorization requirements have not been met.</p> <p>Intermediaries are required to notify CySEC of any projected changes in circumstances affecting the conditions of the license.</p> <p>On CySEC's website, there is a list of intermediaries authorized by it indicating the services for which they were authorized.</p> <p>CySEC has the power to inspect intermediaries and has carried out 13 on-site inspections last year.</p> <p>Intermediaries who solely provide investment advice (i.e., they do not deal on behalf of clients, they do not hold client assets, they do not manage investment portfolios) are not as yet subject to regulation by CySEC. This will change with the transposition into national law of the new EU Investment Services Directive, known as the Markets in Financial Instruments Directive, and under which investment advice is regarded as an investment service. The Central Bank, however, does regulate International Financial Advisory Firms. These offer advice only and act for nonresidents only (e.g., U.K. ex-patriates located in the Middle East). A draft law has been prepared, even before the transposition of the Markets in Financial Instruments Directive into Cyprus Law, to transfer responsibility for their supervision from the Central Bank to CySEC.</p> <p>Currently, the Investment Firms unit in CySEC employs a staff of eight who are involved in the authorization and on-going supervision of market intermediaries. From discussions with, and observations of the unit, it was concluded that the authorization and supervisory processes and procedures were satisfactory. This was confirmed by visits to a number of investment firms who expressed respect for the competence of the unit.</p>
Assessment	Fully implemented.
Comments	None.
Principle 22.	There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.
Description	<p>The initial own funds of intermediaries varies between Cyprus £100,000 (\$220,000 approx.) and £500,000 (\$1.1 million approx) depending on the investment services they propose to provide. On an ongoing basis, their capital must never fall below 25 percent of the previous year's expenses or the initial capital, whichever is the higher (with a view to being able to absorb losses and effect an orderly run down of business, if necessary). Also, the minimum capital ratio is set at 10 percent. The capital adequacy requirements are structured to reflect the risks to which intermediaries are subject and cover, in particular, position risk, settlement and counter-party risks, foreign-exchange risk, and large exposures in relation to their trading book business.</p> <p>Depending on the services provided, intermediaries are required to report to CySEC on a monthly, quarterly, or six-monthly basis. They must also submit audited (external) annual accounts.</p>
Assessment	Fully implemented.
Comments	None.
Principle 23.	Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.
Description	<p>Under the law, intermediaries are required to have an appropriate management and organizational structure. They are required to have a board of directors that exercises a substantial role in the running of the business and consists of both executive and nonexecutive independent directors, at least two experienced and competent persons to manage it and a viable organizational structure.</p> <p>The law also requires intermediaries to have adequate internal controls systems and to appoint an internal auditor.</p> <p>CySEC has prepared a code of business conduct which must be observed by all intermediaries. In broad terms, it deals with the protection of customers' interests and safeguarding the regular operation of the capital markets. Inter alia, it specifically deals with the need to know customers' investment needs, avoiding/managing conflicts of interests, minimum contents of customer</p>

	<p>agreements, and periodic provision of customer information.</p> <p>Intermediaries must have a unit responsible for the processing and resolution of customer complaints. Resolution of customer complaints must be achieved without undue delay, taking into account the gravity of the complaint and the range of the attendant financial implications resulting therefrom, both for the customer and the intermediary.</p> <p>In accordance with a directive issued by CySEC, intermediaries are required to have in place mechanisms that ensure the safe segregation of customer assets in their possession from their own assets as well as from the assets of their other customers.</p> <p>Intermediaries are required to have a compliance officer for money laundering purposes, and the larger firms will generally have compliance officers for other legal and regulatory purposes. Currently, a draft law exists which provides for the establishment of a financial services ombudsman who will cover all financial sectors (i.e., banking, insurance, and securities).</p>
Assessment	Fully implemented.
Comments	None.
Principle 24.	There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.
Description	<p>CySEC has in place mechanisms that act as early warning systems for difficulties in an intermediary. These include regular capital adequacy returns, management accounts every three months, and annual audited accounts. It also carries out on-site inspections.</p> <p>Section 16 of the IF Law gives CySEC the power to restrict the activities of an intermediary by suspending or withdrawing fully or partly its authorization with a view to minimizing damage and loss to investors. It also has the power to appoint a receiver.</p> <p>Under Sections 45 and 46 of the IF Law, CySEC has the power to communicate and cooperate with both domestic and foreign regulatory authorities in dealing with financial disruption.</p> <p>Section 23(6) of the Investor Compensation Regulations provides that CySEC can prohibit intermediaries from disposing of specific assets with the objective of securing the interests of their clients or take, at its discretion, other appropriate measures to attain this objective.</p>
Assessment	Fully implemented.
Comments	None.
Principles for the Secondary Market	
Principle 25.	The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
Description	<p>The Stock Exchange is the only securities exchange in Cyprus. Under the Stock Exchange Law, it has exclusive rights, for political and historical reasons, to undertake stock market transactions in movable securities in Cyprus. The political and historical reasons relate to the nongovernment controlled areas issue. While there is no authorization regime for exchanges, no new exchange could establish without a change in the law. Such change will happen when the EU Directive on Markets in Financial Instruments (MiFID) is transposed into Cyprus in the next year or two. It requires that the regulator sets out criteria for the authorization of exchanges.</p> <p>The Stock Exchange was established in 1996. It is 100 percent owned by the State. It deals mainly in equities and bonds. It does not deal in derivatives, and stock lending and short selling is forbidden. Market capitalization is in the region of €C4.4 billion (\$10 billion approx.). There are 17 main listings, including 4 banks. Dealings in the banks' stocks account for most of the trading activity. Turnover is quite low—in the region of €C1.2 million daily. However, this fell to €C250,000 in late March/early April 2005 partly due to the collapse of a broking firm. All listed securities, except government bonds, are dematerialized. Talks are being held with the Athens' Stock Exchange with a view to establishing a common trading platform. (An agreement was reached in October 2005, and the platform will commence trading in 2006). The exchange has eight members.</p> <p>In 1999/2000, the exchange witnessed a severe collapse in prices. The index fell from about</p>

	800 points to about 80 points. While many Cypriots suffered significant losses, there was no drawdown on the exchange's compensation fund which was established to ensure the security of Stock Exchange transactions in cases where its members (i.e., broking firms) face financial difficulties in meeting their obligations to their clients or third parties.
Assessment	Fully implemented..
Comments	This has been a very difficult principle to assess. There are no authorization procedures for the establishment of exchanges; however, no new exchange can establish without a change in the law. The granting of exclusive rights to the current exchange was not to restrict new entrants but for political and historical reasons relating to the nongovernment controlled areas issue. In any event, when the MiFID is adopted, exchange authorization criteria will have to be introduced. In the circumstances, a "fully implemented" assessment was deemed the most appropriate.
Principle 26.	There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.
Description	<p>CySEC is charged with the supervision of the Stock Exchange; but, as indicated under Principle 3, it faces a particular difficulty in carrying out that supervision. CySEC, like the exchange, is a public-administrative body and one public-administrative body cannot supervise another public-administrative body. Accordingly, it cannot directly impose a range of actions such as restrictions or conditions on the exchange or withdraw its authorization. In a situation where it would want to take action against the exchange, it could notify the minister of finance of such; the minister could in turn recommend to the Council of Ministers that the exchange be ordered to suspend temporarily its operations. However, such an order can be given in extraordinary circumstances justified by the public interest. In practice, CySEC and the exchange appear to have a satisfactory supervisor/supervisee relationship, but clearly, the inability of the former to take action against the latter is unsustainable. The issue will have to be addressed at the latest with the transposition into national law of the EU Directive on Markets in Financial Instruments which specifies that the national regulator must regulate market operators.</p> <p>Because of these difficulties, CySEC has never carried out an inspection of the Stock Exchange. It is strongly recommended that when the constitutional difficulty has been resolved, CySEC carry out an inspection of the exchange as a matter of urgency.</p> <p>Notwithstanding the above, CySEC monitors trading on the exchange on a daily and real-time basis. It processes and analyzes the data received by the real-time database and produces exception reports from the database.</p> <p>Amendments to the rules of the exchange and trading system require the prior approval of CySEC.</p>
Assessment	Not implemented.
Comments	It is essential that CySEC be in a position to supervise effectively the Stock Exchange.
Principle 27.	Regulation should promote transparency of trading.
Description	<p>Market users have instant access to all pre-trade and post-trade information. Any information on the screens of the market participants' terminals is relayed promptly and synchronously to all, including investors (through data vendors).</p> <p>The exchange does not permit derogation from the objective of real-time transparency.</p>
Assessment	Fully implemented.
Comments	None.
Principle 28.	Regulation should be designed to detect and deter manipulation and other unfair trading practices.
Description	<p>Under Section 67 of the Cyprus Securities and Stock Exchange Laws, a person engaging in market or price manipulation commits an offense which is punishable by imprisonment of up to seven years or with a fine of up to €20,000 (\$44,000 approx.) or both. (The amended law of September 2005 repeals section 67, market manipulation is now punishable under the market abuse law, No. 116(I)2005 that tightens the criminal sanctions and allows for administrative fines). Providing misleading information and insider trading also constitutes offenses punishable by imprisonment and a fine.</p> <p>CySEC seeks to detect and deter such action through its direct connection to the exchange's trading</p>

	<p>system. CySEC is also connected to the Central Depository and Central Registry of the Stock Exchange. This provides CySEC with instant access to the identities of all investors. In the event of unusual and potentially improper trading, CySEC contacts the internal auditor of the brokerage firm and seeks explanations. Whenever there is an indication of potentially improper trading, CySEC has wide powers to deal with the issue, e.g., to enter and investigate, impose administrative sanctions, including fines, suspend, and withdraw authorization.</p> <p>If a CySEC officer identifies a potential violation of the laws relating to market abuse, the Board of CySEC can instigate a more formal investigation or submit the case to the Attorney General, depending on the level and quality of evidence and whether the violation prima facie constitutes a criminal offence. The enforcement procedures have generally been effectively enforced since the coming into force of the CySEC Laws in 2001. There are, however, two impediments to their full effectiveness. The first is the weakness identified in Principle 1 concerning the lack of supervisory clarity arising from the overlap of responsibilities between CySEC and the Central Bank in the supervision of issuers of securities.⁹ The second relates to the inability of CySEC to supervise the Stock Exchange. This prevents CySEC from applying enforcement actions to the Stock Exchange (see Principle 26). As the assessments for both Principle 1 and Principle 26 have been qualified to reflect the above respective weaknesses, it is not intended to duplicate these qualifications here.</p>
Assessment	Fully implemented.
Comments	None.
Principle 29.	Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.
Description	<p>The large exposures of investment firms are monitored by CySEC in its monitoring of capital adequacy ratios. In addition, in order to cover counter party risk, each member of the Stock Exchange places in a special clearing deposit account an amount of at least £C50,000 (\$110,000 approx.) and a percentage of the value of his transactions each year. Also, each investor's holding is held in a segregated account.</p> <p>Should a member of the exchange fail to pay, the exchange will immediately advise CySEC, who will investigate the matter.</p> <p>The exchange makes its default procedures available to market participants through its laws, regulations, rules, and circulars.</p>
Assessment	Fully implemented.
Comments	None.
Principle 30.	Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.
Description	<p>The laws, regulations, rules, and contractual provisions of the Stock Exchange are published in the Official Cyprus Gazette, and copies are available at the Stock Exchange. Among the procedures in place to protect customers are a delivery versus payment system and the fact that customers' assets are kept in segregated accounts (in their own individual names) in the Central Depository Central Registry.</p> <p>Trades are settled on a rolling T+3 basis. No failed trades have occurred over the last three years. In the case of a failure, the exchange has the power to use the member's deposit balances referred to in Principle 29, sell securities and credit the member accordingly, impose on the member a fine not exceeding £C500 or up to 10 percent of the total amount of the transaction for every day that the member fails to meet his obligations.</p>

⁹ The authorities have indicated that the planned amendment to the Stock Exchange Law was enacted in September 2005. It is expected that this would have brought the necessary clarity to CySEC's role.

	<p>Securities lending is not permitted.</p> <p>All securities except government bonds are dematerialized. There is no lag between settlement and registration.</p> <p>The settlement bank is the Bank of Cyprus, the largest commercial bank in Cyprus. Settlement takes place in Cyprus pounds only.</p> <p>The head of each department in the exchange reviews the processes for identifying and managing operational risks on a continuous basis. They are also reviewed by the internal auditor.</p>
Assessment	Fully implemented.
Comments	None.

Table 19. Summary Implementation of the IOSCO Objectives and Principles of Securities Regulation

Assessment Grade	Principles Grouped by Assessment Grade	
	Count	List
Implemented	23	3, 4, 5, 6, 7, 9, 10, 12, 14, 15, 16, 17, 18, 19, 21, 22, 23, 24, 25, 27, 28, 29, 30
Broadly Implemented	2	2, 8, 13
Partly Implemented	2	1, 20
Not Implemented	3	11, 26
Not applicable	0	

H. Recommended Actions and Authorities' Response to the Assessment

Recommended Actions

Table 20. Recommended Plan of Actions to Improve Implementation of the IOSCO Objectives and Principles of Securities Regulation

Reference Principle	Recommended Action
Principles Relating to the Regulator (P 1–5)	<p>Principle 1. The uncertainty surrounding the respective responsibilities of CySEC and the Stock Exchange in the supervision of issuers of securities should be addressed as a matter of urgency to bring clarity to the situation. It is noted that an appropriate amendment is to be made to the Stock Exchange Law.¹⁰</p> <p>Principle 2. It is recommended that the provision in the CySEC Law whereby CySEC must provide the minister of finance with any information he may deem necessary for the benefit of the public interest should be revoked to maintain without question the operational independence of CySEC.</p> <p>Principle 3. While staff numbers appear to be generally adequate at present, extra resources will be required in the near future to cope with the expanding work load of CySEC, e.g., the implementation of new EU Directives.</p>
Principles of Self-Regulation (P 6–7)	Fully implemented.
Principles for the Enforcement of Securities Regulation (P 8–10)	
Principles for Cooperation in Regulation (P 11–13)	<p>Principle 11. It is recommended that the authorities remove the obstacle that prevents CySEC from sharing information and carrying out investigations on behalf of foreign regulators in situations where CySEC does not have an independent interest in the matter being investigated. It is noted that this issue will be addressed in forthcoming legislation.</p> <p>Principle 13. In the interests of being able to cooperate fully with foreign regulators, it is important that CySEC confirms the ability to obtain information on the beneficial owners of shares from lawyers acting as nominees. It is noted that CySEC aims to seek an amendment in forthcoming legislation to remove the uncertainty.</p>
Principles for Issuers (P 14–16)	Fully implemented.

¹⁰ The authorities inform that the appropriate amendment to the Stock Exchange Act was enacted in September 2005. It is expected that this would have achieved the required clarity.

Principles for Collective Investment Schemes (P 17–20)	Principle 20. It is recommended that for UCITS, CySEC introduce specific rules for the valuing of assets other than shares in publicly quoted companies. CySEC has undertaken to have these rules in place before authorization is given.
Principles for Market Intermediaries (P 21–24)	Fully implemented.
Principles for the Secondary Market (P 25–30)	Principle 26. Legislation should be introduced as a matter of urgency to allow CySEC to supervise effectively the Stock Exchange. This would entail a revision to the equal constitutional status of both bodies whereby CySEC as a public-administrative body cannot supervise the exchange, another public-administrative body.

Authorities' Response

Reference Principle	Authorities Response
Principles Relating to the Regulator (P 1–5)	<p data-bbox="808 401 922 432"><i>Principle 1</i></p> <ul data-bbox="808 464 1411 974" style="list-style-type: none"> • On September 9 2005, three laws came into force in the Republic of Cyprus, which go a long way towards bringing greater clarity to the respective responsibilities of CySEC and the Cyprus Stock Exchange. The first (Law N.115(I)/2005) is a law providing for significant amendments to the Stock Exchange Law, and clearly designates the responsibilities of the Cyprus Stock Exchange and the CySEC regarding issuers, so as to remove ambiguities and overlaps in the exercise of their respective competencies which existed in the previous legal regime (for example, in the supervision of issuers and the imposition of sanctions). The other two are laws designed for the transposition into domestic law of the EU Prospectus Directive (Law N. 114(I)/2005) and the EU Market Abuse Directives (Law N. 116(I)/2005) and the complete harmonization of the legal regime in Cyprus with the European <i>acquis communautaire</i> in the respective areas. <p data-bbox="808 1005 922 1037"><i>Principle 2</i></p> <ul data-bbox="808 1068 1411 1234" style="list-style-type: none"> • CySEC is finalising the drafting of a bill amending the CySEC Law, under which the provision currently contained in the CySEC Law whereby CySEC must provide the Minister of Finance with information, is revoked. It is expected that this bill will be enacted into law in 2006. <p data-bbox="808 1266 922 1297"><i>Principle 3</i></p> <ul data-bbox="808 1329 1411 1491" style="list-style-type: none"> • CySEC plans to significantly increase the numbers of its skilled staff in the following months in order to meet its increased responsibilities. Its budget approved and voted for by the Parliament for the 2006 financial year provides for a 29 percent increase in the budget allocated for staff costs.

Principles for Cooperation in Regulation (P 11–13)	<p><i>Principle 11</i></p> <ul style="list-style-type: none"> • CySEC is finalising the drafting of a bill amending the CySEC Law, under which the obstacle in sharing information and carrying out investigations on behalf of foreign regulators in situations where CySEC has no independent interest in the matter being investigated, is removed. It is expected that this bill will be enacted into law in 2006. <p><i>Principle 13</i></p> <ul style="list-style-type: none"> • CySEC has proposed appropriate amendments to the CySEC law in order to give CySEC clear authority to secure information on the identity of beneficial owners of shares which are registered in the names of lawyers acting as nominees of the beneficial owners. The enactment of this bill is expected to take place in 2006.
Principles for Collective Investment Schemes (P 17–20)	<p><i>Principle 20</i></p> <ul style="list-style-type: none"> • No schemes have been authorised by CySEC to-date. CySEC undertakes to have these rules in place before any such authorisation is given.
Principles for the Secondary Market (P 25–30)	<p><i>Principle 26</i></p> <ul style="list-style-type: none"> • CySEC shall take the appropriate steps, so as this issue is addressed with the transposition into national law of the EU Directive on Markets in Financial Instruments and to soon be in position to effectively supervise the Cyprus Stock Exchange.