EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 26 November 2013

on the licensing, regulation and supervision of cooperative credit institutions

(CON/2013/81)

Introduction and legal basis

On 3 September 2013, the European Central Bank (ECB) received a request from the Minister for Finance of the Republic of Cyprus for an opinion on a series of proposed amendments to Cypriot banking legislation (hereinafter the 'amending laws'). The amending laws were adopted by the House of Representatives on 5 September 2013 and published in the Official Gazette on 9 September 2013.

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the third and sixth indents of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions[1], as the amending laws relate to rules applicable to the Central Bank of Cyprus (CBC) and to financial institutions insofar as they materially influence the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the amending laws

1.1 General

The amendments follow the need to implement the Memorandum of Understanding between the Republic of Cyprus and the European Stability Mechanism, and specifically to bring the licensing, regulation and supervision of cooperative credit institutions (CCIs) into line with the regime for commercial banks by integrating these functions into the CBC. The amending laws are also intended to strengthen the corporate governance of commercial banks and CCIs. Additionally, the amending laws put the Deposit Protection Fund (DPF) for CCIs under the CBC's general responsibility and specifically under the administration of the Deposit Protection and Resolution of Credit and Other Institutions Scheme. The amending laws amend the following legislative and regulatory instruments:

1.2 *The Business of Credit Institutions Laws of 1997 to (No. 3) 2013*

Several new provisions refer to the CBC's licencing, regulation and supervision of CCIs. All legislative provisions currently applicable to banks are made applicable to authorised credit

1 OJ L 189, 3.7.1998, p. 42.

institutions (ACIs), which are defined to include CCIs. CCIs are required to obtain a licence from the CBC before accepting deposits from the public and lending funds in the Republic of Cyprus or abroad. A CCI's affiliation to the Cooperative Central Bank (CCB), which is the CCI's central institute, requires the CBC's prior approval under conditions that are set by the CBC. Additionally, the solvency and liquidity of the CCB and the CCIs are subject to the CBC's supervision, and CCIs are subject to the same liquidation and winding up rules applicable to commercial banks. CCIs are prohibited from providing cross-border services prior to 31 March 2014. Additionally, existing regulations, directives and other administrative acts also apply to and shall be implemented by CCIs.

Several amendments pertain to the corporate governance of commercial banks and CCIs. ACIs are prohibited from having any credit exposure to independent members of their management bodies; credit exposure to non-independent members of ACIs' management bodies is permitted under certain conditions. The level of credit facilities available to all non-independent members of ACIs' management bodies is reduced to 10% of own funds and the level of unsecured credit facilities to 1% of own funds. Credit facilities available to any non-independent member of the ACIs' management bodies are limited to EUR 500 000, whereas independent members are not allowed to obtain any credit facilities. An ACI's credit exposure to shareholders who directly or indirectly hold more than 10% of their share capital is limited to 20% of own funds, and to 2% if the credit exposure is not secured with tangible security. ACIs are obliged to terminate the appointment of members of a management body whose facilities are in arrears, and the restrictions imposed in relation to members of a management body extend to their related persons, including their spouses and dependents.

ACIs are prohibited from acquiring or dealing in their own shares for their own account without the CBC's prior approval. They are also prohibited from financially assisting in the acquisition of their own shares, or shares of their holding or subsidiary companies.

1.3 *The Laws on Cooperative Societies of 1985 to (No. 3) of 2013*

Several provisions refer to the transfer of the licensing, regulatory and supervisory powers over CCIs from the Cooperative Societies Authority to the CBC. Basic terms have been introduced which will govern CCIs' ordinary shares so they are classified as Common Equity Tier-1 capital in accordance with Regulation (EU) 575/2013 of the European Parliament and the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms[2].

The external audit of CCIs' accounts whose size exceeds the limit set by the CBC will be performed by independent auditors instead of the Cooperative Societies Audit Service. The independent auditors will be appointed by a CCI's general assembly and will be approved by the CBC.

2 OJ L 176, 27.6.2013, p. 1.

Arrangements are introduced for the recapitalisation of the CCB and CCIs through the acquisition of capital from the Republic of Cyprus, and CCIs are prohibited from lending to individuals who are not their members.

The liquidation of CCIs will be carried out in accordance with the provisions of the Business of Credit Institutions Laws and the Companies Law, and provisions have been introduced to facilitate CCI mergers.

The amendments also include provisions under which the Law on the Financial Ombudsman is applied to the arbitration framework of CCIs. In addition, the CBC Code of Conduct in relation to the management of loans or other credit facilities in arrears is also applied to CCIs.

The Deposit Protection Scheme for CCIs is under the CBC's responsibility and will be governed by the provisions of the Law on the Deposit Protection and Resolution of Credit and Other Institutions Scheme.

1.4 *The Laws on the Central Bank of Cyprus of 2002 to 2013*

Amendments have been introduced to generally reflect that the supervision of CCIs is brought within the CBC's regulatory and supervisory competence, and restrictions have been imposed on CBC officers from holding office in ACIs or from participating in the capital of ACIs, without first obtaining approval from the CBC's Board.

1.5 *The Law on the Deposit Protection and Resolution of Credit and Other Institutions Scheme*

The main purpose of the amendments is to implement the transfer of the DPF of CCIs under the administration of the Management Committee of the Deposit Protection and Resolution of Credit and Other Institutions Scheme.

2. Appropriate time to consult the ECB

The consulting authority sent the request for an opinion only two days before the amending laws were adopted by parliament. The consultation request did not make any reference to such timetable and did not indicate such a deadline for preparing the opinion. Pursuant to Article 4 of Decision 98/415/EC, the ECB must be consulted at an appropriate stage in the legislative process. This implies that the consultation should take place at a point in the legislative process that allows the ECB sufficient time to examine the draft legislative provisions and adopt its opinion, and the national authorities to take into account the ECB's views in accordance with Decision 98/415/EC. Therefore, the ECB would appreciate the consulting authority honouring its obligation to consult the ECB in good time in future.

3. Principle of central bank independence

3.1 The principle of central bank independence requires Member States to ensure that national central banks (NCBs) have sufficient financial resources to perform European System of Central Banks or

Eurosystem-related tasks as well as their own national tasks[3]. Pursuant to the Laws on Cooperative Societies of 1985 to (No. 3) of 2013, the powers of licencing, regulation, supervision and imposition of supervisory measures over CCIs are transferred from the Cooperative Societies Authority to the CBC. The transfer of these tasks to the CBC should not affect the CBC's ability to carry out its Eurosystem-related tasks from an operational and financial point of view. In this respect, the new CBC functions should be performed in a manner that is fully compatible with the CBC's institutional and financial independence and consequently should not impede the proper performance of its Eurosystem-related tasks. The CBC should be able to collect fees for the performance of its new supervisory tasks that began on 9 September 2013. In this respect, the ECB welcomes that pursuant to Section 26(3) of the Business of Credit Institutions Laws, the CBC has the power to demand that authorised credit institutions, including CCIs, pay to it the costs relating to their supervision, thereby safeguarding its financial independence. The ECB understands that the CBC has put in place a regulatory framework implementing Section 26(3) of the Business of Credit Institutions Laws under which the supervised entities pay supervisory fees.

3.3 The ECB understands that the transfer of jurisdiction and power from the Cooperative Societies Authority to the CBC as regards CCIs provided by the Laws on Cooperative Societies of 1985 to (No. 3) of 2013 does not involve any transfer of liabilities. Provisions under which an NCB becomes the legal successor to any liabilities of a specific supervisory authority may raise issues in regard to financial independence and compliance with the prohibition of monetary financing laid down in Article 123(1) of the Treaty[4], read in conjunction with Council Regulation (EC) No 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b (1) of the Treaty[5].

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 26 November 2013.

[signed]

The President of the ECB

Mario DRAGHI

3 See, *inter alia*, the ECB's Convergence Report of June 2013, p. 30, paragraph 3 of Opinion CON/2011/69 and paragraph 2.3 of Opinion CON/2012/52.All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

4 See paragraph 3.2.3 of Opinion CON/2010/33.

5 OJ L 332, 31.12.1993, p. 1.