



EUROPEAN CENTRAL BANK

EUROSYSTEM

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ECB-PUBLIC

OPINION OF THE EUROPEAN CENTRAL BANK

of 11 October 2016

on the handling of real property or share capital acquired by a credit institution after a debt settlement process

(CON/2016/48)

Introduction and legal basis

On 9 August 2016 the European Central Bank (ECB) received a request from the Ministry of Finance of Cyprus for an opinion on a draft law amending the Laws on the business of credit institutions 1997 to 2016¹ (hereinafter the 'draft law').

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/EC², as the draft law contains provisions relating to a national central bank, the ESCB's task of contributing to the smooth conduct of policies pursued by competent authorities relating to the prudential supervision of credit institutions and the stability of the financial market system pursuant to Article 127(5) of the Treaty, and the tasks conferred on the ECB pursuant to Article 127(6) of the Treaty concerning policies relating to the prudential supervision of credit institutions. 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 draft law

- 1.1. The main purpose of the draft law is to harmonise Cypriot law with Directive 2013/36/EU of the European Parliament and of the Council³, Directive 2014/59/EU of the European Parliament and of the Council⁴, and Directive 2014/17/EU of the European Parliament and of the Council⁵, as well as

¹ Business of Credit Institutions Law of 1997 to 2016 (L. 66(I)/1997),(L. 74(I)/1999),(L.94(I)/2000),(L.119(I)/2003),(L.4(I)/2004),(L.151(I)/2004),(L.231(I)/2004),(L.235(I)/2004),(L.20(I)/2005),(L.80(I)/2005),(L.100(I)/2009),(L.123(I)/2009),(L.27(I)/2011),(L.104(I)/2011),(L.107(I)/2012),(L.14(I)/2013),(L.87(I)/2013),(L.102(I)/2013),(L.141(I)/2013),(L.5(I)/2015),(L.26(I)/2015),(L.35(I)/2015),(L.71(I)/2015),(L.93(I)/2015),(L.109(I)/2015),(L.152(I)/2015),(L.168(I)/2015),(L.21(I)/2016).

² Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

³ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.06.2013, p.338).

⁴ Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.06.2014, p.190).

to ensure that Cypriot law complies with Guidelines EBA/GL/2012/06 of the European Banking Authority⁶.

- 1.2 The draft law also introduces certain provisions that are specific to Cypriot law. In particular, the draft law expands the circumstances in which a credit institution may exercise a business activity where the credit institution, as a consequence of debt settlement proceedings, has acquired immovable property or share capital in another company. Under the draft law, a credit institution that acquires property following such proceedings may (a) carry out maintenance work on the property, (b) lease the property to third parties as long as the rent does not limit the possibilities of selling the property or (c) in cases where the credit institution has taken all the appropriate actions to sell the property but these were unsuccessful, may complete any semi-finished works or develop the property in order to make it marketable, in line with a viability study⁷. The draft law further provides that, if a credit institution has acquired share capital in a company following debt settlement proceedings, the credit institution may appoint a receiver or a manager to wind up the company or a manager to run the company with a view to maintaining its value prior to foreclosure⁸. Credit institutions that acquire another company's share capital during debt settlement proceedings must dispose of this share capital within three years of the date of its acquisition. However, upon request by the credit institution, the Central Bank of Cyprus (CBC) may agree to extend the three-year deadline due to exceptional circumstances⁹.
- 1.3 Additionally, the draft law imposes restrictions on granting credit facilities to the members of the management bodies of credit institutions and to persons holding more than 10% of the share capital of the credit institution. According to the draft law, these restrictions apply subject to Part Four of Regulation (EU) No 575/2013 of the European Parliament and of the Council¹⁰.
- 1.4 The draft law also provides that, in determining compliance with the restrictions on granting credit facilities to the members of the management bodies and to persons holding more than 10% of the share capital of the credit institution, the CBC may exempt any exposure having regard to the exceptionally low risk arising from the exposures concerned. The draft law deletes the existing provision in the Laws on the business of credit institutions 1997 to 2016, which states that such exemptions must not be in conflict with Union legislation currently in force in Cyprus.
- 1.5 The draft law prohibits legal entities from acting as members of the management board of a credit institution established in Cyprus. The draft law further specifies that no person may act as a member of the management board or a senior manager, nor may any person hold a key function or

5 Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 (OJ L 60, 28.02.2014, p. 34).

6 Guidelines EBA/GL/2012/06 of the European Banking Authority of 22 November 2012 on the assessment of the suitability of members of the management body and key function holders, available on the European Banking Authority's website at www.eba.europa.eu.

7 Article 6 (1A) of the draft law.

8 Article 6(1B) of the draft law.

9 Article 6(1C) of the draft law.

10 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.06.2013, p.1).

participate in meetings of the management board of a credit institution established in Cyprus, without the CBC's prior approval. The draft law exempts experts and senior managers of credit institutions from this approval procedure if they have been asked to give advice on specific issues under consideration by the management board. If, in the CBC's opinion, a member of the management board, the chief executive officer, a senior manager or a key function holder of a credit institution established in Cyprus is not a fit and suitable person to continue to act in that position, the CBC may order that that person be removed from the position. The draft law specifies that the assessment procedure and the criteria determining the fitness and suitability of the above mentioned individuals are laid down in the CBC's Directive on the Assessment of the Fitness and Probity of Members of the Management Board and managers of Authorised Credit Institutions of 2014 (hereinafter the 'CBC Directive')¹¹.

2. General observations

- 2.1 This opinion does not address whether Cypriot law has been effectively harmonised with Directive 2013/36/EU, Directive 2014/59/EU, and Directive 2014/17/EU, for which the Commission is responsible, neither whether the draft law observes Guidelines EBA/GL/2012/06 or whether the provisions of the draft law that specifically interact with directly applicable provisions of Union law are fully compliant with such directly applicable provisions.
- 2.2 The ECB notes that the draft law broadens the scope of the activities of credit institutions, as it expands the circumstances in which a credit institution may exercise a business activity where, as a consequence of debt settlement proceedings, it acquires immovable property or share capital of another company. The ECB appreciates that this proposal is necessary due to the high number of non-performing loans in Cyprus. Therefore, it is extremely likely that credit institutions will acquire a substantial number of immovable properties and shareholdings as a result of debt settlement arrangements, which will need to be dealt with. Allowing credit institutions to conduct business activities with immovable properties and shareholdings they acquire will facilitate the preservation of financial stability and the soundness of the Cypriot banking sector. However, having immovable property and shareholdings on the credit institutions' balance sheets will result in the credit institutions' solvency and profitability being more sensitive to fluctuations in the value of immovable property and share prices. The ECB recommends that credit institutions should take measures to ensure that they are adequately protected from such changes and that they employ individuals with the appropriate expertise to manage real estate portfolios, since this is not a part of their core business activity.
- 2.3 The ECB considers that the proposed restrictions on granting credit facilities to the members of the management bodies of credit institutions and to persons holding more than 10% of the share capital of the credit institution should positively contribute to more robust governance arrangements in the Cypriot banking sector.

¹¹ Available on the CBC's website at www.centralbank.gov.cy.

- 2.4 The ECB welcomes the provisions concerning the evaluation of, inter alia, key function holders, which aim to comply with Guidelines EBA/GL/2012/06. The key function holders may substantially influence the day-to-day management and risk profile of credit institutions, and thus play a crucial role in ensuring compliance with robust government arrangements. The ECB would like to recall that the ECB will conduct the suitability assessment of members of the management bodies of significant institutions, with the assistance of the CBC. In that regard the CBC Directive should be aligned with ECB administrative practices.

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

Done at Frankfurt am Main, 11 October 2016.

[signed]

The President of the ECB

Mario DRAGHI