

Constantinos Herodotou: Sustainability, digitization, profitability

Statement of Mr Constantinos Herodotou, Governor of the Central Bank of Cyprus, at fireplace chat "Challenges for banks in a new operating environment" at the 10th Banking Forum, Nicosia, 9 December 2022.

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I would first like to thank Andrea for accepting my invitation to participate at today's event and share his valuable insights with us.

In the aftermath of the two consecutive crises, the first round adverse effects have been limited for the banking sector. Nevertheless, with the level of uncertainty still tilted to the upside, the full extent of the consequences has not yet materialised especially in the area of credit risk. If we were though to draw a lesson from both crises, this would be the significance that technology plays for the banking sector, not only for the conduct of the normal banking operations but also for the sustainability of its profitability.

The banking sector has proven resilient and continued to provide credit to the economy. However, the legacy structural weaknesses of the sector remain. At the same time, competition from challenger banks has been increasing. Therefore, the banks need to move more decisively in the road to digital transformation. This is presumably the only way if they are to address their structural weaknesses while retaining their competitive advantage against new players in the market. Investing in technology can become the catalyst in their effort to strengthen efficiency and build sustainable profitability.

It is acknowledged that digitalisation comes together with the favourite topic of any supervisor- risks, and especially cyber risk. This has been duly recognised by all European institutions and authorities and is very high on the supervisory agenda. Pivotal role in the efforts to address cyber risk, is the enactment of the Digital Operational and Resilience Act. I expect that this will be a cornerstone in the efforts to improve operational resilience of the banking sector. Cyber-attacks have increased significantly over the last couple of years with though a limited number of incidents, both in numbers and impact, in the Cyprus banking sector. Nevertheless, banks should gear up their resilience to withstand the anticipated incidents, while also ensuring that a robust disaster recovery plan and business continuity plan are in place for possible such incidents.

At the same time, the banking sector faces the challenges of the adverse macroeconomic developments, which may deteriorate asset quality, leading to an upward pressure on impairments and provisions. Prudent provisioning policies and the provision of fast and viable restructurings to customers is the appropriate way to address effectively the consequences of the adverse economic environment.

The Russian invasion in Ukraine has elevated further the importance of climate risk due to its interconnectedness with geopolitical risk. The ongoing effort to reduce the dependence on Russian energy frontloaded the need to reduce carbon emissions and move promptly towards a greener economy. The banks have a key role to play in this effort through financing the transition as well through providing adequate disclosures to the markets. We therefore expect them to adopt both their business models and risk

management frameworks to incorporate climate and environmental risks. The fact that certain banks have started making tangible steps in this regard is a positive development, but there is still some way yet to be travelled. The management of climate risk by banks is on the top of the supervisory agenda. We acknowledge the challenge that this poses especially for smaller banks. However, we do expect them to act more decisively in the said direction. By default, this will ultimately also target the banks' clientele and the submission of detailed climate related information in order to feed the banks' risk management processes.

The challenges noted above, require significant up- front investment before reaping the benefits. The banks should proceed without undue delays to the transformation of their business models to address a new challenging business environment. Complacency emanating from short term profits is not a viable option. Sustainability through transformation is the way forward.

Thank you.