

Christodoulos Patsalides: The Central Bank of Cyprus agenda - strategic vision and priorities

Speech by Mr Christodoulos Patsalides, Governor of the Central Bank of Cyprus, at the 12th Banking Forum and Fintech Expo, Nicosia, 16 January 2025.

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Introduction - Strategic Vision Statement and Elaboration

Distinguished guests, esteemed colleagues,

I would like to extend my sincere thanks to the organizers of the 12th Banking Forum and Fintech Expo for bringing us together for this important exchange of ideas and insights.

It is my privilege to have today the opportunity to present the strategic vision and priorities of the Central Bank of Cyprus. In an ever-evolving global and digital economy, we are committed to leading the way in fostering a resilient, innovative, and sustainable financial sector for Cyprus. Our agenda focuses on embracing digital transformation, ensuring robust governance, addressing societal and environmental challenges, and safeguarding financial stability.

Today, I will outline our key priorities, including advancements in the digital economy, the evolving role of digital payments, the potential introduction of a digital euro, and the regulatory frameworks that ensure responsible governance and societal considerations in our financial systems. Through these efforts, we aim to strengthen Cyprus' position as a dynamic player within the European financial landscape.

Cyprus Economy

To ground our strategic vision, we must first examine the economic landscape in which the Cyprus economy operates. With its key sectors-ICT (Information Communication Technology), tourism, trade, shipping, and construction-, the economy has demonstrated resilience and adaptability despite the consecutive significant geopolitical challenges, including the ongoing conflicts in Ukraine and the Middle East. In recent years, Cyprus has achieved robust growth rate well above the EU average and maintained a strong fiscal position, consistently posting surpluses that have bolstered public finances. As a result, international rating agencies have upgraded their ratings well within the investment grade, highlighting our sound economic management, fiscal discipline, and reforms in the banking sector.

Banking Sector in Cyprus

Building on the strength of our economy is the Cypriot banking sector, which has built up remarkable resilience and robustness despite a series of unprecedented and successive crises in recent years. The sector's solvency, as indicated by the Common Equity Tier 1 (CET1) ratio, rose to 23,5% in the third quarter of 2024, achieving its highest level on record and significantly surpassing the European average of 16,0%.

Additionally, the Liquidity Coverage Ratio (LCR)-a key indicator of credit institutions' capacity to withstand severe liquidity stress-reached 336% in September 2024. This level exceeds the regulatory minimum of 100% by more than threefold and stands well above the European average of 161,4%. The non-performing loan (NPL) ratio fell to 6,5% in the third quarter of 2024, marking its lowest level since 2014, when the NPL definition was standardized across the European Union.

However, there is no room for complacency as macroeconomic uncertainty, geopolitical risks, and emerging threats like cyber and climate risks grow. Banks must adapt quickly to identify and address these evolving challenges effectively. Moreover, technological advancements bring about a new landscape in which banks are called upon to compete. The pursuit of an appropriate business model is key.

Digital Economy and Global Digital Trends

As we look toward the future, the digital economy emerges as a defining feature of global trends. Technology has the ability to sustain and improve our standards of living and the long-term productivity of our economy. Examples of innovative technologies used in financial services (usually referred to as FinTech) include artificial intelligence, cloud computing, digital wallets, big data analytics and biometrics. These technologies have been applied to improve customer service, automate payments, reengineer business processes, detect suspicious activity, and assist with customer profiling and digital onboarding. However, we are yet to see the realization of potential in other promising new technologies such as distributed ledger technology (DLT), smart contracts and tokenization.

As technology becomes more widespread in our evolving digital economy, cyber risk and data security continue to be by far the most prominent driver of operational risk for banks. Technological advances with increased sophistication, growing reliance on digital solutions, but also growing capabilities of cyber offenders, have all resulted in enhanced risk exposure for banks, including vulnerability to sophisticated cyber-attacks. Cyber risk is often driven by geopolitical risk, thus raising overall risk to a much higher level. Supervising these risks remains one of our priorities.

To take full advantage of the potential of innovative technologies responsibly while managing risks, common supervisory and regulatory approaches are essential. The EU has introduced key legislation such as DORA, PSD3, FiDA, MiCAR, and the AI Act, which aim to strengthen financial sector resilience and boost consumer and investor confidence by guiding responsible innovation. Recognizing the evolving market dynamics, the Central Bank of Cyprus has established an Innovation Hub to foster dialogue with fintech stakeholders and support domestic financial innovation.

Digital Payments in Cyprus

A key element of the digital economy is the rapid rise of digital payments. We find ourselves in an era where digital transformation is reshaping economies, and Cyprus is no exception. One of the most prominent trends is the proliferation of digital payments, which now capture around 96% of cashless payments. At the same time, preference for cash payments is shrinking, as evidenced by a remarkable decline of 11% since 2022 that placed Cyprus at the top of euro area countries. Cypriots use cards 1,3 times more

frequently than their European peers, while our contactless card payments capture more than half of all card payments consistently since 2022. This reflects the readiness of local businesses to accept cards and to opt for terminals that embed Near-Field-Technology.

In the same vein, e-commerce exhibits gradual expansion, manifested by online purchases via cards almost doubling over a six-year period to 28% of the total of card payments. It is indeed remarkable that the use of mobile phones for online purchases has almost reached one quarter of the total, outperforming the EU average which stands at 16%.

As of the 9th of January of this year, instant payments have become a reality for all banking participants. This signifies that account-to-account payments can be effected at the speed that people demand in the digital and social media age: transmission within 10 seconds, with immediate access to funds on a 24/7/365 basis, as opposed to the current 1-2 days waiting time. Consumers and businesses will reap the benefits in the months to come.

Electronic Money Institutions & Payments Institutions

E-money payments are gaining traction, driven by opportunities in fintech, e-commerce, and digital payments. Having licensed 4 electronic money institutions this year, the Central Bank of Cyprus now supervises 27 electronic money institutions and 11 payment institutions.

As part of our broader strategic agenda, we are committed to drawing on international experience in supporting the Central Bank of Cyprus in refining its approach for regulating, licencing and supervising Electronic Money Institutions (EMIs) and Payment Institutions (PIs) in Cyprus.

In December, the CBC, announced the establishment of a comprehensive licensing and supervisory strategy for the sector of these institutions.

For the development of this strategy, the CBC appointed an international consultancy firm whose experts, in collaboration with CBC staff, conducted an analysis of the sector and its inherent risks.

The objective of the new strategy is to pursue the prudent and sustainable growth of the sector. Among other measures, the strategy includes:

- The enhancing and enriching of the licensing processes for institutions applying to participate in the sector.
- The Strengthening of the supervision of institutions by implementing a risk-based supervisory approach for each institution and enriching supervisory tools.
- And the adoption of best practices for the operation of the sector.

To achieve these objectives, a Division for the Supervision of Electronic Money and Payment Institutions is being established, which will henceforth undertake the prudential supervision of the sector.

Digital Euro

Moving on to the digital euro, I will give a brief status update from last year's forum. As legislative negotiations continue in Brussels, the Eurosystem is progressing through the first part of the preparation phase for the digital euro, focusing on calibrating the holding limits without compromising financial stability or bank intermediation as the banks will retain their role vis-à-vis their customers. The ECB continues to rapport with the market, with specific holding entitlements to be defined later. The rulebook formulation, developed with stakeholder input, will set standards for future digital euro distributors, leveraging existing frameworks for cost efficiency and allowing flexibility for innovation. Consumers and businesses prioritize functionalities like conditional payments and effortless bill-splitting, guiding expectations for future services.

Moving on to the platform and infrastructure preparations, the ECB is now selecting candidates from its recent application process and plans to enhance engagement with distributors to ensure readiness for the potential issuance and successful distribution of the digital euro, if and when the decision to issue is made.

Allow me to take a moment to refer to our efforts at raising awareness within our market through various communication channels, targeting the general public, the business community, and financial institutions. Aside from articles that we regularly publish in the press and on professional social networking platforms, we invite various stakeholder groups to the CBC premises. Last July we gave a press conference with Mr Piero Cipollone, member of the Executive Board of the European Central Bank, as keynote speaker. In November we held a focus session with business associations and their members, and in December we presented a thorough status update of the project to the members of our National Payments Committee. Last but not least, the Central Bank of Cyprus participates in panel discussions and presents the digital euro project at various local and international conferences.

ESG Regulatory Landscape: Governance, Society, and Climate Change

A. Governance

As we embrace these innovations, we remain steadfast in our commitment to strong governance. Governance, a core pillar of ESG, is crucial in enhancing transparency, accountability, and ethical standards in financial institutions. Strong governance enables sound lending decisions, reduces conflicts of interest, and ensures compliance with regulations including the updated Directive on Corporate Sustainability and ESG provisions in the recently enacted CRD 6, protecting institutional reputation and minimizing financial risks.

B. Encompassing Society Considerations in Business Activity: Financial Conduct

Social factors, including diversity, labour practices, community engagement, and adherence to human rights standards, are also vital for modern credit institutions. Embedding diversity in governance and fair pricing in operations fosters trust among stakeholders, promotes financial inclusion, and enhances institutional resilience, strengthening reputation and market standing.

C. Climate Change – CBC Initiatives

The Central Bank of Cyprus actively engages in thematic reviews, stress tests, and in-depth analyses led by the European Central Bank to assess institutions' preparedness on climate risk and its integration into their strategy, governance, risk management and disclosures. This supervision helps ensure credit institutions speed up their preparations to manage ESG risks while meeting necessary sustainability and resilience standards. Additionally, the smaller institutions, directly supervised by us, were requested to develop implementation plans, with specific milestones, in order to advance the management of climate related risks, in line with the ECB's 13 supervisory expectations which stipulate how banks should integrate climate and environment risks into their business models and strategies, governance and risk appetite.

Beyond what is expected from the supervised institutions, the Central Bank of Cyprus has set up internally a Sustainability Team, aiming to support the CBC in addressing climate change in line with its mandate to maintain price stability, safeguard financial stability, supervise banks and support the general economic policy of the State, while also contributing to the target of net zero carbon emissions, and the continuation of strong governance. The recent visit of Mr Frank Elderson, member of the ECB's Executive Board and Co-Chair of the Task Force on Climate-related Financial Risks of the Basel Committee on Banking Supervision touched upon these issues as well.

Concluding remarks

Let me now conclude: the strategic vision of the Central Bank of Cyprus is built on the pursuit of price stability and financial stability in its capacity as the macroprudential authority of the country. By embracing the digital economy, ensuring robust governance, and addressing climate change, we are positioning Cyprus as a forward-looking financial hub in Europe. Together, we will navigate the challenges and opportunities of the future, ensuring stability and prosperity for all.