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**TO** : Cyprus Investment Firms

**FROM** : Cyprus Securities and Exchange Commission

**DATE** : 10 August 2022

**CIRCULAR No.** : C526

**SUBJECT** : Common weaknesses identified during the review of the Recovery Plans (Form 20-01) submitted by CIFs which qualify for the simplified Recovery Plan

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The Cyprus Securities and Exchange Commission ('CySEC') wishes, with this circular, to inform the Cyprus Investment Firms<sup>1</sup> which fulfil the criteria of par. 4 of the [Directive DI20-01 on the establishment of simplified obligations as to the content and details of their Recovery Plans \(qualifying CIFs\)](#), of the following:

During the years 2021-2022, CySEC reviewed a sample of the Recovery Plans (Form 20-01) submitted in 2020 by qualifying CIFs. These CIFs are requested to draw up a recovery plan which shall include, as a minimum requirement, the content and details referred to in CySEC's [Form 20-01](#). A CIF's recovery plan should be in place to enable it to deal with for periods of financial distress, recover from financial losses and improve its financial position.

Below is a summary of **the main weaknesses** identified during CySEC's review of the Recovery Plans submitted, as well as further comments and clarifications that should be considered while preparing the Form 20-01 for the year ended 31.12.2022, which are due to be submitted by the 30<sup>th</sup> of September 2022.

### **1. Governance arrangements**

CySEC expects the recovery plan to include a clear assignment of roles and accountability for each procedure within the recovery, together with the escalation process assigned.

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<sup>1</sup> With Initial capital requirement of €750.000 per section 9(1) of [Law 165\(I\)/2021](#) regarding the prudential supervision of Investment Firms

It is important for the qualifying CIF to identify the actions required during the recovery process, who will be responsible for each action, and in which order these actions need to be executed. A lack of clarity of responsibilities and procedures is likely to result in delay and confusion in decision-making, which could make otherwise valid recovery options worthless, or of limited benefit.

Moreover, a detailed description on how the recovery plan fits within the overall risk management framework of the qualifying CIF is expected.

## **2. Strategic Analysis**

In some recovery plans, it has been observed that qualifying CIFs declared critical functions that indicate unawareness of the criteria that should be fulfilled for a function to be categorized as critical, as defined in the [Commission Delegated Regulation \(EU\) 2016/778](#). For example, some CIFs identified their compliance function as a critical function.

Qualifying CIFs should consider the criteria relating to the determination of critical functions as stated in Article 6 of the [Commission Delegated Regulation \(EU\) 2016/778](#) during their determination.

## **3. Stress Scenarios**

CySEC expects that a qualifying CIF will identify at least two scenarios that will be severe enough to bring the CIF close to default. In some cases, CySEC observed that the scenarios used by qualifying CIFs did not bring the indicators to the red level as required.

Qualifying CIFs should use scenarios relevant to their business model. In addition, the scenarios should be explained clearly and in detail, identifying the impact that they would have on the qualifying CIF's recovery indicators. Qualifying CIFs should ensure that at least one scenario affects the firm on a stand-alone basis and at least one scenario affects the financial market in its entirety. Qualifying CIFs should use scenario testing to test the effectiveness of their recovery options and to test the adequacy of their recovery indicators.

The EBA has published "[Guidelines on the range of scenarios to be used in recovery plans](#)" which should be taken into consideration by the qualifying CIFs when designing their scenarios.

#### **4. Recovery Options**

The recovery options presented should be feasible and have an actual impact within the right timeframe. In some cases, the options given by CIFs were not specific, where others could not be considered as feasible or that could have an actual impact on the recovery of the qualifying CIF. For example, an option presented was the “reduction of costs”. This is not considered to be a detailed option, as it does not give a clear picture of the specific costs to be reduced, how and if this is feasible or not. Furthermore, recovery options like the financial support of the shareholder should be reconsidered as the crisis in the Ukraine has showed that some shareholders may not be in a position to provide immediate financial support if needed.

Furthermore, it has been observed that some CIFs did not present the capital ratios after the recovery options were applied, in the Table 2 of the “Recovery Options\_Simplified” tab. CySEC expects that the qualifying CIFs will present the indicators that derived from the application of the recovery options, in order to indicate their impact on the recovery indicators.

Qualifying CIFs should identify a broad range of recovery options available to them towards having more alternatives available to implement in different situations. In addition, qualifying CIFs should assess the plausibility of the recovery options including any cases in which such options might not be available during the stress periods and the ways of mitigating such cases.

Qualifying CIFs should consider all operational and legal impediments before considering specific recovery option. There should be a realistic timeframe for management action to deliver the expected outcome.

#### **5. Good Practices**

- i) **Planning:** Planning is key in having a good recovery plan. Identifying the core business lines together with the risk indicators is the first step before designing the Stress Tests Scenarios.
- ii) **Feasible Stress Test Scenarios:** Sufficiently severe scenarios should be designed, relevant to the qualifying CIF’s business model to test their readiness in periods of financial stress. The scenarios should be feasible, realistic, and explained clearly.

- iii) Clear assignment and accountability: A clear assignment of the roles for each task is needed so that everyone in the qualifying CIF understands what should be done within the timeline set.
- iv) Communication with the CySEC: Good communication with the CySEC is important during periods of financial stress in order to ensure that all the necessary measures are taken.

Finally, CySEC would like to remind qualifying CIFs that the preparation of the recovery plan is an ongoing process and should be reviewed regularly and updated when the circumstances change in order to have a plausible plan to respond to any periods of financial stress.

**CySEC expects qualifying CIFs to take into consideration all the above points while preparing their next recovery plan (Form 20-01), which is due to be submitted to CySEC, via TRS only, by 30.9.2022.**

Yours sincerely,

Dr George Theocharides  
Chairman of the Cyprus Securities and Exchange Commission