ΕΠΙΤΡΟΠΗ ΚΕΦΑΛΑΙΑΓΟΡΑΣ ΚΥΠΡΟΥ
CYPRUS SECURITIES AND EXCHANGE COMMISSION

LISTED COMPANIES RBS-F HANDBOOK

The CySEC's Risk Based Supervision Framework ('RBS-F')

2017

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ΕΠΙΤΡΟΠΗ ΚΕΦΑΛΑΙΑΓΟΡΑΣ ΚΥΠΡΟΥ
CYPRUS SECURITIES AND EXCHANGE COMMISSION

CHAIRWOMAN'S STATEMENT

CySEC recognizes the importance of having in place a robust risk assessment framework that would allow it to further strengthen supervision, maximise market compliance and enhance investor protection.

CySEC has implemented a new more sophisticated risk based approach (i.e. "Risk-Based Supervision Framework" ("RBS-F")) to ensure the effectiveness and compliance of the Listed Companies published Financial Statements with the relevant financial reporting framework.

The RBS-F is in line with European regulatory practices. It is a structured approach to assess risk and was designed to assist CySEC in setting its regulatory priorities and intensity of supervision, focusing where risks are greater. Following ESMA's guidelines, the selection process of the Financial Statements for review, is enriched with a sampling on rotation approach.

Through its use, emphasis is placed on those entities which are of greatest importance in terms of the risks they tend to have and their potential impact in case of a misstatement in the published Financial Statements, ensuring market confidence and no regulatory arbitrage. At the same time, it upgrades CySEC's ability to assess and analyse the particular characteristics of the Listed Companies.

Consequently, CySEC's judgment of the risk, significance and impact that each entity poses to its statutory objectives will determine the extent of review of the Listed Companies Financial Statements.

This risk-based approach is being considered the best and most widely used practice among Supervisory Authorities and it is in line with the regulatory practices adopted in Europe.

Overall, we strongly believe that the implementation of the RBS-F in the Cyprus securities market is an important milestone that greatly enhances investor protection and confidence, which is a prerequisite for the healthy development of the financial market and the economy at large.

Demetra Kalogerou

Chairwoman

INTRODUCTION

CySEC has implemented a new more sophisticated risk based approach (i.e. "Risk-Based Supervision Framework" ("RBS-F")) to ensure the effectiveness and compliance of the Listed Companies published Financial Statements with the relevant financial reporting framework.

The RBS-F is in line with European regulatory practices. It is a structured approach to assess risk and was designed to assist CySEC in setting its regulatory priorities and intensity of supervision, focusing where risks are greater.

Consequently, CySEC's judgment of the risk and significance that each entity poses to its statutory objectives will determine the overall intensity of the supervisory approach to be followed.

Furthermore, following ESMA's guidelines, the selection process of the Financial Statements for review, is enriched with a sampling on rotation approach.

What is covered in this paper?

This document explains the key principles of the risk supervisory framework and aims to provide entities with a general understanding of the rational and practices to be followed by CySEC.

It sets out what Listed Companies can expect from the risk assessment process during their Financial Statements review. Aim is to provide an understanding of the different approaches that will be followed by CySEC, depending on the profile of each entity.

Specifically, this paper explains:

- The framework, how risk is assessed and how this is linked to our objectives.
- How the framework is applied to our supervisory activities.
- What will the RBS-F mean for your entity.

Who should read this paper?

The RBS-F is implemented to companies that have issued securities admitted to trading on a regulated market. For the RBS-F purposes, Listed Companies are categorised in:

- **Local Listed Companies:** Companies that have securities listed on the regulated market of the Cyprus Stock Exchange (CSE) and whose Cyprus is the home member state and
- **International Listed Companies:** Cyprus Companies that have securities listed on a regulated market of an EEA Country and whose Cyprus is the home member state.

Any of the above types of entities, will be subject to our risk based approach and will fall under the annual risk assessment process. The RBS-F for Listed Companies, supports the process relating to the selection of a sample of Listed Companies' Financial Statements for review of their compliance with the relevant reporting framework (IFRS), using the risk based approach. This sample is complimented with a sample selected on rotation, as well as a sample selected based on the European Common Enforcement Priorities defined by ESMA each year.

Depending on the risk profile of the entity, the scope of review will differ (as further explained in Diagram 4).

The Management and the persons involved in the preparation of Financial Statements as well as other relevant persons and stakeholders of Listed Companies, may want to have an understanding of the approach to be followed during our supervisory activities. The purpose of this document is to provide such information.

The benefits from the RBS-F

The implementation of a risk-based approach has a number of benefits both for CySEC, as well as for Listed Companies.

The RBS-F, aims to assist CySEC to control the risk of failing to meet its statutory obligations, while at the same time taking into consideration any reputational risk arising from its duties and its role within the international financial markets and that of the European Union (EU) specifically.

It is expected that CySEC, will be in a position to:

- Exercise better risk based judgment prioritizing activities;
- Achieve efficiencies and better allocate resources where risks are considered to be greater;
- Develop evidence based policies using the knowledge obtained;
- Take prompt and consistent action where necessary.

AN OVERVIEW OF THE RISK BASED SUPERVISION FRAMEWORK

The Risk Based Supervision Framework (RBS-F), is designed to ensure that risks are managed at a relevant level. It is noted that the framework for the Listed Companies, supports the process in relation to the selection of a sample of Financial Statements to review their compliance with the relevant Financial Reporting Framework (i.e. IFRS).

Specifically, in accordance with ESMA's Guidelines on Enforcement of Financial Information "*The objective of enforcement of financial information included in harmonised documents is to contribute to a consistent application of the relevant financial reporting framework and, thereby, to the transparency of financial information relevant to the decision making process of investors and other users of harmonised documents. Through enforcement of financial information, enforcers contribute to the protection of investors and the promotion of market confidence as well as to the avoidance of regulatory arbitrage*". In light of this, CySEC should ensure that its supervisory processes contribute to a consistent application of the IFRSs, in the regulated markets falling under its regulatory scope.

Below we provide the architecture of the risk model, its components, and how different parameters are combined to assess individual risks for each entity.

What risk refers to?

A **risk** for CySEC, is something which can cause harm to its statutory objectives. More specifically, in relation to Listed Companies, risk is the possibility of a misstatement in the published Financial Statements which may result to investors and other users making decisions based on misleading information which as a result may affect market confidence and create regulatory arbitrage. Each entity bares different risks for its Financial Statements to be misstated, which may relate to its:

- *External environment,* depending on the regulatory framework, the composition of ownership, the country and the market that is traded, its industry, the services provided etc.
- *Internal Environment,* depending on the governance arrangements, policies, procedures and systems implemented.

Identifying and assessing risks, is a process that CySEC will perform on an on-going basis as explained in the following section.

CySEC's Risk Appetite

We define our supervisory approach based on our **risk appetite**. The supervisory framework is designed to determine the scope of review of the Listed Companies' Financial Statements and whether these will be selected for review for a given financial period. The methodology was established to allow and identify those entities which warrant more intensive review. It is acceptable that risk cannot be entirely eliminated, while some of the risks accepted or that are not eliminated, may lead to misstatements.

The size of each entity gives a significant indication of risk, since the impact of misstatement in the Financial Statements of bigger entities is expected to be higher. Therefore, the fact that entities are categorised to be of higher risk for CySEC, does not mean that they may have significant misstatement in their Financial Statements, but may indicate the importance of these entities within the market due to their size. However, regardless of an entity's size, in cases where there are indications that the probability that an entity's Financial Statements may have misstatements is high, such entity's audited Financial Statements will be also subject to review.

The components of the RBS-F were designed to capture and assess these two indicators (i.e. **impact and probability**) in a manner that is comparable amongst all Listed Companies included in the scope of supervision.

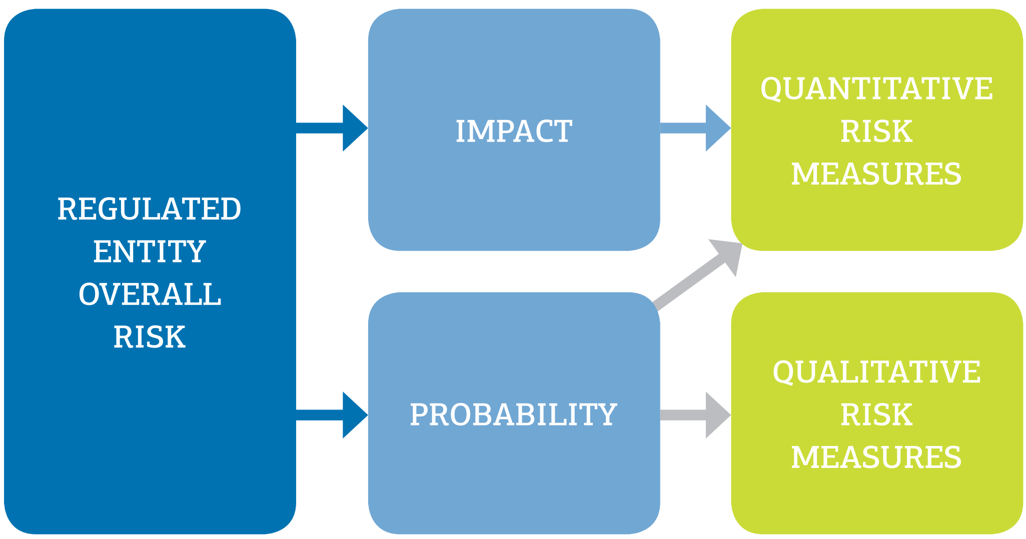
How does the model work?

Each entity's overall score is calculated along specified assessment criteria and with the use of an IT support system that provides a standardized framework.

We consider and assess risk for each entity as a combination of:

- **Impact** (i.e. the potential harm that could be caused) and
- **Probability** of misstatement in the Financial Statements

Diagram 1



As illustrated in the diagram above, the assessment of an entity is based on a comprehensive and pre-defined set of "*quantitative*" and "*qualitative*" criteria / risk indicators, referred to as "**risk measures**", which allow the risk assessment to be performed in a consistent manner and facilitate comparability amongst entities (of the same type).

- **Impact** is measured in a way that mainly captures the size of the Listed Company and its importance within the market and is mostly based on quantitative elements using numerical data extracted from facilitated returns.
- **Probability** assesses the likelihood of material misstatements in the Financial Statements.

For the purposes of the risk assessment, CySEC will be obtaining and analyzing both quantitative data and qualitative information.

Quantitative Probability aims to capture the risk of misstatement in the Financial Statements of an entity through quantifiable risk measures, using data derived from the audited Financial Statements of the Listed Company.

Qualitative Probability aims to capture the risk of misstatement in the Financial Statements through a qualitative assessment of the Listed

Company's audited Financial Statements, the audit opinion, the complexity of its industry, the culture/experience of the management etc.

Entity Overall Score

An entity's overall score indicates the importance of each entity to CySEC and is calculated as a combination of its impact and probability.

We will score each entity in four (4) categories (the supervisory stances): Low (L), Medium-Low (ML), Medium-High (MH), High (H).

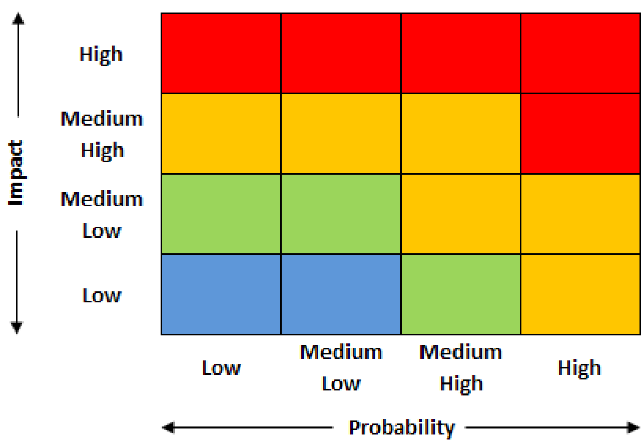
Diagram 2

ENTITY SUPERVISORY STANCES (overall score)	
	High
	Medium High
	Medium Low
	Low

Based on risk appetite, we have defined how the combination between the two would result to each entity's overall score.

The diagram below illustrates the relationship of impact and probability to define an entity's overall score:

Diagram 3



For example, an entity that is of high impact, will be scored as high, irrespective of its probability of misstatement. Entities whose probability is rated as high, may be scored either as High or Medium High, depending on the entity's impact.

Entity stances and approach to supervision

In line with the RBS-F, the approach and intensity of review is proportionate to the importance (and thus overall score) that each entity poses to our objectives. The profile of each entity will define the scope of review and the area of focus.

The scope of review will be less in the case of entities that do not pose a major risk of misstatement in their Financial Statements. Such differentiation may affect the supervisory methods, the depth and scope of review.

Based on each entity's overall score a sample of financial statements will be selected for review. This sample selected using the risk based approach is combined with a sampling on a rotation approach. The purpose of this mixed selection model is to ensure that all Listed Companies have a possibility for selection for review of their Financial Statements. Therefore, further to the classification of the entities based on the Risk Based Supervision Framework, CySEC, will select a sample on rotation as well as a sample based on the European Common Enforcement Priorities defined by ESMA each year.

In each case the extent of review will depend on factors which may include amongst others the level of probability of misstatement, the risk factors that triggered the selection as well as the last day of review of the Financial Statements of the Listed Company. This is indicated in the diagram below:

Diagram 4

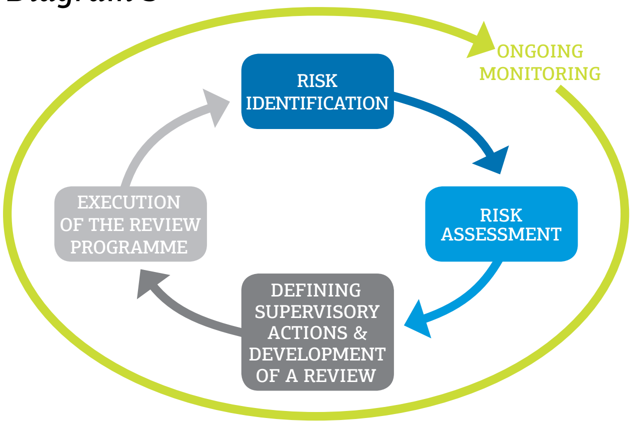
RBS-F outcome	Extent of Review
H	• Full review or • Thematic/ focused review based on the riskiness of the separate components
MH	• Full review or • Thematic/ focused based on the riskiness of the separate components
ML	• Selection on Rotation (Full Review or Thematic/ Focused review)
L	• Selection on Rotation (Full Review or Thematic/ Focused review)

HOW RISK BASED SUPERVISION WORKS IN PRACTICE

The RBS-F is the link between our statutory objectives and our supervisory activities, and is designed to identify the main risks to our objectives and measure the importance of those risks.

We regularly review the amount of risk we are prepared to accept (i.e. risk appetite) and focus our resources on the risks that matter most. The results of the assessment will evolve throughout the supervisory cycle which is designed to be continued for each entity (i.e. this is not a one off exercise that occurs on a certain point of time during the year, but will be updated on an on-going basis from the results and events which might occur). Our supervisory cycle is as follows:

Diagram 5



Risk Identification

During this phase, we aim to identify new, emerging or changing key risks deriving from the market and ensure that our framework is updated and relevant to capture and assess those risks.

Through an ongoing basis, this process will examine if the risk model is up to date and if there is a need to include further measures. To achieve this, data collected is used to calibrate the model and also other sources of information, such as trends followed in the European environment and in general the macro and micro economic environment, are considered to identify new and changing risks.

Risk Assessment

This process is performed internally within CySEC on an **annual basis**, and includes the assessment of each entity's risk based on quantitative and qualitative criteria.

This is performed based on data derived from the returns that you have submitted, and historic trends of your entity.

Following a comprehensive analysis of data / information available and the processing of such data / information to identify unusual conditions, we will define each entity's quantitative probability and impact. Alongside this, a qualitative assessment is performed based on available information from various sources. By combining the two assessments, we are getting the classifications of the entities as described in the previous section.

Defining supervisory actions and development of a review program

Defining the supervisory action is an important stage in the process, because it is only through defining the appropriate supervisory action that risks may be reduced to an acceptable level. In general, supervisory actions undertaken must be proportionate to risk. As previously stated, the supervisory plan relates to the sample selection and extend of review of the Listed Companies' Financial Statements.

To define the review approach, we look at where each Listed Company falls within the defined Heat Map of the RBS-F (the relationship amongst the impact and probability scores - Diagram 3) and this defines the extent of review.

Additionally, we generate the additional sample for review, from the sampling on rotation approach and based on the European Common Enforcement Priorities and finalise the overall review plan.

Execution of the review program

Once the review program for each entity has been defined, and the sample of the Listed Companies has been finalised, officers from the Issuers department proceed with its execution.

COMMUNICATING THE RESULTS OF THE REVIEW TO YOUR ENTITY

The examination of the Financial Statements selected for review for compliance with IFRS is made by the officers of the Issuers department. The review can either be a full review or a thematic/focused review on specific areas of the Financial Statements depending on the risk factor that triggered the selection. If issues are identified for which clarifications are needed, a letter will be sent to the Listed Company requesting such clarifications. The final findings of the review will be communicated to the Listed Company. Material findings may trigger corrective actions or measures in accordance with the applicable Law.

Listed Companies should expect that CySEC will monitor the implementation of the comments or corrective actions addressed to you by CySEC.