ACCOUNTANTS FOR BUSINESS

Financing SMEs in Cyprus: no stone left unturned?

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ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies in all stages of development. We aim to develop capacity in the profession and encourage the adoption of consistent global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We work to open up the profession to people of all backgrounds and remove artificial barriers to entry, ensuring that our qualifications and their delivery meet the diverse needs of trainee professionals and their employers.

We support our 162,000 members and 428,000 students in 173 countries, helping them to develop successful careers in accounting and business, with the skills needed by employers. We work through a network of over 91 offices and centres and more than 8,500 Approved Employers worldwide, who provide high standards of employee learning and development.

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ACCA's global programme, *Accountants for Business*, champions the role of finance professionals in all sectors as true value creators in organisations. Through people, process and professionalism, accountants are central to great performance. They shape business strategy through a deep understanding of financial drivers and seek opportunities for long-term success. By focusing on the critical role professional accountants play in economies at all stages of development around the world, and in diverse organisations, ACCA seeks to highlight and enhance the role the accountancy profession plays in supporting a healthy global economy.

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This report presents the findings of an independent study by RTD Talos into ways of improving SMEs' access to finance in Cyprus, as well as ACCA's response and policy recommendations. It is based on a series of stakeholder interviews and member input following a global call for evidence by ACCA.

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Foreword

While visiting Cyprus in late 2013, I had a chance to hear at first hand from ACCA's members and stakeholders how the current financial and economic crisis was affecting the country's small and medium-sized enterprises (SMEs.)

As a sign of ACCA's commitment to our membership in Cyprus, to the SME sector and to the public interest, I promised at the time that ACCA would commission independent research into the subject of SME financing, and return with recommendations for government, businesses and professional accountants.

It is now my pleasure to fulfil this promise, by publishing the independent report prepared for ACCA by RTD Talos, as well as our own response and recommendations. I am delighted to see the range and calibre of stakeholders from Europe and beyond who have responded to ACCA's international call for evidence, and I am grateful to all contributors.

Talos's findings underscore the value of financial information and good financial management as the most reliable building blocks of SMEs' access to finance. They point to a role for government, not merely as a lender or carrier of risk, but as a builder of financial infrastructure around which the private sector can first heal, and then innovate.

What happened in Cyprus in 2013 is almost without precedent: the overnight shutting-down of a developed country's banking system. Nonetheless, this does not mean that policymakers cannot benefit from international experience – only that they must draw from a wider pool of good practices, and often from unexpected places.

I believe that the scope of ACCA's global Access to Finance programme and the breadth of skills among our membership make us a natural partner of both government and industry in Cyprus. From frontier capital markets in south east Asia, to microfinance intermediaries in east Africa, to the Fintech champions in the City of London or the public-funding juggernauts of Brussels and Luxembourg, the reach of our professional network is unparalleled.

Most important of all, however, will be the contribution of our members on the ground. As SMEs' most trusted advisers, finance professionals in practice and in business will undoubtedly be the ones to lead the sector on the long road to recovery. They can count on our unwavering support.

Helen Brand
ACCA chief executive

1. Introduction

Cyprus is facing a credit and liquidity crunch unprecedented among developed countries, following the collapse of the country's disproportionately large, international financial system in early 2013. The bail-in of March 2013 was originally aimed at recapitalising Cypriot banks in order to return them to health, while strict capital controls (previously considered impossible in the Eurozone) were aimed at preserving their deposit base. Neither worked quite as envisaged, with evidence of sharply reduced lending, rising delinquencies and continued deposit flight throughout the country. Meanwhile, the country's international bailout is itself subject to a great deal of criticism, especially with regard to debt sustainability. The combination of a banking system and government powerless to assist businesses has exacerbated what was already a very difficult situation.

The scale of capital flight, caused by the decision of the Eurogroup to force depositors to recapitalise the banks in which they held their deposits and by the decision to sell Cypriot banks' subsidiaries in Greece, has been phenomenal, changing the financial landscape in many ways. Companies that depended on their cash flow to pay salaries and suppliers no longer had the funds or had limited or no access to them. Access to any type of bank financing was all but eliminated for more than a year. Wary depositors no longer trusted the banks with their money and capital controls introduced following the banking crisis prohibited the opening of new accounts at any bank for local residents, other than making a deposit above €5,000. The combination of falling wages and job insecurity literally stopped consumers from making any major purchase decisions beyond essential ones.

The charts below highlight the scale of capital flight. On March 2012, the Central Bank of Cyprus reported total deposits of €70.7bn. By June 2013, that figure was at €50.7bn and by March 2014, total deposits were at €46.2bn, a 35% reduction in two years. Loss of business deposits has been even more rapid than that of household deposits.

The reduction in deposits by local residents was 31%, with €32.5bn deposited in banks as of March 2014 compared with €42.6bn in February 2013 and an estimated €1bn currently held outside banks. The situation will only get worse as the Bank of Cyprus, Cyprus's largest bank, is partly financed through €9.55bn-worth of Emergency Liquidity Assistance (ELA) provided by the Central Bank of Cyprus, liquidity that will be gone from the local market as the Emergency Liquidity Assistance is partly repaid.

Figure 1.1: Deposits at banking institutions in Cyprus (in €millions)

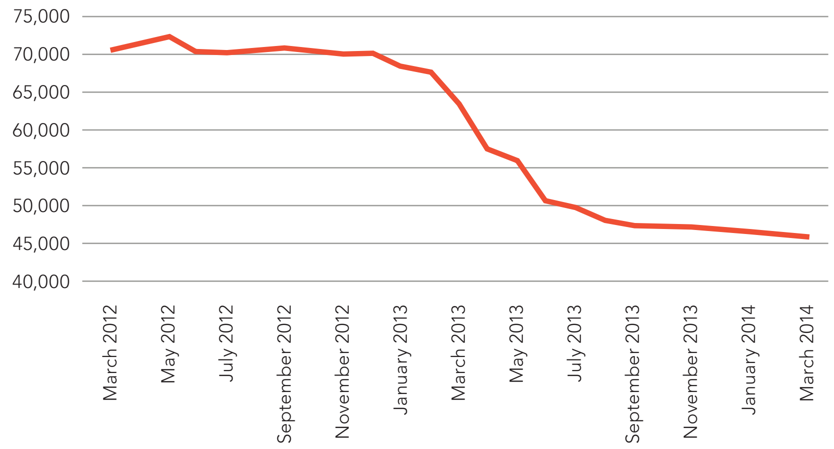


Figure 1.2: Company deposits in Cyprus (in €millions)

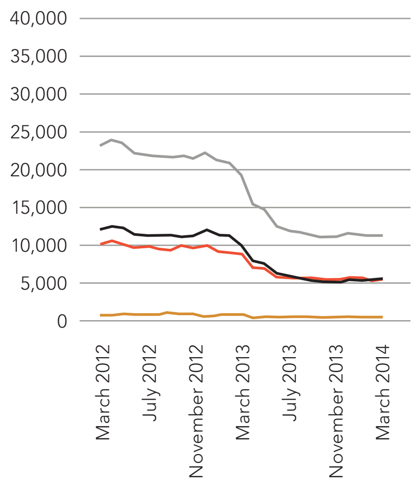


Figure 1.3: Household deposits in Cyprus (in €millions)

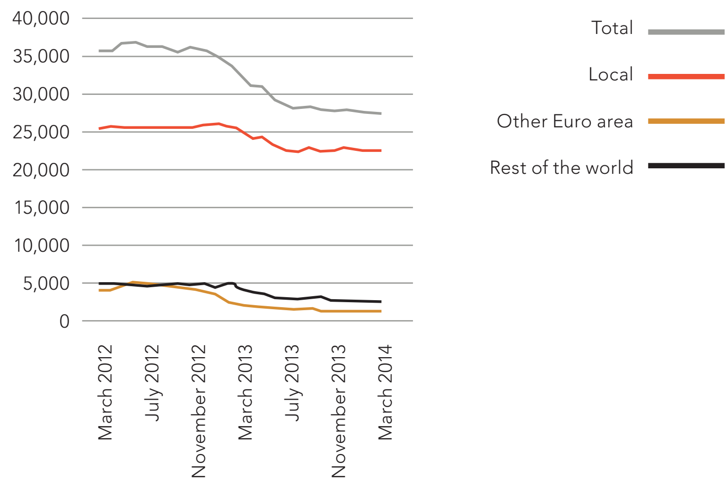


Figure 1.4: Insurance and pension funds deposits in Cyprus (in €millions)

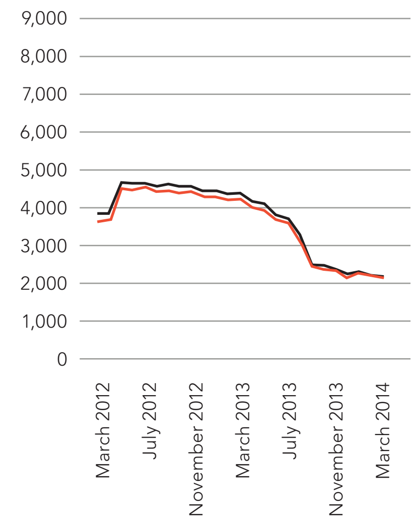
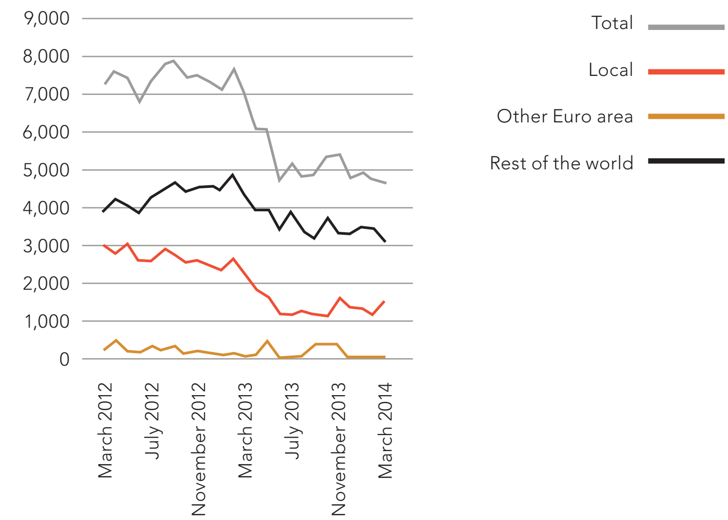


Figure 1.5: Other financial deposits in Cyprus (in €millions)



Source: Central Bank of Cyprus (2014)

In response to this situation, ACCA launched an international Call for Evidence in March 2014 (ACCA 2014), inviting local and international stakeholders as well as its members and students to share their views on the situation in the country and what can be done to make access to finance easier for Cypriot SMEs. This study discusses the results of this Call for Evidence.

The Call for Evidence focused on the options available to bankers, other finance providers, entrepreneurs and policymakers for financing Cyprus's Small and Medium Enterprises (SMEs), starting from existing Access to Finance policies and schemes that are either underperforming under current liquidity and demand conditions or could be adjusted in order to perform better. It also aimed to identify the unexplored opportunities for financing SMEs, and the institutions and organisations that may be able to help.

In particular, the Call for Evidence, and the research behind Talos's study, focused on existing and underused options for:

- accessing official funding from Europe or further afield
- exploring options provided by State Aid rules in order to allow the government to support Cyprus's SMEs directly
- unlocking credit and liquidity in the supply chains of major corporates and the government
- overcoming restrictions placed on the banks by liquidity and capital requirements
- assessing the creditworthiness of informationally opaque businesses
- sidestepping the banks and appealing directly to investors to finance SMEs, on a scalable basis
- accessing funding for SMEs through the capital markets, either directly or through customers with uninterrupted access to them
- financing SMEs in Cyprus by offering SME credit and equity to savers and investors as alternatives to bank deposits.

STATE OF SMES IN CYPRUS

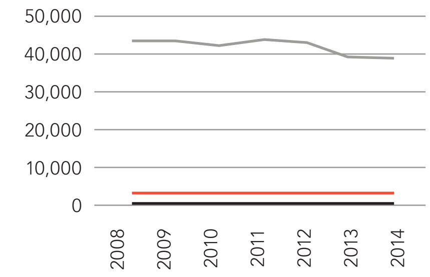
The majority of SMEs in Cyprus are businesses employing up to nine employees, with an average of 2.1 employees per business in that category. Specifically, 92.5% of businesses (about 40,000) in Cyprus fall within this category, with 6.3% (about 2,600) falling in the 10–49-employees category, 1.1% (about 500) in the 50–249-employees category and 0.2% (about 78) in the >250-employees category (Eurostat et al. 2013).

Each size band produces about the same amount of revenue, about €2bn a year, making 250+ employee businesses the most productive per employee, with close to €50,000 revenue per employee compared with about €41,000 revenue per employee for 10–49 and 50–249 employee size bands. In the 0–9-size band, each employee generates about €27,000 in revenue.

Almost 38% of all employees in Cyprus work for businesses with 0–9 employees; almost 23% work for businesses with 10–49 employees; 20% work for a company that employs 50–249 people; and the remaining 20% work for companies that employ at least 250 people.

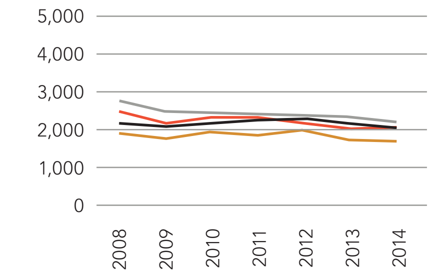
The data shows that SMEs, especially micro companies, are important in Cyprus because of the large number of people they employ.

Figure 1.6: Cypriot companies categorised by size, 2013



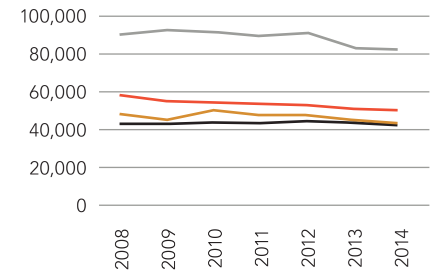
Source: Eurostat et al.2013

Figure 1.7: Output for the different size categories of Cypriot companies



Source: Eurostat et al.2013

Figure 1.8: Distribution of employment according to company size



Source: Eurostat et al. 2013

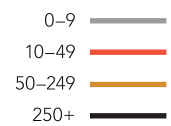
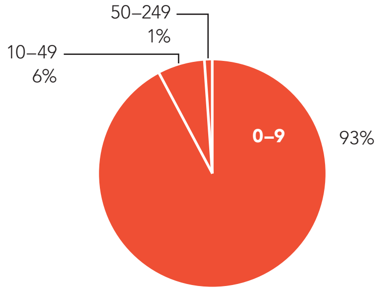
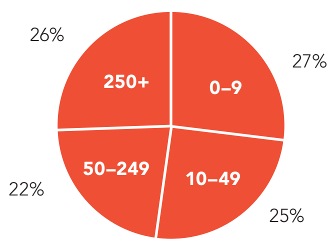


Figure 1.9: SME share, 2013



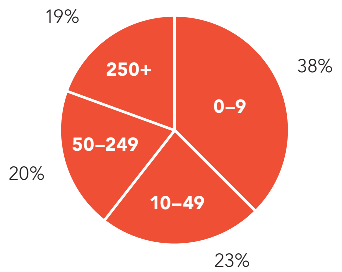
Source: Eurostat et al.2013

Figure 1.10: SME output share, 2013



Source: Eurostat et al.2013

Figure 1.11: SME employee share, 2013



Source: Eurostat et al.2013

2. Stakeholder interviews

A number of interviews were held with local stakeholders as well as European and International organisations to identify common themes and different opinions among interviewees, as well as to solicit proposals to address the issue of financing SMEs in Cyprus.

Each interviewee was asked a sub-set of the structured interview questions developed by Talos and ACCA that matched their personal background and institutional agenda. Areas of inquiry included what initiatives and new laws the government needs to make, what funding options and new programmes the international community needs to offer to help SMEs access funds, what the banks need to do in order to provide the liquidity and what SMEs themselves need to start doing to gain access to liquidity.

The institutions that provided the perspectives for the study are shown in Box 2.1:

BOX 2.1: INSTITUTIONS THAT PROVIDED THE PERSPECTIVES FOR THE STUDY

- Bank of Cyprus
- Bartercard Cyprus
- CNBI
- Cooperative Central Bank of Cyprus
- Cyprus Business Angels Network
- Cyprus Chamber of Commerce and Industry
- Cyprus Commissioner for State Aid Control
- Cyprus Federation of Industrialists and Employers
- Cyprus Institute of Certified Management Consultants.
- Cyprus Securities and Exchange Commission
- Directorate General for European Programmes, Coordination and Development of the Republic of Cyprus
- EY
- EU Commission's Directorate General for Enterprise and Industry
- European Association of Craft, Small and Medium-sized Enterprises
- European Banking Federation
- European Investment Bank
- European Investment Fund
- Fast Moving Consumer Goods Association Cyprus
- Hellenic Bank
- Infocredit
- Institute of Certified Public Accountants of Cyprus
- Institute of International Finance
- Ministry of Agriculture
- Ministry of Energy, Commerce, Industry and Tourism
- Ministry of Finance.

3. Overview of recommendations

Talos believes that SMEs in Cyprus need liquidity from multiple sources and for a range of purposes. Existing SMEs need ways of unlocking liquidity held up in their invoices as well as access to funds to help them grow. Export-driven SMEs need access to funds to procure materials for their overseas contractual obligations, while import-driven SMEs need access to funds to ensure that their supply chains have the inventory to maintain operations. Start-ups need access to initial as well as working capital.

In Cyprus, liquidity has traditionally been provided by the banking sector. In the researcher's discussions with banks, each insisted that they have the resources to provide funding to SMEs. Indicatively, Bank of Cyprus received just 85 applications for its JEREMIE-funded loan product (see Appendix), with an average funding request of €75,000. As the campaign was running for a couple of months, the low demand cannot be explained by SMEs' ignorance of this initiative.

One of the reasons for the lack of demand could be the historical overleveraging of business in Cyprus, whose outstanding loans fell from 168% of GDP in 2012 (Eurostat 2014) to 142% of GDP in late 2013 (IMF 2014).

Businesses, including SMEs, do not have the appetite to borrow further in an uncertain market. Although banks claim that they have funds to lend, circumstantial evidence suggests that they are inclined to reject loan applications, especially for start-ups, or to suggest that the loan application should be for a lower amount than that requested.

Another reason can be the documentation, as specified by the Central Bank of Cyprus, that is required in order to apply for a loan, and which can discourage applications by SMEs. Although up-to-date information should be available to any financial institution to help it make sound decisions on extending a loan facility, the rapid transition from a less-restrictive loan application process to a very restrictive process has caused many SMEs to refrain from applying for new loans with the banks in Cyprus.

SMEs still need to finance their working capital and with the limits placed on their daily financial activities as a result of the resolution of Laiki Bank, the bail-in of the Bank of Cyprus by depositors and the subsequent absorption of Laiki Bank by Bank of Cyprus in 2013, SMEs in Cyprus have developed new short-term needs for funding, purely to sustain themselves.

New means of financing need to be deployed. Talos therefore recommends a number of initiatives that will increase liquidity for SMEs in Cyprus.

This chapter outlines a set of recommendations that form the framework of actions suggested by Talos to end the current situation of limited liquidity and market reluctance to use additional liquidity or gain access to liquidity.

While all recommendations can be implemented independently, Talos is also suggesting a 'big-bang' approach whereby the government of Cyprus would act as a facilitator for new, more efficient market structures through changes in legislation and partnerships with appropriate funding organisations.

In summary, Talos recommends that the banks, government and credit providers in Cyprus jointly take on the following initiatives.

BANK INITIATED SOLUTIONS

Banks remain the major supplier of liquidity to SMEs in Cyprus. Although banking business practices of the past led to an overleveraged private sector, future stability and growth depend on the appetite of banks to lend again to SMEs. With regard to providing much-needed liquidity to SMEs, banks need to focus on the following activities.

Better implementation of the Arrears Management Directive

The Arrears Management Directive issued by the Central Bank of Cyprus (CBC) is creating a number of problems; most importantly, it inhibits the willingness of the SMEs to apply for business loans and creates demands for additional collateral on existing loans.

Participation in European Investment Bank funded projects

All European Investment Bank (EIB) projects that relate to SME funding have identified banks as the risk-sharing funding intermediary. Banks should make every effort to participate in the projects and work diligently to supply the appropriated funds to eligible SMEs.

Limit payments on the Emergency Liquidity Assistance and use part of the unallocated Emergency Liquidity Assistance funds to increase liquidity to banks

The Emergency Liquidity Assistance provides low-cost funding as well as funds that the Cyprus economy cannot do without.

GOVERNMENT-INITIATED SOLUTIONS

Create a development bank for SMEs

The government should create a development bank in partnership with an experienced European organisation, to finance SMEs' working capital and provide services as a guarantee institution.

Create a credit bureau and a national credit scoring system

The government should establish a credit bureau that rates all trading companies in Cyprus. Banks, financial institutions, government entities, utilities and SMEs should then provide data to the bureau on a regular basis. The objective is to provide scores that reflect a company's overall trustworthiness, whether positive or negative.

Enable leasing

The government should develop an enhanced legal framework that would allow companies to provide capital items on a lease basis.

Absorption of EU structural funds

The government should aim to use all structural funds, amounting to about €950 million, in the next three years instead of over the usual seven-year cycle.

Reconciliation of obligations arising from the Late Payments law of 2012

The government and the banks need to ensure that invoices and dues, including VAT refunds, are paid on time whether they are originated in the private or the public sector. A process for reconciliation of money owed to SMEs should be put in place.

Tax incentives for investing into SMEs by individuals

Investing into SMEs through direct lending and in the form of spending on research and development should be tax-deductible for private investors.

ALTERNATIVE FINANCE-PROVIDER-INITIATED SOLUTIONS

Alternative finance – factoring and invoice auctioning

A platform should be created to enable SMEs to sell their yet-to-be-paid invoices to a pool of local and global investors. Invoices can be insured by EU trade credit insurers.

Alternative finance invoice financing – bartering of services and products

Examine the option of supporting platforms that deal with bartering products and services that will safeguard liquidity in the business environment. The government can help and provide liquidity by recycling the tax revenues generated by the platform back into the platform.

4. Bank-initiated solutions

BETTER IMPLEMENTATION OF THE ARREARS MANAGEMENT DIRECTIVE

As mentioned in Chapter 3, the Arrears Management Directive issued by the Central Bank of Cyprus (CBC) is creating a number of problems, primarily that it inhibits the willingness of the SMEs to apply for business loans and creates demands for additional collateral on existing loans

As stated by the Central Bank of Cyprus: 'the purpose of the Directive is the application by all Accredited Credit Institutions (ACI) of efficient and effective strategies, policies, structures, procedures and mechanisms for the management of arrears and the attainment of fair and viable restructurings of credit facilities of borrowers with financial difficulties in Cyprus. The CBC goal was to ensure financial stability as it forms the means of improving the loan portfolios of institutions whilst relieving borrowers of onerous loan instalments and reducing the risk of losing their properties'.

Banks, cooperatives and borrowers are all required to adopt a constructive approach to the restructuring of debt with a view to agreeing fair and sustainable solutions. In this respect, the Code of Conduct provides that banks and cooperatives must exercise every reasonable effort to cooperate with borrowers and to obtain all the necessary financial information that will enable them to carry out a thorough assessment of borrowers' ability to repay their loans. Such efforts must ensure that the repayment arrangement is acceptable to both the institutions and the borrowers.

It has been observed that although banks and cooperatives are obliged to implement a fair and viable pricing policy, which entails charging the minimum possible fees and lowering the interest rate to be in line with the repayment ability of borrowers, they have not done so. Additionally, internal Appeals Committees, which must ensure compliance with the code and try to reach a reasonable compromise between the borrower and their institution, have not been established within most ACIs even though this is stipulated in the Directive.

Additionally, the Directive has created a more rigid approach that is alien to SMEs in Cyprus, such as the requirement for submission of a business plan for each funding facility that they request, which inhibits the willingness of owners of SMEs to borrow money to invest in their businesses. This creates a hiatus within the business environment, in which nobody is investing to take advantage of the current market situation of lower prices for goods and services. This then increases the overall negative business sentiment.

Talos recommends that Central Bank of Cyprus and commercial banks address the issues created by the Directive in the following ways.

1. Banks should invite accredited independent professionals to work in a consultative manner with internal appeals committees at each bank and/or act as mediators while appeals committees are being formed.

2. The Central Bank of Cyprus should review the information required during loan processing to ensure that new or restructured loan processing is faster. while at the same time ensuring that the objectives of the Directive are met.

3. As specified in the Directive, the Central Bank of Cyprus should ensure that interest rates on existing loans are reduced in order to increase liquidity at SMEs.

How can this recommendation be implemented?

- Parliament should vote into law the Directive on Arrears Management.

- The Central Bank of Cyprus should increase the penalties for banks that fail to adhere to the Directive.

- There is no cost for implementing this recommendation by the stakeholders above.

- Cyprus should follow the example of Ireland and its management of Mortgage Arrears Plan.

Benefits to SMEs

- An Appeals process that works will speed up the process of loan restructuring at SMEs.

- A less detailed loan processing effort will give an incentive to SMEs to apply for new loans.

- Lower interest rates on existing loans will provide additional liquidity to SMEs, which can invest that additional liquidity in their growth.

PARTICIPATION IN EUROPEAN INVESTMENT BANK FUNDED PROJECTS

All European Investment Bank (EIB) projects (see Chapter 6) that relate to SME funding have identified banks as the risk-sharing funding intermediary. Banks should make every effort to participate in the projects and work diligently to get the allocated funds to eligible SMEs.

The EIB has made a number of funding mechanisms available to banks in Cyprus (European Investment Bank 2013). These mechanisms are the Cyprus Entrepreneurship Fund (CYPEF), the Trade Finance facility, the cooperation with the Cooperative Central Bank to support SMEs and youth employment, and the JEREMIE initiative (see Appendix).

The CYPEF is a fund established by the Republic of Cyprus to support and strengthen entrepreneurship in the country by enhancing access to finance for small and medium-sized enterprises (SMEs). CYPEF's financial instruments will be deployed by local banks. CYPEF will initially offer a 'funded risk-sharing loan product' by providing to selected financial intermediaries funds at less than the market rate to lend to SMEs while sharing the underlying risk for each individual SME loan.

The Trade Finance Facility is geared towards supporting the foreign trade activities of Cypriot SMEs. Under this instrument, the EIB offers guarantees to foreign banks that provide trade finance to Cypriot SMEs.

The EIB cooperation with the Cooperative Central Bank (CCB) addresses the priority areas, for Cyprus and the EU as a whole, of growth, innovation and jobs. The Cooperative Central Bank facility includes a financing window under the 'Jobs for Youth' programme and offers even more favourable financial terms to eligible SMEs.

JEREMIE (Joint European Resources for Micro to Medium Enterprises) is an initiative developed by the European Commission and the European Investment Bank (EIB). Two products have been designed: first, a co-financing product where the EIB, working with the European Investment Fund, will co-finance, on a loan-by-loan basis, eligible SME loans with the selected banks, and a guarantee product where the European Investment Fund will provide guarantees to support eligible loans that will be provided from the selected banks to SMEs.

Talos urges all banks in Cyprus to participate in the funding projects in order to create a competitive environment that will help eligible SMEs get access to funding that will help them grow.

How can this recommendation be implemented?

- EIB should host additional events that demonstrate to banks the benefits of participating in the various initiatives and at the same time extend the initiative to non-banking organisations.
- The cost of implementing the above recommendation should be within the EIB budgeted costs.

Benefits to SMEs

- Fresh funding would help banks spread the risk, thus allowing for lower interest rates.
- There would be competition among banks to provide funding to SMEs, because EIB is sharing the risk.
- This approach would enable banks to start focusing on project-based funding instead of supplying overdrafts, which helps SMEs achieve results on a project-by-project basis, making them more performance oriented.

LIMIT PAYMENTS ON THE EMERGENCY LIQUIDITY ASSISTANCE AND USE PART OF THE UNALLOCATED EMERGENCY LIQUIDITY ASSISTANCE FUNDS TO INCREASE LIQUIDITY TO BANKS

The Emergency Liquidity Assistance provides low-cost funding as well as funds that the Cyprus economy cannot do without.

The Emergency Liquidity Assistance is a tool consisting of the support given by central banks in exceptional circumstances and on a case-by case basis to temporarily illiquid institutions and markets. This support may be warranted to ease an institution's liquidity strains, as well as to prevent any potential systemic effects or specific implications such as disruption of the smooth functioning of payment and settlement systems.

In Cyprus, Emergency Liquidity Assistance is provided to the Bank of Cyprus at the level of €9.55 billion. The cost of this facility is estimated at 2.5%.

Talos recommends that the Bank of Cyprus, in agreement with the Central Bank of Cyprus, limits payments to the Emergency Liquidity Assistance for as long as Cyprus remains bound by its memorandum of understanding (MOU) with the Troika (ie the European Commission, European Central Bank and the International Monetary Fund) – this will most likely be the case until mid-2016. Such moves will increase liquidity in the market, which will help SMEs. Additionally, the Central Bank of Cyprus should seek ways of providing Emergency Liquidity Assistance funding to other banks in order to provide short-term facilities, for periods of three to six months, mostly financing working capital.

How can this recommendation be implemented?

- The Central Bank of Cyprus should direct any unallocated Emergency Liquidity Assistance to banks, which can use these funds to lend to SMEs as working capital.

- There is no cost associated with the above recommendation.

Benefits to SMEs

- This approach will provide increased liquidity to SMEs.

5. Government-initiated solutions

CREATING A DEVELOPMENT BANK FOR SMES

Government should create a development bank in partnership with an experienced European organisation, to finance SMEs' working capital and provide services as a guarantee institution.

Currently, the financing of SMEs is done through commercial banks and the cooperative banks. The majority of the micro and small enterprises in Cyprus do not have any access to experienced banking staff other than those in a branch. There is a great need for financing for SMEs that relates to their business cycles, whether this means tourism, which operates between May and October, agriculture, which is based on crop seasonality, or export-based businesses.

The, now private, Cyprus Development Bank was created in 1963 with all the right intentions that it should act as a typical development bank that would help businesses develop in the domestic markets and beyond. The same spirit should be applied to the creation of a new development bank in Cyprus that would work on the model of KfW of Germany. KfW is the most successful state development bank in Europe, and is both export oriented and domestic-production oriented. The willingness of the German government to support Cyprus through a proposed KfW loan facility could encourage kfW itself to partner with the new national development bank and offer its expertise.

The new development bank should focus on supporting the growth of SMEs and business start-ups and on providing finance for SME exports, whether they are products or services. Additionally, this bank could make funds available to finance innovation by technology enterprises or for environmental protection, as well as the use of renewable energy and enhancing energy efficiency in enterprises. Besides funding, the new development bank could provide consultancy and information to enterprises in Cyprus, allowing them to benefit from local and European initiatives.

To get the new development bank off to a quick start, Talos recommends that the government splits the SME banking business of the 99% government-owned Cooperative Central Bank into a separate business unit. This will have two benefits, namely providing access to deposits that households in Cyprus have at the Cooperative Banks throughout Cyprus and acting as an extensive branch network for SMEs' banking.

The government can invite European organisations such as the EIB and the EBRD or other European institutions such as KfW to participate in the share capital of the separate business unit.

How can this recommendation be implemented?

- The government of Cyprus, as the owner of the Central Cooperative Bank, can take all SME clients of the Central Cooperative Bank and transfer them to a separate commercial entity where a partner such as the European Bank for Reconstruction and Development (EBRD) or KfW, can invest and provide expertise in setting up the new development bank.

- There is some administrative cost when setting up a new bank as well as compliance and other costs, but the Central Cooperative Bank could convert one or more of the existing 18 banking entities to a development bank, retaining its staff and banking licence.

- KfW and its partnerships, eg in Spain, can provide a template.

- Where the government of Cyprus acts as an intermediary for funding to SMEs, all funding, estimated at around €1bn, should be directed through the development bank.

- The development bank should be established as the funding partner for all structural fund projects, and should have the ability to perform the functions of project assessment, fund disbursement, monitoring and reporting to public administrations and on-site inspections.

- The development bank should focus on:
  - ensuring that all structural funds are allocated to projects that will be completed in the next three years rather than the next seven years
  - using invoice data collected either internally or externally, and starting to provide finance against invoice receivables whose risk is deemed acceptable
  - creating a leasing arm within the development bank, which will start using currently unallocated ELA funds for short-term leasing of 12 to 24 months
  - creating a funding mechanism for working capital for all export-oriented activities of SMEs in Cyprus
  - creating a start-up fund within the development bank to use unallocated structural funds to co-finance start-ups created by young people.

Benefits to SMEs
A dedicated development bank would provide better, targeted, financial services to SMEs.

SMEs would gain access to better consultative financing such as accessing EU programmes, exporting to new markets and making innovation work for them.

SHORT HISTORY OF THE ORIGINAL CYPRUS DEVELOPMENT BANK

In 1963, the government of Cyprus created the Cyprus Development Bank (CDB) to promote the economic development of Cyprus, creating a broad spectrum of funding for the Cypriot manufacturing and industrial processing sectors by providing medium-term and long-term loans as well as equity and venture capital. After 1974, the CDB focused on export-oriented activities and the development of tourism. In 1991 the European Investment Bank acquired a 5.5% share in the CDB, increasing that to 12% in 1996. In anticipation of Cyprus's accession to the European Community (EC), the CDB established its EC Centre in 1992, aimed mainly at providing advice on EC programmes and funding opportunities to local businessmen.

During the 1990s, the CDB shifted its emphasis towards financing the services sector; the Investment Banking Division strengthened its international network of banking and other institutions with a view to providing services on an international level. With the participation of the European Bank for Reconstruction and Development (EBRD) in 1999 it created the Investment Bank of Kuban in Russia, with EBRD having 25% of the share capital and CDB 75%. A new business unit, Project Financing, was created to assess and support large new investment projects and start-ups. The Management Consultancy Division undertook several assignments to assist the reform of various economic sectors, public services and organisations. It also helped strengthen Cyprus as a regional telecommunications centre and helped finance the development of the two major airports in Cyprus.

In April 2001, the CDB obtained a banking licence from the Central Bank of Cyprus, enabling it to carry out the full range of banking operations. In 2008, the bank was privatised.

CREATE A CREDIT BUREAU AND A NATIONAL CREDIT SCORING SYSTEM

A credit bureau should be established to rate all trading companies in Cyprus. Banks, financial institutions, government entities, utilities and SMEs should provide data to the bureau on a regular basis. The objective would be to provide scores that reflect a company's overall trustworthiness, whether positive or negative.

Currently there are two separate directories that collect data for bad debtors in Cyprus, namely ARTEMIS, which is run by the commercial banks, and AIANTAS, which is run by the Cooperative Banks. There is a process in hand to unify the directories into a single mechanism and a Directive has been issued by the Central Bank of Cyprus that covers the types of data that will be collected and how the mechanism will operate (Central Bank of Cyprus 2013).

The collected data will include, for natural persons, the customer's demographic information such as name, identity card number for Cypriot citizens and passport number for foreign citizens, profession, standard coding of the business sector of the employer, details of permanent residence, date and place of birth, title, marital status and level of education.

For legal persons, the directory will include the name of the business, registration number and customer classification by business sector.

Each customer will be classified on the basis of the internal rating system of the authorised credit institution (ACI) and there will be information such as whether a lawsuit has been initiated against the customer, together with relevant data, whether the account has been terminated, or whether a court decision has been issued or the customer is undergoing an arbitration procedure. Additionally, there will be data that relates to the customer's income for at least the last five years, as well as information about persons connected to the customer.

Among the data on each customer will be a detailed statement of all customer facilities per ACI and credit institution, the purpose for which it was granted, the date the account was opened, scheduled date of settlement, repayment schedule, total and base interest rate, balance and limit of account, date of rescheduling, etc as well as the total recoverable value of tangible security of the customer.

Talos recommends that the above information, once in place, should also include information that creates a score measuring the risk of default by taking into account various factors in a customer's balance sheet, cash flow and financial history. Historical data should include payment history such as late payments on loans including mortgages, credit card or car loans or on invoices for the purchase of goods by persons or companies. A late payment will reduce the score, timely payments will increase the score. A very good model of such data gathering and scoring is the Banque de France rating, which is an assessment of a company's ability to meet its financial commitments over a three-year period (Banque de France 2013).

Talos suggests that this information is collected by the agency that will merge the ARTEMIS and AIANTAS directories. A legal requirement for registered companies to provide such data should also include non ACIs such as companies with sales of more than €600,000 annually, including activity overseas, renters with three or more rentals, and whether they are fixed or movable assets, as well as other applicable information that will create a true reflection of the ability of a borrower or user of a service to pay their dues. Unincorporated businesses should be encouraged, but not compelled, to provide the same data, on the basis that this will improve their access to finance.

Additionally, information should be maintained on credit use, such as the ratio of current revolving debt to the total available revolving credit or credit limit, which will show the propensity to create additional debt and will show which customers are revolvers and which pile up debt. Talos also recommends that data for new credit requests should be maintained.

To avoid the risk of populating the credit bureau with distorted data as a result of the business practices of the past and the financial crisis of 2012–13, Talos recommends that any transactional data is only collected and stored for activities following the live operation of the credit bureau, so enough time is available for SMEs to prepare and have their books in order.

How can this recommendation be implemented?

- The Central Bank of Cyprus or a private company should create a framework for receiving and compiling data, which should be used as the file interface standard for all entities to use.

- Each SME that is required to submit data needs to ensure that its accounting system is capable of producing such reports.

- There are about 3,000 companies, about 7.5% of all companies in Cyprus, that should comply with this requirement, with an estimated €1,000 to €5,000 cost per company.

- The example of Banque de France should be followed.

Benefits to SMEs

- SMEs that pay promptly will be recognised, which will lead to their obtaining lower interest rates and better prices, and this will lead to more profits for them.

- SMEs will be able to differentiate creditworthy businesses from riskier ones, which will allow them to focus on building their relationships with prospective customers rather than being concerned about whether they have made the right decision about doing business with them.

- Enable leasing.

AN ENHANCED LEGAL FRAMEWORK IS NEEDED THAT WOULD ALLOW COMPANIES TO PROVIDE CAPITAL ITEMS ON A LEASE BASIS.

Currently in Cyprus there is a legal framework that offers the possibility of purchasing goods on an instalments basis, with stipulations in the law that cover the rights of the seller and the buyer in case of non-payment (Cylaw 2010).

Additionally, car rental companies offer the possibility of 'leasing' a car for a period of 3–36 months, although this model of leasing is really the same as renting a car, with the 36-month lease period being the same as making a full purchase of the car. There is a limited range of fee-per-use services applied mostly in the printing industry, with monthly rentals of equipment based on the number of pages printed per month.

Talos recommends that the legal framework is amended with regards to ownership rights and access to the asset in a lease plan.

Specifically, Talos recommends that amendments are made to enable hire purchase plans that give the lessee the right to terminate the contract when there is a valid reason, subject to terms and conditions agreed at the time of signing the lease, or plans that give them the right to bargain an option to acquire ownership of the asset at the end of the lease period.

How can this recommendation be implemented?

- The government of Cyprus should present an amendment to the existing law so that leasing can be enabled. There are no costs for this recommendation.

- Cyprus should follow the example of Germany, which has 20% of the leasing market in Europe.

Benefits to SMEs

- Leasing is less capital-intensive than purchasing.

- Leasing can help businesses safeguard cash flow by paying for equipment as it generates revenue.

- Capital assets may fluctuate in value while leasing shifts risks to the lessor.

- Depreciation of capital assets has different tax and financial reporting treatment from ordinary business expenses since lease payments are considered expenses rather than assets.

ABSORPTION OF EU STRUCTURAL FUNDS

The government of Cyprus should aim to use all structural funds, amounting to about €950m, in the next three years instead of the usual seven-year cycle.

The EU structural funds in Cyprus are managed through the Directorate General for European Programmes, Coordination and Development, a government agency. The current financial crisis and the inability of SMEs to obtain funding for any major projects, forces the government of Cyprus to ensure a more efficient mechanism for supporting companies through EU grants.

Talos recommends, among other things, that Cypriot banks perform the functions of project assessment, fund disbursement, monitoring and reporting to public administrations and on-site inspections. This may entail several advantages for the government, as banks will select eligible projects that they are also prepared to support through pre-financing and co-financing, thereby leveraging the available grants. Moreover, banks can become adept at, and develop efficiencies in, providing certain administrative tasks and monitoring projects throughout the entire financing period.

Additionally, Cyprus should take advantage of the Youth Opportunities Initiative (YOI), through which the European Commission has launched 'youth action teams' to tackle youth unemployment in the hardest-hit member states and regions. The aim of the initiative is to use unallocated money from structural funds to finance measures to combat youth unemployment and help SMEs access loans and other forms of financing.

The government of Cyprus can limit the business areas in which banks can offer facilities, so as to match the government growth strategies. Such business areas can be based on the Smart Specialisation EU initiative, in which public funding is made available to those business areas where Cyprus can focus on its strengths. Through this initiative, available technology, infrastructure and know-how are used to boost regional innovation, which leads to growth. Such initiatives, coupled with the ability of the banks to monitor the entire funding and implementation process, enable high-value-added activities to be funded, and these offer the best chances of strengthening SMEs' competitiveness.

How can this recommendation be implemented?

- The government of Cyprus should ask banks to create internal business units, which will run programmes that use structural funds.
- Each bank should liaise with the Directorate General for European Programmes, Coordination and Development, which will participate as an audit entity.
- There is no administrative cost to the government or banks.

Benefits to SMEs

- There would be a one-stop shop for all procedures and funding requirements.
- A reduction in bureaucratic procedures would help firms to focus on their business activities.

RECONCILIATION OF OBLIGATIONS ARISING FROM THE LATE PAYMENTS LAW OF 2012

Government and banks need ensure that invoices and dues are paid on time whether they originate in the private or the public sector including VAT refunds. A process for reconciliation of money owed to SMEs should be put in place.

Cyprus was the first EU country to transpose into national law the Late Payment Directive of 2011 (Cylaw 2012) that aims to combat delays in payments in commercial transactions and other related issues.

For government obligations the law stipulates that an 8% interest rate plus the European Central Bank reference rate, currently at 0.5%, may be applied in any obligation after 30–60 business working days. For delays in payments in the private sector the reference rate is set by the Central Bank of Cyprus and is currently set at 11.81% (Central Bank of Cyprus 2014b).

Those interviewed for this report stated that it usually takes nine months for the government to make payments such as VAT refunds to SMEs, which hinders the ability of the SMEs to access liquidity.

Talos recommends that a mechanism, managed by the Central Bank of Cyprus, is put in place between the government, banks, Central Bank of Cyprus and SMEs, which would allow reconciliation, on a regular basis, of:

- any amounts that the government owes to banks and SMEs that they are eligible to receive
- any amounts that banks owe to the government
- payments that banks need to make to SMEs, such as their point-of-sale merchant-acquiring-based receivables
- payments that SMEs need to make to other SMEs that are eligible for payment.

Such a mechanism would streamline payments to eligible parties and would remove any dominant position that certain players, such as the government and retailers, have in the market.

Such mechanisms are becoming part of doing business in Europe. Recently, new EU rules such as the European Account Preservation Order are making it easier for companies to recover claims in cross-border debts by allowing creditors to preserve the amount owed in a debtor's bank account.

How can this recommendation be implemented?

- The Central Bank of Cyprus should incorporate the mechanism into the existing reconciliation process among banks.
- Banks should modify their existing contracts with SMEs to facilitate such fund blocking and diversion.
- There is a small administrative cost to the Central Bank and other banks.

Benefits to SMEs

- It would reduce the ability of retailers to withhold payments to SMEs who supply them with goods and services.
- It would allow faster access to funds that the government is withholding because it cannot make payments on time.
- There would be no disruption to the chain of payments down the supply chain of intermediaries to SMEs.

TAX INCENTIVES FOR INVESTING INTO SMES BY INDIVIDUALS

Investing into SMEs in the form of lending and for research and development should be tax deductible for private investors.

To create an environment in which private individuals would lend to SMEs, Talos suggests that tax incentives are provided for such lending.

Talos suggests that the government creates two tax incentive schemes, a lending to SMEs working capital scheme and a lending to SMEs R&D investment scheme.

The lending to SMEs working capital scheme would allow individuals to lend to SMEs for their 'business as usual' activities. Interest earned would be tax deductible and the maximum interest rate should not be higher than the Central Bank of Cyprus reference interest rate, which currently stands at 11.81%. While this is a high rate, it will create an incentive for private investors to fund SMEs since currently the deposit rate is low at about 2.5% and interest earned is taxed at 30%–35%.

The lending to SMEs R&D investment scheme would allow individuals to lend to SMEs for their R&D projects. Such projects, which are funded by private investors, will have certain characteristics such as the employment of the unemployed and use of existing infrastructure that is currently idle. The investment would be tax deductible at twice the amount of the investment. While this is aggressive, it is at par with similar schemes in other countries and would create a competitive environment for R&D in Cyprus.

How can this recommendation be implemented?

- The Government of Cyprus should submit amendments to the existing legal structure related to income tax deductions.

- There will be some revenue lost because of reduced income tax payments of about 30%–35%, which will be compensated by income tax, social contributions and VAT revenue arising from the additional earnings and employment at the company. Cyprus should follow the example of Singapore.

Benefits to SMEs

- SMEs would have access to funds from outside the banking sector.

6. Solutions initiated by alternative finance providers

ALTERNATIVE FINANCE – FACTORING AND INVOICE AUCTIONING

A platform should be created to enable SMEs to sell their yet-to-be-paid invoices to a pool of local and global investors (OICU–IOSCO 2014). Invoices can be insured by EU trade credit insurers.

Currently in Cyprus there is one platform that provides invoice financing, namely CNBI. CNBI works by scoring an invoice through a service offered by Sungard, a software and technology services company with annual revenue of about $2.8bn. Sungard's service evaluates the creditworthiness of a debtor, their ability to pay back the debt and the likelihood of default. The score represents the credit rating agency's evaluation of qualitative and quantitative information for a company, including non-public information.

In addition to Sungard, another Cyprus-based company named Infocredit offers similar data gathering services that allows a scoring company to process data and generate scores that enable other intermediaries, such as banks or insurance companies, to provide facilities to a commercial transaction.

Another platform with Cyprus-based roots is SMEmarkets.com. According to its website, 'SME Markets has developed an online collaborative marketplace where SME borrowers are able to submit loan requests and lenders can identify lending opportunities that match their specific lending criteria. SME Markets serves as a facilitator for these interactions, providing expert financial assistance to borrowers and secure bankable transactions for lenders, making the entire lending process much more timely and cost efficient."

The process of invoice financing works in the following way.

1. A company requests funding by submitting its issued invoices or signed contracts to a platform that can accommodate such request.

2. An independent organisation will evaluate the information and provide a score for these requests.

3. On the basis of the score, an insurance company can provide insurance for the investment, usually at a commission rate of about 0.5%–1.25%.

4. Investors, institutional or private, can offer to buy or fund the request at an agreed rate of return usually in the range of 4% to 9%, depending on the risk profile and the credit score.

Talos recommends that in tandem with the creation of a credit bureau, data is provided to any entity that wishes to set up a platform for processing funding requests from Cyprus-based companies to institutional and private investors. Such platforms could be independent, functioning as technology facilitators, or could be offered by investment firms to attract investors.

Talos also recommends that the government encourage companies with tax incentives to cover the insurance cost of each scored invoice and if there are available unused funds from the Emergency Liquidity Assistance mechanism, unused EU structural funds, or unused EIB-initiated projects funds, they should be used by the proposed development bank to buy insured invoices.

How can this recommendation be implemented?

- The credit bureau should be created.

- The government of Cyprus should submit amendments to the existing legal structure that deals with tax deductions for legal entities.

- Tax incentives will have low cost since they relate to a small percentage cost of the overall invoice, about 1%. There will be some revenue gained by trading insured invoices.

Benefits to SMEs

- SMEs would have faster access to funds since they would not have to go through the lengthy application process of a bank to obtain funding.

- They would have cheaper and less restrictive invoice financing than is typically possible through the banking sector.

- SMEs could shop around for the best rates among a larger number of potential financing vehicles than just banks.

- Insured invoices and contracts would attract more investors with lower cost than using a bank, creating new funding entities, such as investment firms, that could compete with banks.

ALTERNATIVE FINANCE INVOICE FINANCING – BARTERING OF SERVICES AND PRODUCTS

The government should examine the option of supporting platforms that deal with bartering products and services that will safeguard liquidity in the business environment. The government can help, and provide liquidity, by recycling the tax revenues generated by the platform back into the platform.

Bartering is the exchange of goods or services for other goods or services without using money. It is different from an alternative currency, since there is no money involved. A unit of measurement keeps the balance between the supply of and demand for goods or services, which can be exchanged only for other goods or services. Bartering replaces money at times of financial crisis, when money is not available, or when hyperinflation diminishes its value.

Currently in Cyprus there is a commercial entity, namely Bartercard Cyprus, offering a platform on which businesses can exchange their products and services. Bartercard facilitates and monitors all purchases and sales undertaken by its members in the same way that the Visa and MasterCard schemes provide services to cash-paying consumers. Members receive a plastic transaction card and an interest-free line of credit with monthly statements detailing member transactions and Trade Euro balance. A Trade Euro has the same value as a monetary euro, but can be used only on the Bartercard platform.

The Bartercard system works in the following way.

- Trade Euros are credited to the member's Bartercard account upon the sale of goods and services through the exchange.

- Members use their Bartercard transaction card to spend their credit balance on, or draw on their interest-free line of credit for, goods and services from any other Bartercard member.

Bartercard advises members to treat a Trade Euro as they would a cash euro from a tax perspective. Barter transactions are assessable and deductible for income tax purposes to the same extent as other cash or credit transactions. Therefore, the advantages and disadvantages are similar to ordinary cash revenue or expenses. For the purposes of the tax laws, payments including VAT or income tax must be remitted to the tax office in local cash currency.

Bartering platforms are based on the premise that no one accumulates Trade Euros and that there will be a zero balance at the end of the year. Growth of bartering platforms is inhibited since the necessary matching of supply and demand limits the application of such platforms to a small number of enterprises. Nonetheless, there is growth of revenue potential for the government since any bartering transaction would probably not have occurred if it had had to be transacted with cash.

In order to increase the appeal of the bartering platforms, Talos recommends that the government of Cyprus recycle any VAT that is generated from the bartering platform back into it as Trade Euros. Such Trade Euros could be in the form of payments made in relation to its social policy or could be part of the additional liquidity that the government might be willing to supply to SMEs.

SMEs can use Trade Euros that they earn to pay part of their obligations, say 10%, to the government for Income tax payments, employment taxes or VAT payments, etc. Since each Trade Euro generates VAT and other government revenue, there will not be a glut of Trade Euros.

How can this recommendation be implemented?

- The government of Cyprus should identify revenue generated from bartering and direct that revenue in the form of coupons in lieu of other payments, to be used at the bartering network.

- There will not be any significant costs for the government; in fact it should be possible to achieve savings which would in turn fund new facilities

Benefits to SMEs

- The bartering platform provides an outlet for selling products and services involving underused resources such as commodities, excess stock and immobilised resources.

- New uses of resources and new customer base offers would increase opportunities for growth.

7. Restoring access to finance for Cyprus's SMEs: ACCA's response

ACCA welcomes the independent report by RTD Talos into the matter of financing Cyprus' small and medium-sized enterprises (SMEs), and is grateful for the thoughtful contributions of policy stakeholders in Cyprus, the rest of Europe and further afield, and for the authors' own insights. ACCA is also pleased to offer the authorities in Cyprus the benefits of its global network and body of expertise in their efforts to improve conditions in this respect.

Cyprus's SMEs account for 75% of the country's economic output and 81% of employment (EC 2013); all clichés aside, their survival and growth are a matter of macroeconomic and financial stability.

Nor is this a challenge for Cyprus alone. Despite European officials' assurances to the contrary, Cyprus's case is not a one-off. The most salient features of the events of 2013 could easily be replicated elsewhere in Europe. The imposition of capital controls, long held to be impossible within the Eurozone, has created an undeniable precedent, while depositor bail-ins are now a permanent and prominent part of the EU's single resolution mechanism (EC 2014). Yet as the events of March 2013 demonstrate, solutions that appear viable on paper can falter without the right financial, regulatory and institutional infrastructure.

When the Q3 2013 edition of the ACCA/IMA Global Economic Conditions Survey (ACCA 2013) looked into finance professionals' attitudes towards the Cyprus bail-in, members in Malta, Luxembourg, Greece, Belgium, Ireland, the Netherlands, and Italy (in that order) emerged as the most likely to say they expected a bank depositor bail-in in their own countries over the next five years. As Table 7.1 demonstrates, this list is not primarily made up of heavily indebted countries, but rather countries with large, international financial systems: those with financial sector liabilities of more than 20 times their annual government revenues.

Hence, even after the Eurozone debt crisis has fully abated, some of Europe's most dynamic, international financial centres could still benefit from learning the lessons of Cyprus and anticipating the impact of a rescue plan on SMEs.

Table 7.1: Financial sector liabilities in selected EU countries

Country	Non-consolidated financial sector liabilities as a multiple of annual general government tax revenue	General government gross debt as a multiple of annual tax revenue
EU-27	15.3 (1)	1.9 (2)
Eurozone (2)	13.3 (1)	2.0 (2)
Cyprus	23.4 (1)	2.8 (2)
Malta	21.8 (1)	1.8 (2)
Luxembourg	336.9 (1)	0.5 (2)
Greece	6.1 (2)	3.8 (2)
Belgium	8.6 (2)	2.0 (2)
Ireland	63.4 (1)	3.4 (2)
Netherlands	28.1 (1)	1.6 (2)
Italy	7.5 (1)	2.8 (2)

Source: Eurostat and ACCA calculations. Notes: (1)2012 data (2)2013 data. (3)'Eurozone' refers to the 17 member states prior to the accession of Latvia in 2014.

RESPONSE TO RECOMMENDATIONS

ACCA has considered Talos's report and is grateful to the researchers for their insights and considered, expert opinions. ACCA's responses to the individual recommendations are as follows.

1. Improving the implementation of the Central Bank of Cyprus's Arrears Management Directive

ACCA accepts the authors' recommendation, and believes that the establishment of internal appeals committees should proceed without further delay. ACCA strongly supports the involvement of qualified independent professionals, including accountants, in the Arrears Management and mediation process. The example of Ireland's Mortgage Arrears Management process, whereby lenders were required by their Code of Conduct to encourage borrowers to seek professional financial advice, should be followed in Cyprus.

Arguably, arrears management, however necessary, is not enough. World Bank evidence from emerging markets (World Bank 2014) suggests that what is paramount, especially in the case of business customers, is to restore the pre-existing banking relationship as well as reducing the client's liabilities. Without this element, arrears management is more likely to result in SMEs' disengagement from the banking sector, risking continued under-investment in the medium term. Finance professionals working with SMEs should, as intermediaries, aim to fill this gap and strive to maintain engagement with the financial sector where possible.

It should be stressed that supplying financial information to credit providers is not, and should not be treated by policymakers, as a burden – it is the most crucial input to any financial decision. ACCA urges the authorities to review the administrative elements of Arrears Management only with the aim of maximum efficiency – preserving relevant financial information while reducing irrelevant administrative information.

2. Participating in projects funded by the European Investment Bank

ACCA accepts the authors' recommendation. Significant efforts have apparently been made already in Cyprus, but a large share of potential funding remains untapped, which counteracts the vital need for liquidity among the country's SMEs.

In addition to RTD Talos' recommendations, ACCA believes that the banking sector should seek to explore further the EIB's new SMEs ABS [Asset-backed Securities] initiative, whereby high-quality SME loans can be securitised and the securities sold to the EIB. Alternatively, part of such security issues could be pledged as high-quality collateral in exchange for cheap ECB funding. This approach, if successful, could have the twin benefit of reducing banks' capital requirements and unlocking new central banking liquidity – thus further reducing the cost of capital (EIB 2013). As the first SME ABS securitisation deal was struck in Spain in November 2013 (EIB 2013), it should soon be possible to assess the effectiveness and impact of the scheme.

3. Limiting repayment of Emergency Liquidity Assistance (ELA) and use of the unallocated facilities to direct liquidity through the banks to SMEs
ACCA recognises that the matter of ELA reliance is sensitive and welcomes Talos's thoughtful contribution. While being more expensive than traditional ECB liquidity (full access to which should be a priority), ELA is certainly cheaper than alternative financing sources and more readily available. ACCA appreciates that the banking system's reliance on ELA is monitored on a monthly basis and – for better or worse – interpreted as a sign of the banking system's health; and that in that respect continued reliance can send negative signals to investors and wary depositors.

On balance, ACCA agrees with Talos that for the time being ELA access is necessary to ensure liquidity in the real economy and that prolonged reliance on the facility is becoming less likely as bank liquidity and the country's credit rating both continue to improve. Nonetheless, this must be accompanied by regular communication with investors to maintain confidence.

4. Creating a development bank for Cyprus
ACCA concurs with Talos that the creation of a development bank could anchor SMEs' access to finance and help create new financing markets. As with all instruments of long-term industrial policy, this should be developed with a view to the next several decades and remain free from political interference in its early formative period. The availability of a government-owned bank, complete with its own branch network, is an opportunity unlikely to present itself again.

Nonetheless, it is important to appreciate the dramatically enhanced skills needs of the new bank compared with its predecessor. The breadth and depth of the required expertise will require a significant investment in staff training and development to ensure that the needs of growth-oriented SMEs are prioritised and that the new bank has an understanding of the foreign markets in which its clients are likely to do business.

ACCA notes the suggestion that such a development bank should be modelled after, and work with, Germany's KfW; more specifically, it is arguable that an appropriate blueprint for this relationship would be Spain's own development bank, ICO, which in 2013 signed an agreement with KfW to provide loans to Spanish SMEs (KfW 2013). France's Bpifrance is similarly active and has a long track record of working with the EIB group and overseas finance providers. Plans for a similar development bank are under way in Greece, which would provide some further opportunity for testing of the concept in a post-crisis environment.

5. Creation of a credit bureau and a national credit-scoring system
ACCA welcomes this recommendation by RTD Talos as well as the researchers' emphasis on the central role of a credit bureau in the 'Big Bang' programme of reform that it advocates. We believe that financial information is the single more important and sustainable building block for SMEs' access to finance, and the introduction of public credit bureaux is a proven method of making this widely available (Galindo & Micco 2010).

Elements of a credit bureau are already being put in place as the merger of the commercial and Cooperative Banks' directories (ARTEMIS and AIANTAS respectively) gathers pace. Augmenting these with an official credit-scoring system shared with the banking regulators, after the example of the Banque de France, would be a decisive element that would improve access to finance.

Such efforts, of course, need to survive early implementation without being discredited, and must therefore be sensitive to the actual liquidity conditions in Cyprus. Despite improvements, these are still extremely tight. Credit scoring should not be compromised from the outset by building in excessive lenience, but it can reflect the solvency and liquidity positions of companies as separate measures and attempt to model distinct insolvency and illiquidity risks as opposed to generic default risk (see, for example, Davydenko 2012).

6. Enabling leasing

SMEs need access to a broad range of financing options as well as adequate advice to help them choose the right ones – ACCA therefore strongly endorses Talos's recommendation of a regulatory framework that supports true leasing. At the EU level, leasing is the second most popular form of external finance among SMEs (Ipsos Mori 2013), and can be of particular assistance in times of credit rationing. It should be noted that, as with the introduction of any new product line, a new regulatory framework for leasing will create a significant need for learning among both financial institutions and user businesses. Anecdotal evidence from ACCA members suggests that rapid market entry by banks to new product markets during a crisis has, in the past, been accompanied by reduced levels of service and frustration on both the supply and demand side.

7. Absorption of EU structural funds

ACCA supports Talos's recommendations regarding the absorption of structural funds – a long-overdue set of initiatives, given the magnitude of the current crisis. Nonetheless, the radical transformation of banks' capabilities required by Talos's proposals is a medium-term goal. In the short-term it is imperative that banks refer clients to appropriate sources of advice on business planning and financial management in order to maximise their chances of success when seeking funding.

8. Reconciliation of obligations arising from the late payments law of 2012

ACCA echoes the researchers' recommendations regarding the need for a bank-administered system for the reconciliation of payments. Throughout their fieldwork, the researchers noted that this is a bold initiative that has never been fully tested elsewhere and one that will, moreover, test to its limit the SME sector's remaining goodwill towards the banks. This caveat notwithstanding, this is a worthy medium-term goal for government and the banking sector. Apart from the implementation of the EU Late Payment Directive, which Cyprus has led, an additional impetus towards this already exists for the public sector in that the terms of the memorandum between Cyprus and its creditors include provisions limiting the maximum amount that can be owed to the public sector's trade creditors at any given time.

ACCA is particularly intrigued by the potential of the European Account Preservation Order to improve cash flow conditions for small, open economies such as that of Cyprus, in particular, and urges the authorities and the banking sector to aim for another EU-wide first in implementing this new framework. There are natural synergies between this effort and the bank-led reconciliation of payment obligations, and ACCA is keen to explore them further with local stakeholders.

9. Tax incentives for investing into SMEs by individuals

Tax incentives are a valid means of encouraging investment in research and development (R&D), by improving the payoff structure of what can often be high-risk, cash-negative investments. ACCA therefore welcomes Talos's proposal for an R&D investment scheme, while noting that appropriate advice should be taken by both sides before entering such agreements – a lot of R&D investment is best financed through equity, and fiscal incentives should not get in the way of matching appropriate finance to the needs of each business.

Similar aggressive tax subsidies, eg Singapore's Productivity and Innovation Credit (PIC),[1] provide businesses with tax credits (up to 400% in the case of PIC) and/or cash pay-outs for qualifying investment. A more complex incentive structure might be needed in the case of individuals, perhaps based on the example of France's relief from solidarity wealth tax for business angels.[2] In any case, ACCA urges policymakers to consider the range of qualifying activities very carefully, in line with their long-term strategic outlook for Cyprus's SME sector, rather than focusing on current conditions.

10. Creating or supporting receivables trading and bartering platforms

ACCA has spent the last three years championing alternative sources of finance for SMEs throughout Europe – raising the issue with the European Federation of Accountants (FEE) as early as 2011 (FEE SMP Task Force 2012). ACCA therefore strongly supports Talos's recommendations regarding the creation and support for receivables trading and bartering platforms in Cyprus. In the case of receivables trading, European Directives including MiFID provide a ready-made regulatory framework and the need for regulatory innovation is limited, as long as the platforms target mainly sophisticated investors.

ACCA has first-hand experience of a successful government intervention in this area – the small business tranche of the UK government's Business Finance Partnership (BFP) scheme,[3] under which £10m of government money was invested in MarketInvoice, the UK's largest receivables trading platform – releasing about £40m of new lending per year. ACCA also recently worked with the Hellenic Confederation of Professionals, Craftsmen and Merchants (GSEVEE) on a fact-finding mission to explore the possibility of developing a similar platform to MarketInvoice (among other models) in Greece.

ACCA's experience of the BFP intervention in this and other alternative finance sectors was that its purpose, and main function, was to force a heavily fragmented industry to coalesce around a small number of leading platforms and business models, as well as to create awareness of the market among operators with complementary resources and skills. The impetus provided to the industry through this approach is hugely valuable, as it has accelerated its development significantly. Hence its results should not be evaluated solely on the basis of the lending provided.

That said, these are heavy-handed interventions given the lack of maturity of the fledgling industries involved and should therefore be considered extremely carefully and remain open to applicants from the broadest possible range of industries. Moreover, in the case of Cyprus, the possibility of cross-border collaborations, including with platforms nominally based overseas, should be explored, in order to guarantee a liquid market for investors and an appropriate range of bartered goods and services respectively.

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1. More information on the PIC is available from the website of the Inland Revenue Authority of Singapore (IRAS 2014).

2. More details of the scheme and its treatment under State Aid rules are available on the European Commission's State Aid website (European Commission 2008).

3. More information about the Small Business Tranche of the BFP scheme, as well as instructions to applicants, can be found on the UK government's archives (National Archives 2013).

Appendix: An overview of EU Funded Liquidity Instruments

THE CYPRUS ENTREPRENEURSHIP FUND (CYPEF)

CYPEF is a fund established by the Republic of Cyprus to support and strengthen entrepreneurship in the country by enhancing access to finance for small and medium-sized enterprises (SMEs) (European Investment Fund 2014). Dedicated amounts paid by the Cypriot government to CYPEF are made available through financing from the European Investment Bank (EIB). CYPEF is managed by the European Investment Fund.

CYPEF's financial instruments will be deployed by local banks, to be selected by the European Investment Fund following Calls for Expression of Interest (CEoI), and these will therefore act as the European Investment Fund's financial intermediaries. These financial intermediaries will make available CYPEF's financial instruments to eligible SMEs at favourable terms, in the form of reduced interest rates and potentially reduced collateral requirements, extended loan maturities and grace periods.

The €100m of initial capital pulled together under CYPEF by the government of Cyprus will be matched by equal contributions from the European Investment Fund's selected financial intermediaries, translating into €200m of finance for the benefit of Cypriot SMEs. Additional amounts may become available at a later stage, subject to satisfactory market absorption of the CYPEF funds.

CYPEF benefits enterprises based in Cyprus as well as self-employed entrepreneurs registered under the Cyprus social insurance scheme operating in the majority of economic sectors. Any economic activity financed under CYPEF needs to be performed within the area effectively controlled by the government of Cyprus. CYPEF's financial products can support both working capital and investment loans. Business taxes such as Value Added Tax (VAT) are only eligible if they are non-recoverable.

CYPEF will initially offer a 'funded risk-sharing loan product', providing to selected financial intermediaries funds at attractive cost to on-lend to SMEs and sharing the underlying risk for each individual SME loan. Other products, such as portfolio guarantees, may be offered at a later stage, in line with market needs.

A portion of CYPEF's funds is earmarked to finance existing loans under a specific eligibility framework. Loan re-financing is allowed strictly for economically viable SMEs and is aimed at improving their financing conditions and strengthening their liquidity position and cash flows.

For SMEs and self-employed entrepreneurs

Detailed information about eligibility and financing terms can be obtained from CYPEF's financial intermediaries, which are solely responsible for receiving and evaluating loan applications and subsequently disbursing and monitoring the SME loans. These CYPEF financial intermediaries evaluate each loan request according to their own internal rules and procedures. The European Investment Fund exercises a supervisory and monitoring role over all CYPEF financial intermediaries.

THE TRADE FINANCE FACILITY

The Facility is geared to supporting the foreign trade activities of Cypriot SMEs. Under this instrument, the EIB offers guarantees to foreign banks providing trade finance to Cypriot SMEs. By mitigating the risks involved in trade financing, the Facility should contribute to re-igniting trade flows with Cyprus, favouring an export-led recovery promoted in particular by SMEs and mid-caps.

The EIB, as a long-term lender, has adapted to the real economic needs of EU member states under adjustment programmes and has enlarged its tool-kit with a short-term lending instrument for supporting international trade.

The EIB guarantees provided to foreign banks under the Facility will cover risks related to letters of credit and other trade finance instruments issued by Cypriot banks. This will both alleviate cash collateral constraints otherwise imposed on most SMEs and increase access to international trade instruments at a time when trade has a significant role to play in economic development.

COOPERATION WITH THE COOPERATIVE CENTRAL BANK TO SUPPORT SMES AND YOUTH EMPLOYMENT IN CYPRUS

The European Investment Bank (EIB) renewed its cooperation with Cooperative Central Bank (CCB) of Cyprus and has authorised a new €50m credit line for SMEs.

The cooperation addresses the areas of growth, innovation and jobs that are priorities for Cyprus and the EU as a whole. SMEs contribute to all three of them. Youth unemployment is one of the main challenges currently facing Cyprus and the rest of Europe. In a bid to support a whole generation across Europe, last year EIB developed a dedicated youth employment programme, which was launched for the first time in Cyprus, in cooperation with the Cooperative Central Bank. This will extend the existing successful cooperation and will boost the creation of new professional opportunities for young people.

The Cooperative Central Bank facility includes a financing window under the 'Jobs for Youth' programme and offers even more favourable financial terms to eligible SMEs. This new EIB product, developed under the dedicated youth employment initiative launched by the EIB in July 2013, is part of a larger initiative of the member states and the Commission to tackle youth unemployment, in line with the decision of the European Council in June 2013. This product targets, in particular, countries with high unemployment rates among young people.

In order to benefit from financing under the 'Jobs for Youth' window, SMEs in the fields of industry, commercial services and tourism must fulfil a limited number of conditions, including the employment or training of young people.

JEREMIE IN CYPRUS

JEREMIE is an initiative developed by the European Commission and the European Investment Bank (EIB) Group, represented by the European Investment Fund, in the context of the EU programming period 2007–13. The initials stand for Joint European Resources for Small and Medium-sized Enterprises.

JEREMIE offers the possibility for member states to create a holding fund, and within it to transfer part of their EU Structural Fund allocations, as well as using national resources. EU member states have the option of selecting either the European Investment Fund or any other qualified financial institution, according to the provisions of the applicable EU Structural Funds regulation. The Republic of Cyprus has decided to appoint the European Investment Fund as its holding fund manager.

The principal benefits are set out below.

- Portfolio approach and flexibility: various financial products can be designed and implemented in Cyprus with substantial flexibility as far as the allocation of resources between them is concerned. Products will be designed according to market needs.
- Re-investment of funds: the holding fund is of a revolving nature, meaning that the financial products will be provided on a repayment basis and not as grants. This implies that returns will be used again and again, either through the same or different financial products, for the benefit of SMEs.
- Leverage: a significant implied advantage of JEREMIE is its potential ability to engage the financial sector to contribute to the financial products that will eventually reach the SMEs. This is expected to happen at product level and in various forms, depending on the type of financial product envisaged: for example, risk sharing (for guarantees), co-financing for loans and co-investing for equity investments.
- The European Investment Fund's expertise in the sector of SME financing can be of particular added value, especially in the design and implementation of suitable financial products that will address correctly the needs of the SMEs in line with local market reality.

The Republic of Cyprus will inject an initial amount of €20m into the holding fund.

According to the provisions of applicable Structural Fund regulation, financial products are to be channelled to eligible SMEs through financial intermediaries. Therefore, in order for eligible SMEs to benefit from JEREMIE resources, they would need to approach those financial intermediaries that will be selected by the European Investment Fund. The public will be formally informed about the selected financial intermediaries in due course. Financial intermediaries are selected on the basis of a call for expression of interest/tender procedure. In Cyprus, financial intermediaries for debt products (which are expected to be launched first) could be either qualified commercial banks or credit cooperatives, whereas for equity products, financial intermediaries could be qualified venture capital funds.

Two products have been designed, namely:

- a co-financing product where the holding fund will co-finance eligible SMEs' loans on a loan-by-loan basis with the selected financial intermediaries, and

- a guarantee product whereby the holding fund will provide guarantees to support eligible loans that the selected financial intermediaries will provide to SMEs.

JEREMIE products aim to facilitate access to finance for eligible SMEs, especially in the context of the current negative financial and economic conditions. In particular, the initial JEREMIE products are expected to result in lower interest rates, longer loan repayment and grace periods and also potentially lower collateral requirements for the SMEs.

JEREMIE products will, in principle, support both investment and working capital needs.

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