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Proposal for a

**COUNCIL IMPLEMENTING DECISION**

**amending Implementing Decision 2013/463/EU on approving the macroeconomic  
adjustment programme for Cyprus**

## EXPLANATORY MEMORANDUM

Upon a request by Cyprus, for financial assistance from the European Stability Mechanism (ESM), the ESM Board of Governors decided on 24 April 2013 to grant, in principle, stability support to Cyprus and approved the Memorandum of Understanding on Specific Economic Policy Conditionality (hereinafter referred to as the "MoU") and its signing by the Commission on behalf of the ESM. On 8 May 2013 the ESM Board of Directors approved the financial assistance facility agreement. The macroeconomic adjustment programme aims at restoring financial market confidence, re-establishing sound macroeconomic balances and enabling the economy to return to sustainable growth.

The macroeconomic adjustment programme for Cyprus was initially adopted by the Council by Decision 2013/236/EU on 25 April 2013. Following the entry into force of Regulation (EU) No 472/2013, the programme was readopted on the basis of Article 7(2) of Regulation (EU) No 472/2013 by Council Implementing Decision 2013/463/EU. At the same time, Decision 2013/236/EU was repealed.

In line with Article 1(2) of Decision 2013/463/EU, the Commission, in liaison with the European Central Bank (ECB), and, where appropriate, with the International Monetary Fund (IMF), has conducted the third review to assess the progress on the implementation of the agreed measures as well as their effectiveness and economic and social impact. As a result, the programme should be updated in the areas of financial sector reform, fiscal policy, and structural reforms. For the financial sector, the revised MoU will stipulate that a communication strategy on the roadmap for the relaxation of the capital controls and on the implementation of the banking sector strategy is to be designed by a joint Central Bank of Cyprus (CBC) and Ministry of Finance task force. In addition, the revised MoU will call for the timely reporting of banks' estimates of the potential impact of the newly introduced and upcoming European Union (EU) rules on capital requirements and non-performing loans (NPLs) on capital, profitability and coverage ratio. Finally, a new section on the reform of the legal framework of private debt restructuring is to be added. Under this policy advice, a task force is to be established to assess the magnitude of registered by untitled land sales contract, and to provide recommendations on this issue. A comprehensive reform framework establishing appropriate corporate and personal insolvency procedures is to be established. Finally, the Civil Procedure Code and Court Rules will be reviewed to ensure a smooth and effective functioning of the revised foreclosure and insolvency frameworks. With regard to fiscal policy, the general government primary deficit target in 2014 is revised to 1.8% of GDP. In the area of structural reforms, the revised MoU will include a commitment to implement a first stage of the National Health System (NHS), having first defined and adopted a full roadmap to NHS. It is also required that the policies on pricing and reimbursement of medical goods and services, including those related to pharmaceutical expenditure, are to be revised. Moreover, it is required that a Privatisation Unit is established. In addition, the revised MoU will contain a commitment that Cyprus presents an action plan for addressing the shortcoming identified in Phase 2 of the peer review by the Organisation for Economic Co-operation and Development (OECD) Global Forum on Transparency and Exchange of Information for Tax Purposes. Lastly, the new MoU includes a requirement to develop a growth strategy based on Cyprus' competitive advantages to help the Cypriot authorities to kick-off the economy.

The proposed decision will ensure full consistency between the Union multilateral surveillance framework established by the Treaty of the Functioning of the European Union (TFEU) and the policy conditionality underpinning the financial assistance. Notably, Article 10 of Regulation (EU) No 472/2013 provides for consistency in reporting and monitoring obligations.

Proposal for a

## **COUNCIL IMPLEMENTING DECISION**

### **amending Implementing Decision 2013/463/EU on approving the macroeconomic adjustment programme for Cyprus**

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability<sup>1</sup>, and in particular Article 7(2) and (5) thereof,

Having regard to the proposal from the European Commission,

Whereas:

- (1) Regulation (EU) No 472/2013 applies to Member States already in receipt of financial assistance, including those from the European Stability Mechanism (ESM), at the time of its entry into force.
- (2) Regulation (EU) No 472/2013 sets the rules for the approval of macroeconomic adjustment programme for Member States in receipt of financial assistance, which need to be consistent with the provisions of the Treaty of Establishing the ESM.
- (3) Upon a request of 25 June 2012 by Cyprus for financial assistance from the ESM, the Council decided on 25 April 2013 by Decision 2013/236/EU<sup>2</sup> that Cyprus was to rigorously implement a macroeconomic adjustment programme.
- (4) On 24 April 2013 the ESM Board of Governors decided to grant, in principle, stability support to Cyprus and approved the Memorandum of Understanding on Specific Economic Policy Conditionality (hereinafter referred to as the "MoU") and its signing by the Commission on behalf of the ESM.
- (5) In accordance with Article 1(2) of Implementing Decision 2013/463/EU, the Commission, in liaison with the European Central Bank (ECB), and, where appropriate, with the International Monetary Fund (IMF), has conducted the third review to assess the progress with the implementation of the agreed measures as well as their effectiveness and economic and social impact.
- (6) As a result, Decision 2013/463/EU should be updated in the areas of financial sector reform, fiscal policy and structural reforms, notably with regard to (i) the design of a communication strategy by a joint Central Bank of Cyprus (CBC) and Ministry of Finance task force on the roadmap for the relaxation of the capital controls and on the implementation of the banking sector strategy; (ii) the timely reporting of banks'

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<sup>1</sup> OJ L 140, 27.5.2013, p. 1.

<sup>2</sup> Council Decision 2013/236/EU of 25 April 2013 addressed to Cyprus on specific measures to restore financial stability and sustainable growth (OJ L 141, 28.05.2013, p. 32).

estimates of the potential impact of the newly introduced and upcoming EU rules on capital requirements and non-performing loans (NPLs) on capital, profitability and coverage ratio; (iii) the establishment of a task force to assess the magnitude of registered by untitled land sales contract, and to provide recommendations on this issue; (iv) the reform of corporate and personal insolvency procedures; (v) the review of the Civil Procedure Code and Court Rules to ensure a smooth and effective functioning of the revised foreclosure and insolvency frameworks; (vi) a revision of the primary deficit target for 2014 to 1.8% of GDP; (vii) the implementation of a first stage of the National Health System (NHS), having first defined and adopted a full roadmap to NHS; (viii) the revision of policies on pricing and reimbursement of medical goods and services, including those related to pharmaceutical expenditure; (ix) the establishment of a Privatisation Unit; (x) the presentation of an action plan for addressing the shortcoming identified in Phase 2 of the peer review by the Organisation for Economic Co-operation and Development (OECD) Global Forum on Transparency and Exchange of Information for Tax Purposes; (xi) the development of a growth strategy based on Cyprus' competitive advantages to help the Cypriot authorities to kick-off the economy. The implementation of comprehensive and ambitious reforms in financial, fiscal and structural areas should safeguard the medium-term sustainability of the Cypriot public debt.

- (7) Throughout the implementation of Cyprus' comprehensive policy package, the Commission should provide additional policy advice and technical assistance in specific areas. A Member State subject to a macroeconomic adjustment programme experiencing insufficient administrative capacity is to seek technical assistance from the Commission, which may constitute, for that purpose, groups of experts.
- (8) The Cypriot authorities should seek the view, in accordance with current national rules and practises, of social partners and civil society organisations in the preparation, implementation, monitoring and evaluation of the macroeconomic adjustment programme,

HAS ADOPTED THIS DECISION:

#### *Article 1*

Article 2 of Implementing Decision 2013/463/EU is amended as follows:

- (1) Paragraph 5 is replaced by the following:

5. With a view to restoring the soundness of its financial sector, Cyprus shall (i) continue to implement the restructuring of the banking and cooperative credit institution sectors, (ii) continue to strengthen the supervision and regulation, (iii) undertake a reform of the debt restructuring framework and (iv) gradually lift capital restrictions in line with its roadmap, while safeguarding financial stability. The programme shall provide for the following measures and outcomes:

- (a) ensuring that the liquidity situation of the banking sector shall be closely monitored. Temporary restrictions on the free movement of capital (inter alia, limits on cash withdrawals, payments and transfers) shall be closely monitored. The goal is that controls shall remain in place only for as long as is strictly necessary to mitigate serious risks for the stability of the financial system. The implementation of the roadmap for the gradual relaxation of restrictive measure shall continue, taking also into account the credit institutions' liquidity situation. A well-targeted communication strategy shall be designed aiming to

regularly communicate information regarding the abovementioned roadmap and the progress made in the implementation of banking sector strategy. The funding and capital plans of domestic banks relying on central bank funding or receiving state aid shall realistically reflect the anticipated deleveraging in the banking sector and the gradual easing of restrictive measures, and shall reduce dependency on borrowing from the central banks, while avoiding asset fire sales and a credit crunch;

- (b) adapting the minimum capital requirements, taking into account the parameters of the balance sheet assessment and the EU-wide stress test;
- (c) ensuring that any restructuring plans shall be formally approved under State aid rules, before any state aid is provided. Banks with a capital shortfall may, if other measures do not suffice, ask for recapitalisation aid from the state in accordance with state-aid procedures. Banks with restructuring plans shall report the progress in their implementation of the plans;
- (d) ensuring that a credit register is created and operational, that the current regulatory framework on asset impairment and provisioning, and on the treatment of collateral in provisioning is amended, as necessary, and that the implementation of EU rules on capital requirements and non-performing loans are timely adopted;
- (e) easing constraints on the seizure of collateral. This shall accompany the preparation of legislation on the basis of a comprehensive reform framework establishing appropriate corporate and personal insolvency procedures, as well as ensuring the smooth and effective functioning of the revised foreclosure and insolvency frameworks. In addition, once reformed, the new private sector debt restructuring legal framework shall be reviewed and additional measures shall be defined as needed;
- (f) implementing the strategy for the future structure, functioning, and viability of the cooperative credit institution sector, as designed by the Central Bank of Cyprus in consultation with the Commission, the ECB and the IMF;
- (g) enhancing the monitoring of the indebtedness of the corporate and household sectors and establishing a framework for targeted private sector debt restructuring to facilitate new lending and diminish credit constraints. The banks' arrears management policies and practices shall be reviewed and the Arrears Management directive and the Code of Conduct shall be amended, as needed. Administrative measures that interfere with the setting of bank lending rates shall not be introduced;
- (h) continuing to further strengthen the anti-money laundering framework and implementing an action plan ensuring the application of improved practices with regard to customer due diligence and entity transparency, in line with best practice;
- (i) integrating stress-testing into regular off-site bank supervision;
- (j) introducing mandatory disclosure requirements to ensure that banks regularly communicate, to authorities and markets, progress in restructuring their operations;
- (k) ensuring the implementation of the restructuring measures that shall enhance the viability of the cooperative credit sector, following the establishment of the

legal framework for the new governance structure for the management of the State's stake in the sector; and

- (1) ensuring the revision of the governance directive, which will specify, among others, the interaction between banks' internal audit units and bank supervisors.'
- (2) Paragraph 7 is replaced by the following:

'7. Over 2014, the Cypriot authorities shall fully implement the permanent measures included in 2014 Budget Law which shall amount to at least EUR 270 million. They shall also ensure the full implementation of the consolidation measures adopted since December 2012.'
- (3) The following paragraph is inserted:

'7a. For the fiscal policy in 2015-2016, the Cypriot authorities shall pursue a general government balance in line with the adjustment path respecting the Excessive Deficit Procedure (EDP) recommendation.'
- (4) Paragraph 8 is amended as follows:
  - (a) Subparagraph (a) is replaced by the following:

'(a) if necessary, further reforms of the general and public sector pension system to ensure the long-run viability of the pension system, while addressing the adequacy of pensions;'
  - (b) Subparagraph (e) is replaced by the following:

'(e) elaboration of a programme to achieve a solid corporate governance system for state-owned and semi-public enterprises and adoption of a privatisation plan to help improve economic efficiency and restore debt sustainability;'
- (5) Paragraphs 10 to 13 are replaced by the following:

'10. Cyprus shall ensure the implementation of the agreed measures to address the identified shortcomings in its activation policies. Cyprus shall take swift action to create opportunities for young people and improve their employability prospects, in line with the objectives of the Council Recommendation on Establishing a Youth Guarantee<sup>3</sup>. The design, management and implementation of the measures targeted to youth shall be well integrated within the broader system of activation policies and be coherent with the reform of the social welfare system and the agreed budgetary targets.

11. Cyprus shall stand ready to adopt any further necessary amendments to sector-specific legislation required in order to fully implement Directive 2006/123/EC of the European Parliament and of the Council<sup>4</sup>. The Cypriot authorities shall further improve the functioning of the regulated professions. The competition framework shall be improved by enhancing the functioning of the competent competition authority and by reinforcing the independence and powers of the National Regulatory Authorities.

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<sup>3</sup> Council Recommendation of 22 April 2013 on establishing a Youth Guarantee (OJ C 120, 26.4.2013, p. 1).

<sup>4</sup> Directive 2006/123/EU of the European Parliament and of the Council on services in the internal market (OJ L 376, 27.12.2006, p. 36).

12. Cyprus shall ensure a reduction in the title deed issuance backlog, take action to accelerate the swift clearing of encumbrances on title deeds to be transferred to purchases of immovable property, and define deadlines for the issuance of building certificates and title deeds.

13. Cyprus shall amend the rules on the forced sale of mortgaged property and shall allow for private auctions within the shortest feasible timespan. The pace of court case handling shall be improved and court backlogs shall be eliminated by the end of the programme. Cyprus shall take initiatives to strengthen the competitiveness of its tourism sector, by implementing the concrete action plan leading to the attainment of the quantified targets identified, inter alia in the revised Tourism Strategy for 2011-2015. Cyprus shall implement an aero-political strategy leading to the adaptation of Cyprus' external aviation policy, taking into account the EU external aviation and the EU aviation agreements, while ensuring sufficient air connectivity.'

(6) In paragraph 14, subparagraph (b) is replaced by the following:

'(b) a comprehensive outline of the regulatory regime and market organisation for the restructured energy and gas sector, including an appropriate sales framework for the off-shore gas supply aimed at maximising revenues; and'

(7) Paragraph 15 is replaced by the following:

'15. Cyprus shall submit an updated request to the Commission for technical assistance during the programme period. The request shall identify and specify the areas of technical assistance or advisory services which the Cypriot authorities consider essential for the implementation of its macroeconomic adjustment programme.'

(8) The following paragraph is added:

'16. When developing a comprehensive and coherent growth strategy that would allow the kick-starting of the economy, Cyprus shall integrate it into its national institutional framework leveraging on the on-going public administration, public financial management reform, other commitment in Cyprus' macroeconomic adjustment programme and relevant EU initiatives taking into account the Partnership agreement for the implementation of the European Structural and Investments Funds.'

#### *Article 2*

This Decision is addressed to the Republic of Cyprus.

Done at Brussels,

*For the Council  
The President*