



**COUNCIL OF
THE EUROPEAN UNION**

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LEGISLATIVE ACTS AND OTHER INSTRUMENTS

Subject: **COUNCIL IMPLEMENTING DECISION on approving the macroeconomic adjustment programme for Cyprus and repealing Decision 2013/236/EU**

COUNCIL IMPLEMENTING DECISION

of ... 2013

**on approving the macroeconomic adjustment programme for Cyprus
and repealing Decision 2013/236/EU**

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 stability¹, and in particular Article 7(2) and (5) thereof,

Having regard to the proposal from the European Commission,

¹ OJ L 140, 27.5.2013, p. 1.

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 programmes for Member States in receipt of financial assistance; those rules need to be consistent with the provisions of the Treaty Establishing the European Stability Mechanism.
- (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/EU¹, 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 the "MoU") and its signing by the Commission on behalf of the ESM.

¹ 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, 28.5.2013, p. 32).

- (5) In accordance with Article 1(2) of Decision 2013/236/EU, the Commission, in liaison with the European Central Bank (ECB), and, where appropriate, with the International Monetary Fund (IMF), has conducted the first review to assess the progress with the implementation of the agreed measures as well as their effectiveness and economic and social impact. As a consequence of this review, an update has been made to the existing macro-economic adjustment programme, reflecting the steps taken by the Cypriot authorities by the second quarter of 2013.
- (6) Following the entry into force of Regulation (EU) No 472/2013, the macroeconomic adjustment programme is now to be adopted in the form of a Council implementing decision. For the sake of clarity and legal certainty, the programme should be readopted on the basis of Article 7(2) of Regulation (EU) No 472/2013. The substance of the programme should remain identical to the one approved by Decision 2013/236/EU, but also incorporate the results of the review carried out in accordance with Article 1(2) of that Decision. At the same time, Decision 2013/236/EU should be repealed.

- (7) The Commission, in liaison with the ECB and the IMF, has conducted the first 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 MoU has been updated in the areas of financial sector reform, fiscal policy and structural reforms, in particular with regard to (i) a roadmap for the gradual relaxation of capital controls, (ii) establishing the legal framework for a new governance structure to manage the stake of the State in the cooperative credit sector, (iii) an anti-money laundering action plan, (iv) a compensation scheme for provident funds and retirement funds which held deposits at the Cyprus Popular Bank, (v) ensuring that the necessary national funds remain available to cover national contributions for projects funded by the Structural and other EU funds, (vi) providing details of the planned reform of public assistance, and (vii) preparing detailed policy proposals for activation policies and taking swift action to create opportunities for young people and improve their employability prospects. The implementation of comprehensive and ambitious reforms in financial, fiscal and structural areas should safeguard the medium-term sustainability of the Cypriot public debt.

- (8) 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.
- (9) The Cypriot authorities should seek the view, in accordance with current national rules and practices, 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

1. In order to facilitate the return of the Cypriot economy to a path of sustainable growth and to fiscal and financial stability, Cyprus shall rigorously implement the macroeconomic adjustment programme (the "programme"), the main elements of which are laid down in Article 2 of this Decision.

2. The Commission, in liaison with the ECB and, where appropriate, with the IMF, shall monitor Cyprus' progress in implementing the programme. Cyprus shall give the Commission and the ECB its full cooperation. It shall, in particular, provide them with all the information that they deem necessary for the monitoring of the programme. The Cypriot authorities shall consult *ex ante* the Commission, the ECB and the IMF on the adoption of policies that are not included in this Decision but that could have a material impact on the achievement of programme objectives.

3. The Commission, in liaison with the ECB and, where appropriate, with the IMF, shall examine with the Cypriot authorities any changes and updates to the programme that may be needed in order to take proper account of, inter alia, any significant gap between macroeconomic and fiscal forecasts and realised figures (including employment), negative spill-over effects, as well as macroeconomic and financial shocks.

In order to ensure the smooth implementation of the programme and to help the correction of imbalances in a sustainable way, the Commission shall ensure the provision of continued advice and guidance on fiscal, financial market and structural reforms.

The Commission shall at regular intervals assess the economic impact of the programme and shall recommend necessary corrections with a view to enhancing growth and job creation, securing the necessary fiscal consolidation, and minimising harmful social impacts. The macroeconomic adjustment programme, including its objectives and the expected distribution of the adjustment effort, shall be made public.

Article 2

1. The key objectives of the programme shall be: to restore the soundness of the Cypriot banking sector; to continue the ongoing process of fiscal consolidation; and to implement structural reforms to support competitiveness and sustainable and balanced growth. The programme shall address the specific risks emanating from Cyprus for the financial stability of the euro area and shall aim to rapidly re-establish a sound and sustainable economic and financial situation in Cyprus and restore its capacity to finance itself fully on the international financial markets. The programme shall take due account of the Council recommendations addressed to Cyprus under Articles 121, 126, 136 and 148 Treaty as well as Cyprus' actions to comply with them, while aiming to broaden, strengthen and deepen the policy measures required.

2. Cyprus shall pursue fiscal consolidation consistent with its obligations under the excessive deficit procedure by means of high-quality permanent measures while minimising the impact on vulnerable groups.

3. In order to bring its deficit below 3 % of GDP by 2016, Cyprus shall stand ready to take additional consolidation measures. Specifically, in the event of underperformance of revenue or higher social spending needs due to adverse macroeconomic effects, the Cypriot Government shall stand ready to take additional measures to preserve programme objectives, including by reducing discretionary spending, while minimising the impact on vulnerable groups. Over the programme period, cash revenue above the programme projections, including any windfall gains, shall be saved or used to reduce debt. Conversely, over-performance, to the extent that it is deemed permanent, can reduce the need for additional measures in the outer years.

4. Cyprus shall preserve the good implementation of Structural and other EU Funds, in respect of the programme's budgetary targets. In order to ensure the effective implementation of EU funds, the Cypriot Government shall ensure that the necessary national funds remain available to cover national contributions, including non-eligible expenditure, under the European Structural and Investment Funds (ERDF, ESF, Cohesion Fund, EAFRD and EFF/EMFF) in the framework of the 2007-2013 and 2014-20 programme periods, while taking into account available European Investment Bank funding. The authorities shall ensure that the institutional capacity to implement current and future programmes is improved and the appropriate human resources of Managing Authorities and implementing bodies are available.

5. With a view to restoring the soundness of its financial sector, Cyprus shall continue to thoroughly reform and restructure the banking sector and reinforce viable banks by restoring their capital, addressing their liquidity situation and strengthening their supervision. 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. A roadmap for the controls' gradual relaxation has been published, based on milestones and progress with the programme implementation and consistent with the banks' liquidity situation. The medium-term 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 reduce dependency on borrowing from the central banks, while avoiding asset fire sales and a credit crunch. The regulations on the minimum liquidity requirements shall be updated to prevent excessive issuer concentration in the future;
 - (b) adopting the necessary regulatory requirements regarding an increase in the minimum core Tier 1 capital adequacy ratio to 9 % by the end of 2013;

- (c) taking steps to minimise the costs of bank restructuring carried by taxpayers. Undercapitalised commercial and cooperative credit institutions shall raise, to the largest extent possible, capital from private sources before State aid measures are granted. Any restructuring plans shall be formally approved under State aid rules, before any State aid is provided. Commercial 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;
- (d) ensuring that a credit register is created, that the current regulatory framework on loan origination and management processes is reviewed and amended, if necessary, and that legislation strengthening the governance of commercial banks is adopted;
- (e) strengthening banks' governance, including by prohibiting lending to independent board members or their connected parties;
- (f) maximising recovery for non-performing loans, while minimising incentives for strategic default by borrowers. This shall include easing constraints on the seizure of collateral and proper monitoring and managing of non-performing loans;
- (g) completing the harmonisation of the regulation and supervision of cooperative credit institutions with those of commercial banks;

- (h) 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;
- (i) 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;
- (j) further strengthening the anti-money laundering framework and implementing an action plan ensuring the implementation of improved practices with regard to customer due diligence and entity transparency, in line with best practice;
- (k) submitting legislation for mandatory supervision based on capitalisation levels;
- (l) integrating stress-testing into regular off-site bank supervision;
- (m) introducing mandatory disclosure requirements to ensure that banks regularly communicate, to markets, progress in restructuring bank operations; and
- (n) establishing the legal framework for a new governance structure to manage the stake of the State in the cooperative credit sector.

6. Over 2013, the Cypriot authorities shall rigorously implement the 2013 Budget Law (as amended), including the additional permanent measures adopted prior to the granting of the first disbursement of financial assistance, which shall amount to at least EUR 351 million (2,1 % of GDP). Cyprus shall adopt the following measures:
- (a) a reform of its tax system for motor vehicles, based on environmentally-friendly principles and with a view to raising additional revenue in the medium term;
 - (b) a compensation scheme for provident and retirement funds which held deposits at the Cyprus Popular Bank, which ensures comparable treatment with such funds in the Bank of Cyprus, takes into account the cash-flow and actuarial position of each fund and minimises the impact on the general government deficit. Given the social welfare nature of such funds, the 2013 general government deficit target may be revised to incorporate the budgetary impact of this scheme; and
 - (c) full implementation of the consolidation measures adopted since December 2012.

7. The following measures shall be applied by Cyprus as of 1 January 2014:
- (a) on the expenditure side, the budget is to include: a reduction in total outlays for social transfers through better targeting; a further reduction in the public and broader public sector wages and overtime compensation; the introduction of a fee on public transport cards for students and pensioners; and structural reform measures in the educational sector to improve the use of resources; and
 - (b) on the revenue side, the budget for 2014 is to include: an extension of the temporary contribution on gross earnings of public and private sector employees up to 31 December 2016; increases in VAT; increases in excise duties; and an increase in the contributions to the General Social Insurance Scheme.
8. In order to ensure the long-term sustainability of public finances, Cyprus shall implement fiscal-structural reforms, comprising, inter alia, the following measures and outcomes:
- (a) if necessary, further reforms of the general and public sector pension system to ensure the long-term viability of the pension system, while addressing the adequacy of pensions. Reform options shall be provided by an actuarial study;

- (b) control of the growth of health expenditure in order to ensure sufficient means for fundamental healthcare by strengthening the sustainability of the funding structure and the efficiency of public healthcare provision; implement a National Health System, ensuring its financial sustainability while providing universal coverage;
- (c) improvement in the efficiency of public spending and the budgetary process by means of an effective medium-term budgetary framework as part of an improved public finance management, thereby contributing to the budgetary consolidation efforts while taking into account the need to ensure sufficient means for fundamental policies, such as education and healthcare. This framework shall be fully compliant with the Council Directive 2011/85/EU¹ and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, signed in Brussels on 2 March 2012;
- (d) adoption of an adequate legal and institutional framework for Public Private Partnerships designed according to best practice;
- (e) elaboration of a programme to achieve a solid corporate governance system for state-owned and semi-public enterprises and initiation of a privatisation plan to help improve economic efficiency and restore debt sustainability;

¹ Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States (OJ L 306, 23.11.2011, p. 41.).

- (f) elaboration and implementation of a comprehensive reform plan to improve the effectiveness and efficiency of tax collection and administration, including measures to fight against tax fraud and evasion and safeguard the full and timely application of laws and standards governing international tax cooperation and the exchange of tax information;
- (g) reform of the immovable property tax regime;
- (h) reform of the public administration to improve its functioning and cost-effectiveness, in particular by reviewing the size, employment conditions and functional organisation of the public service in order to ensure the efficient use of government resources and the provision of a quality service to the population;
- (i) reforms of the overall structure and the levels of welfare benefits, with the aim of producing an efficient use of resources and ensuring an appropriate balance between welfare assistance and incentives to take up work. The planned reform of public assistance shall ensure that social assistance serves as a safety net to ensure a minimum income for those unable to achieve a basic standard of living, while safeguarding incentives to take up work; and
- (j) undertaking a comprehensive audit of its public finances in order, inter alia, to assess the reasons that led to the building up of excessive levels of debt.

9. Cyprus shall ensure that the suspension of wage indexation in the wider public sector remains in place until the end of the programme. Any change in the minimum wage shall be in line with the economic and labour market developments, and shall be adopted after consultation with the social partners.
10. Cyprus shall prepare detailed policy proposals with regard to addressing 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 Guarantee¹. 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 adopt any remaining necessary amendments to sector-specific legislation required in order to fully implement Directive 2006/123/EC of the European Parliament and of the Council². Unjustified obstacles in the services markets, in particular in relation to regulated professions, shall be eliminated. The competition framework shall be improved by enhancing the functioning of the competent competition authority and by safeguarding the independence and powers of the National Regulatory Authorities.

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

² Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 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 implement guaranteed timeframes for the issuance of building certificates and title deeds.

13. Cyprus shall amend the rules on the forced sale of mortgaged property and 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 period. Cyprus shall take initiatives to strengthen the competitiveness of its tourism sector, by providing a concrete action plan leading to the implementation of the quantified targets identified, inter alia, in the recently revised Tourism Strategy for 2011-2015. Cyprus shall report on air connectivity needs as the basis for an aeropolitical strategy.

14. In the energy sector, Cyprus shall fully implement the Third Energy Package, notwithstanding Article 44(2) of Directive 2009/72/EC of the European Parliament and of the Council¹ and Article 49(1) of Directive 2009/73/EC of the European Parliament and of the Council². Cyprus shall consider whether to make use of the derogations provided to it in those Articles. In parallel, a comprehensive development plan for the rearrangement of the Cypriot energy sector shall be formulated. That plan shall consist of:
- (a) a roll-out plan for the infrastructure required for the exploitation of natural gas, taking into account commercial options and risks;
 - (b) a comprehensive outline of the regulatory regime and market organisation for the restructured energy sector and gas exports, including an appropriate sales framework for the off-shore gas supply aimed at maximising revenues; and

¹ Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC (OJ L 211, 14.8.2009, p. 55).

² Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC (OJ L 211, 14.8.2009, p. 94).

(c) a plan to establish the institutional framework for the management of hydrocarbon resources, including a resource fund, which should receive and manage public revenue from offshore gas exploitation and which is set up on the basis of internationally-recognised best practice.

15. Cyprus shall submit a 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.

Article 3

Decision 2013/236/EU is repealed.

Article 4

This Decision is addressed to the Republic of Cyprus.

Done at Brussels,

For the Council
The President
