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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

On 25 June 2012 Cyprus submitted a request for financial assistance from the European Stability Mechanism (ESM). On 25 April 2013 the Council decided (Council Decision 2013/236/EU) that Cyprus shall rigorously implement a macroeconomic adjustment programme, which 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. Following the entry into force of Regulation (EU) No 472/2013, Council Decision 2013/236/EU was replaced by Implementing Decision 2013/463/EU.

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. On 8 May 2013 the ESM Board of Directors approved the financial assistance facility agreement. The 3-year programme covers the period from mid-2013 to 31 March 2016.

The macroeconomic adjustment programme aims at restoring financial market confidence, re-establishing sound macroeconomic balances and enabling the economy to return to sustainable growth. To achieve these goals, the programme builds on three pillars. The first pillar is a financial sector strategy based on restructuring and downsizing of its financial institutions and strengthening its supervision, with efforts to address capital and liquidity shortfalls. The second pillar is an ambitious fiscal consolidation strategy, building on the consolidation efforts initiated in 2012, in particular through measures to reduce current primary expenditure, enhance government revenues, improve the functioning of the public sector and maintain fiscal consolidation in the medium-term. The aim is to correct the excessive general government deficit and put the gross public debt-to-GDP ratio on a firm downward path in the medium-term. The authorities are committed to reducing the deficit to below 3% of GDP by 2016. The good implementation of Structural and other EU Funds, as well as EU policy initiatives aimed at enhancing jobs and growth should be preserved. This will contribute to the long-term growth path for Cyprus. The third pillar consists of an ambitious structural reform agenda, with a view to supporting competitiveness and sustainable and balanced growth, in line with country-specific recommendations addressed to Cyprus in 2012, and allowing for the unwinding of macroeconomic imbalances. Recalling the Council Recommendation of 22 April 2013 on establishing a Youth Guarantee¹, opportunities for young people and their employability prospects should be enhanced.

In line with Article 1(2) of Implementing Decision 2013/463/EU, the Commission, in liaison with the ECB, and, where appropriate, with the IMF, has conducted the sixth 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 an update of the MoU was agreed at services level in the areas of financial sector reform, fiscal policy and structural reforms. For the financial sector, following the complete liberalisation of the external restrictive measures on 6 April 2015, the authorities committed to continue to closely monitor the liquidity situation of the banking sector. In addition, the revised MoU requires additional measures to address the corporate and household indebtedness and further strengthen the framework for long-term sustainable private debt restructuring, including targets for restructuring non-performing loans and a strategic default study. Furthermore, measures are requested to reform pension and insurance supervision. With regards to the new insolvency and foreclosure framework, the

¹ OJ C 120, 26.4.2013, p. 1.

revised MoU requires the authorities to monitor, on a continuous basis, the implementation and performance of the framework and ensure that it supports its objectives and principles and to adopt amendments if needed. It also includes two prior actions, namely the submission of a legal proposal enabling the sale of loans, and of a legal proposal ensuring that issued title deeds are transferred to property buyers without delay, while safeguarding against abuse.

With regard to fiscal policy, in order to reflect the fiscal performance in the first quarter of 2015, the primary balance target for 2015 should be revised up to a surplus of at least EUR 264 million (1.5% of GDP) and the primary surplus target for 2016-2018 should be readjusted, also to remain in line with the adjustment path prescribed by the Stability and Growth Pact. In the area of fiscal-structural and structural reforms, the revised MoU now foresees the implementation of a National Health System (NHS) by 2017. On revenue administration and tax compliance, the MoU foresees the operationalisation of the new integrated tax agency by setting up a single registration process and approving a new tax procedure code. On the public administration reform, the revised MoU requires, following the horizontal review, the adoption in 2015 of a reform plan that addresses the wage setting mechanism, introduces a new appraisal and promotion system, and enhances staff mobility. On the social welfare reform, the revised MoU provides for the presentation of a single view of benefits, on which basis the monitoring unit will finalise an assessment report of the welfare system reform. It also requires the authorities to submit proposals for the consolidation of disability and student benefits. On the housing market regulation, further requirements are included to accelerate the issuance of title deeds. In the area of tourism, a study will be prepared as an input to the national tourism strategy as part of the Action Plan for Growth. In the area of energy, the authorities will choose the preferred option for the gas and electricity regulatory regime and market organisation in line with the developments regarding the unbundling of the Electricity Authority of Cyprus (EAC).

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

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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 stability², 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 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/EU³ 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 and its signing by the Commission on behalf of the ESM.
- (5) Following the entry into force of Regulation (EU) No 472/2013, the macroeconomic adjustment programme was adopted in the form of a Council Implementing Decision⁴. For reasons of legal clarity and certainty, the programme was readopted on the basis of Article 7(2) of Regulation (EU) No 472/2013. The substance of the programme remained identical to the one approved by Council Decision 2013/236/EU, but also incorporated the results of the review carried out in accordance with Article 1(2) of Decision 2013/236/EU. At the same time, Council Decision 2013/236/EU was repealed.

² OJ L 140, 27.5.2013, p. 1.

³ 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).

⁴ Council Implementing Decision 2013/463/EU of 13 September 2013 on approving the macroeconomic adjustment programme for Cyprus and repealing Decision 2013/236/EU (OJ L 250, 20.9.2013, p. 40).

- (6) Council Implementing Decision 2013/463/EU was already amended by Decision 2014/169/EU and Decision 2014/919/EU. In light of the latest developments, it should be amended again.
- (7) In accordance with Article 1(2) of Council Implementing Decision 2013/463/EU, the Commission, in liaison with the ECB and the IMF, has conducted the sixth 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, changes should be made in the areas of financial sector reform, fiscal policy and structural reforms, reflecting the steps taken by the Cypriot authorities by the first quarter of 2015, in particular with regard to: (i) continuing to closely monitor the liquidity situation of the banking sector; (ii) streamlining regulation and supervision of insurance companies and pension funds; (iii) further measures to strengthen the banks' management of non-performing loans and ensure long-term sustainable restructuring solutions, including targets for the work-out of non-performing loans and a strategic default study; (iv) the submission of a legal proposal enabling the sale of loans; (v) the presentation of a legal proposal ensuring the transfer of issued title deeds without delay while safeguarding against abuse; (vi) the monitoring on a continuous basis of the implementation and performance of the insolvency and foreclosure framework ensuring that it supports its objectives and principles; (vii) to reflect the fiscal performance in the first quarter of 2015, a revision of the 2015 primary balance target to a surplus of at least EUR 264 million (1.5% of GDP) and further adjustments to the primary surplus target for 2016-2018, also to remain in line with the adjustment path prescribed by the stability and growth pact; (viii) the full implementation of a National Health System (NHS) by 2017, (ix) the operationalisation of the new integrated tax agency by setting up a single registration process and approving a new tax procedure code; (x) the adoption of a reform plan for the public administration reform leading to the improvement of the wage setting mechanism, the introduction of new staff appraisal and promotion system and the increase in staff mobility; (xi) the consolidation of disability and student benefits; (xii) the inclusion in housing market regulations of further requirements to fasten the issuance of title deeds; (xiii) the preparation of a study as input for the national tourism strategy as part of the Action Plan for Growth; and (xiv) the choice of a gas and electricity regulatory regime and market organisation and further progress on the unbundling of the Electricity Authority of Cyprus (EAC).
- (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 may 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

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 continue to implement the restructuring of the banking and cooperative credit institution sectors, continue to strengthen supervision and regulation also taking into account the role of the SSM, and undertake a reform of the debt restructuring framework 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 only for as long as is strictly necessary to mitigate serious risks for the stability of the financial system. 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 reduce dependency on borrowing from the central bank, 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 comprehensive assessment;

(c) 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 on the progress in their implementation of the plans;

(d) ensuring that the credit register is fully operational;

(e) taking into account the transition to the SSM, ensuring the full implementation of the regulatory framework with respect to loan origination, asset impairment and provisioning;

(f) ensuring that banks regularly communicate to authorities and to markets on the progress in restructuring their operations;

(g) ensuring the revision of the governance directive, which will specify, among others, the interaction between banks' internal audit units and bank supervisors;

(h) strengthening the banks' governance, including by prohibiting lending to independent board members or their connected parties;

(i) ensuring the necessary staff and amendments in light of the new responsibility taken on by the Central Bank of Cyprus (CBC), in particular for the resolution and supervisory functions, and the transposition into national law of the Single Rulebook, including Directive 2014/59/EU of the European Parliament and of the Council (*) and Directive 2014/49/EU of the European Parliament and of the Council (**);

(j) streamlining of the regulation and supervision of insurance companies and pension funds;

(k) strengthening the management of non-performing loans, taking into account the developments and timelines of the SSM. This notably includes: the monitoring and publication of restructuring targets set by the CBC; measures to allow lenders to obtain adequate financial information on the financial situation of borrowers, and to file for, obtain, and realise an attachment of financial assets and earnings of

delinquent borrowers; measures to allow and facilitate the transfer by lenders to third parties of existing loans, together with all collateral and securities, without having to obtain the consent of the borrower;

(l) legislation ensuring the swift transfer of issued title deeds to property buyers while safeguarding against abuse;

(m) easing constraints on the seizure of collateral, notably by ensuring the smooth and effective functioning of the revised foreclosure framework; this shall be accompanied by implementing and complementing the comprehensive reform of the corporate and personal insolvency procedures, including any additional administrative acts and regulations needed. The implementation and performance of the new insolvency framework shall be monitored on a continuous basis to ensure that it supports its objectives and principles, and if necessary, amendments will be proposed. Also, a comprehensive review of the private sector debt restructuring legal framework shall be conducted by early 2016, with an action plan of modifications to the framework to correct any deficiencies. Recommendations on the Civil Procedure Code and Court Rules shall be formulated to ensure the smooth and effective functioning of the revised foreclosure law and the new insolvency frameworks, also aiming at improving the pace of court handling and the reduction of backlogs in courts;

(n) completing the harmonisation of the regulation and supervision of cooperative credit institutions with those of commercial banks;

(o) ensuring the Cooperative Group provides for timely and complete implementation of the agreed restructuring plan and takes further measures to improve its operational capacity notably in the areas of arrears management, Management Information System, governance, and management capacity;

(p) 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.

(*)Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).

(**)Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (OJ L 173, 12.6.2014, p. 149).'

(2) The following paragraph is inserted:

'7b. For the fiscal policy in 2017-18, the Cypriot authorities shall pursue a general government balance that will ensure debt sustainability and is in line with the adjustment path prescribed by the stability and growth pact.'

(3) In paragraph 8, point (h) is replaced by the following:

'(h) reform of the public administration to improve its functioning and efficiency, in particular by reviewing the size and functional organisation of the public service, improving of the wage setting mechanism, introducing new staff appraisal and promotion systems and increasing staff mobility in order to ensure the efficient use of government resources and the provision of a quality service to the population;'

- (4) Paragraphs 12 and 13 are replaced by the following:
- '12. Cyprus shall ensure a reduction in the title deed issuance backlog, and streamline procedures so as to allow for the swift and efficient issuance of new building certificates and title deeds.
13. Cyprus shall take initiatives to strengthen the competitiveness of its tourism sector, as part of the Action Plan for Growth, notably by implementing the tourism sector's action plan, by identifying impediments to competition in the tourism sector, by adopting a new national tourism strategy, and by implementing an aeropolitical strategy taking into account the EU external aviation and the EU aviation agreements, while ensuring sufficient air connectivity.'
- (5) Paragraph 16 is replaced by the following:
- '16. Cyprus shall implement the Action Plan for Growth with due consideration to the on-going public administration reform, the public financial management reform, other commitments in Cyprus' macroeconomic adjustment programme and relevant EU initiatives taking into account the Partnership Agreement for the implementation of the European Structural and Investment Funds. The Action Plan for Growth will be coordinated and enforced through a single body.'

Article 2

This Decision is addressed to the Republic of Cyprus.

Done at Brussels,

For the Council
The President
[...]