EUROPEAN
COMMISSION

Brussels, 26.8.2014
COM(2014) 541 final

2014/0248 (NLE)

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.

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 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 Guarantee[1], opportunities for young people and their employability prospects should be enhanced.

The 3-year programme covers the period from mid-2013 to mid-2016.

In line with Article 1(2) of Decision 2013/236/EU, the Commission, in liaison with the ECB, and, where appropriate, with the IMF, has conducted the fifth 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. For the financial sector, the revised MoU provides that the authorities will consider further liberalisation of the external restrictive measures only after the successful completion of the Comprehensive Assessement and a smooth transition to the Single Supervisory Mechanism (SSM). This liberalisation, in timely consultation with the Commission, ECB and IMF and informing the ESM, will be consistent with financial stability and comfortable liquidity buffers. The revised MoU also provides for an updated plan for the gradual relaxation of these restrictive measures. In addition, it requires further measures to strenghten the banks' management of non-performing loans. It also includes a provision aimed at concluding the follow-up on the 2013 audit regarding individual financial institutions, imposing sanctions if applicable, and making the final decision public. The revised MoU requires further measures to improve the Cooperative Group's operational capacity. It also

[1] OJ C 120, 26.04.2013, p. 1

includes two prior actions, namely the adoption by the Council of Ministers of the new comprehensive framework establishing appropriate corporate and personal insolvency procedures, as well as the adoption by the House of Representatives of the amendments to the legal framework in relation to foreclosures of mortgaged properties, while its specifies details on the required elements of these two new frameworks. With regard to fiscal policy, the primary deficit target for 2014 was revised down to no more than EUR 210 million (1.3% of GDP) to reflect the fiscal performance in the first half of 2014. In addition, the revised MoU requires the submission of a proposal ensuring the fiscal neutrality of the welfare system reform and the achievement of the 2015 fiscal deficit target, while the primary surplus target for 2017 has been revised down in order to smooth the fiscal adjustment over 2017-2018. In the area of fiscal-structural and structural reforms, the revised MoU sets further steps to operationalize the privatisation process in the Cyprus Ports Authority (CPA) and the Electricity Authority of Cyprus (EAC). On revenue administration and tax compliance, it requires the appointment of the new Commissioner and the two Assistant Commissioners of the new tax department, the establishment of a common taxpayer database, and the adoption of necessary secondary legislation to make the enhanced collection powers operational. The revised MoU also stipulates that the reform of the immovable property taxation will be implemented in 2015. On the social welfare reform, the revised MoU provides for the creation of a national registry of benefits, on which basis the monitoring unit will produce an assessment report of the welfare system reform to ensure its budget neutrality. On housing market regulation, further requirements are included to fasten the issuance of title deeds. In the area of tourism, articles of the current law on the Cyprus Tourism Organisation potentially hampering competition will be assessed, while in the area of energy, a preliminary assessment of the technical and economic potential for further increasing electricity production by renewable energy sources and of the cost price of different sources of renewables compared to conventional primary energy sources will be carried out. The revised MoU also requires the authorities to envisage measures to improve the capacity and independence of the Energy Regulatory Authority (CERA).

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 reasons of legal clarity and certainty, the Commission therefore proposes to readopt the programme on the basis of Article 7 (2) of Regulation 472/2013. The substance of the programme is in essence identical to the one approved by Council Decision 2013/236, but also incorporates the results of the review carried out in accordance with Article 1 (2) of Decision 2013/236. At the same time, it is proposed to repeal Council Decision 2013/236/EU.

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 economic adjustment programme. Notably, Article 10 of Regulation (EU) No 472/2013 provides for consistency in reporting and monitoring obligations.

2014/0248 (NLE)

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[2], 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 European Stability Mechanism (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[3]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) In accordance with Article 1(2) of Council 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 fifth 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 was made to the existing macro-economic adjustment programme, reflecting the steps taken by the Cypriot authorities by the second quarter of 2014.

(6) Following the entry into force of Regulation (EU) No 472/2013, the macroeconomic adjustment programme was adopted in the form of a Council Implementing Decision[4].

---

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)

For reasons of legal clarity and certainty, the programme was readopted on the basis of Article 7 (2) of Regulation 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.

(7) Council Implementing Decision 2013/463/EU was already amended by Decision 2014/169/EU. In light of the latest developments, it should be amended again.

(8) The Commission, in liaison with the ECB and the IMF, has conducted the fifth 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, in particular with regard to: (i) providing an updated plan for the gradual relaxation of external restrictions, which the authorities commit to only start after the successful completion of the Comprehensive Assessement and a smooth transition to the Single Supervisory Mechanism (SSM); (ii) further measures to strenghten the banks' management of non-performing loans; (iii) a requirement to conclude the follow-up on the 2013 audit regarding individual financial institutions, impose sanctions if applicable, and make the final decision public; (iv) the provision of further measures to improve the Cooperative Group's operational capacity; (v) the adoption by the Council of Ministers of the new comprehensive framework establishing appropriate corporate and personal insolvency procedures, as well as the adoption by the House of Representatives of the amendments to the legal framework in relation to foreclosures of mortgaged properties (these are two prior actions), with details on the required elements of these two new frameworks; (vi) a revision of the 2014 primary deficit target to no more than EUR 210 million (1.3% of GDP) to reflect the fiscal performance in the first half of 2014, the submission of a proposal ensuring the fiscal neutrality of the welfare system reform and the achievement of the 2015 fiscal deficit target, while the primary surplus target for 2017 has been revised down to 2.5% of GDP in order to smooth the fiscal adjustment over 2017-2018; (vii) the setting of further steps to operationalize the privatisation process in the Cyprus Ports Authority and the Electricity Authority of Cyprus; (viii) the appointment of the new Commissioners and the two Assistant Commissioners of the new tax department, the establishment of a common taxpayer database, and the adoption of necessary regulations to make the enhanced collection powers operational; (ix) the reform of the immovable property taxation to be implemented in 2015; (x) the inclusion of further requirements to fasten the issuance of title deeds on housing market regulation; (xi) providing a draft action plan for the elimination of court backlogs, detailed statistics on backlogs and duration of proceedings, as well as establishing an administrative Court; (xii) the assessment of articles in the current law of the Cyprus Tourism Organisation that may hamper competition; and (xiii) a preliminary assessment of the technical and economic potential for further increasing electricity production by renewable energy sources and of the cost price of different sources of renewables compared to conventional primary energy sources, together with the inclusion of measures to improve the capacity and independence of CERA.

(9) 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

[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)

experiencing insufficient administrative capacity is to seek technical assistance from the Commission, which may constitute, for that purpose, groups of experts.

(10) 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 in the context of the ongoing transition to the SSM, (iii) undertake a reform of the debt restructuring framework, and (iv) gradually remove restrictive measures 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. The temporary restrictions on the free movement of capital (inter alia, limits on cash withdrawals, payments and transfers) shall be closely monitored. The gradual relaxation of the external restrictive measures shall be consistent with financial sector stability and preserves comfortable liquidity buffers. The Cyprus Central Bank (CBC) will conduct on-site inspections of the implementation of the restrictions, and take appropriate supervisory actions, as needed. Further liberalisation of external restrictive measures will only be considered by the authorities after the successful completion of the Comprehensive Assessment and a smooth transition to the SSM. 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. After the result of the Comprehensive Assessment, the roadmap for the gradual relaxation of restrictive measures will be updated and published. 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 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 the credit register is created and 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) introducing mandatory disclosure requirements to ensure that banks regularly communicate to authorities and markets 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 CBC, including by ensuring a separation between resolution and supervisory functions, the transposition into national law of the Single Rulebook, including the Bank Recovery and Resolution Directive and the Deposit Guarantee Scheme Directive;

(j) strengthening the management of non-performing loans, taking into account the developments and timelines of the SSM. This notably includes: a revision of the Code of Conduct and of bank's arrears management policies and practices; the monitoring 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 attachement of financial assets and earnings of dilinquent borrowers; measures to allow and facilitate the transfer by lenders to third parties of existing individual loans, togheter with all collateral and securities, without having to obtain the consent of the borrower;

(k) 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;

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

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

(n) 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, integrating stress-testing into regular off-site bank supervision.'

(2) In Paragraph 8, point (e) is replaced by the following:

'(e) adoption of a law to achieve a solid corporate governance system for state-owned and semi-public enterprises and implementation of a privatisation plan to help improve economic efficiency and restore debt sustainability;'

(3) Paragraph 13 is replaced by the following:

'13. 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 recently revised Tourism Strategy for 2011-2015, and by amending the Cyprus Tourism Organisation Law, namely those articles that that may hamper competition in the tourism sector. 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.'

(4) In paragraph 14, point (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 a preliminary assessment of the potential for increasing electricity production by renewable energy sources; and'

(5) Paragraph 16 is replaced by the following:

'16 When developing a comprehensive and coherent growth strategy, Cyprus shall integrate it into its national institutional framework leveraging on 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 growth strategy will be developed, coordinated and enforced through the single body that will evolve out of the Task Force for Growth already established and will be anchored in the national institutional framework.'

Article 2

This Decision is addressed to the Republic of Cyprus.

Done at Brussels, […]

For the Council
The President
[…]