

## DECISIONS

## COUNCIL DECISION

of 25 April 2013

**addressed to Cyprus on specific measures to restore financial stability and sustainable growth**

(2013/236/EU)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 136(1), in conjunction with Article 126(6) thereof,

Having regard to the proposal from the European Commission,

Whereas:

- (1) Article 136(1) of the Treaty on the Functioning of the European Union (TFEU) foresees the possibility of adopting measures specific to Member States whose currency is the euro in order to ensure the proper functioning of economic and monetary union.
- (2) On 13 July 2010, the Council adopted a Decision under Article 126(6) of the TFEU stating that an excessive deficit existed in Cyprus<sup>(1)</sup> and issued a Recommendation to Cyprus under Article 126(7) of the TFEU with a view to bringing an end to the situation of an excessive government deficit stating that 'Cyprus's authorities should put an end to the present excessive deficit situation as rapidly as possible and at the latest by 2012'.
- (3) In the Council's Recommendation of 10 July 2012 on the National Reform Programme 2012 of Cyprus and delivering a Council opinion on the Stability Programme of Cyprus, 2012-2015<sup>(2)</sup>, the Council recommended, inter alia, that Cyprus take action to achieve a durable correction of its excessive deficit in 2012, ensure sufficient progress with its debt reduction benchmark, strengthen regulatory provisions for the efficient recapitalisation of the financial institutions and improve competitiveness.
- (4) Cyprus has been under increasing pressure in financial markets, against the background of rising concerns about the sustainability of its public finances, including the required significant public support measures to the weakened financial sector. Some of the imbalances have emerged as a result of negative spill-over effects from the

euro area crisis, including developments in Greece. Other imbalances, as specified in the Commission's 2012 in-depth review for Cyprus and in the Council Recommendation of 10 July 2012, have been domestic and longer-lasting. Amidst consecutive downgrades of Cypriot sovereign bonds by credit rating agencies, the country became unable to refinance itself at rates compatible with long-term fiscal sustainability. In parallel, the banking sector was increasingly cut-off from international market funding and major institutions recorded substantial capital shortfalls.

- (5) In view of these severely adverse economic and financial conditions, the Cypriot authorities officially requested financial assistance under the terms of a loan by the European Financial Stability Facility/European Stability Mechanism (ESM) on 25 June 2012, as well as from the International Monetary Fund (IMF), with a view to supporting the return of Cyprus' economy to sustainable growth, ensuring a properly-functioning banking system and safeguarding financial stability in the Union and in the euro area. On 27 June 2012, the Eurogroup invited the Commission, in liaison with the European Central Bank (ECB), the Cypriot authorities, and the IMF to agree on a macroeconomic adjustment programme for Cyprus, including its financing needs, and to take appropriate action to safeguard financial stability in the current very challenging environment where there is a risk of spill-over effects from sovereign market turbulence. On 25 March 2013, the Eurogroup reached a political agreement with the Cypriot authorities on the cornerstones of a macroeconomic adjustment programme. The banking sector was to be restructured and downsized and efforts were to be stepped-up on fiscal consolidation, structural reforms and privatisation. In addition, the recapitalisation of the two largest banks was to be exclusively generated from within those banks (i.e. from shareholders, bondholders and depositors).
- (6) In the current circumstances, Cyprus should adopt a comprehensive policy package to be implemented in a three-year macroeconomic adjustment programme which would span from 2013 (Q2) to 2016 (Q1).
- (7) The comprehensive policy package should aim to restore financial market confidence, re-establish sound macroeconomic balances and enable the economy to return

<sup>(1)</sup> OJ L 186, 20.7.2010, p. 30.

<sup>(2)</sup> OJ C 219, 24.7.2012, p. 13.

to sustainable growth. It should be structured on three pillars. The first pillar should be a financial sector strategy based on restructuring and downsizing financial institutions and strengthening supervision of the sector, with efforts to address capital and liquidity shortfalls. The second pillar should be an ambitious front-loaded fiscal consolidation strategy to be implemented, in particular, by means of measures to reduce current primary expenditure, enhance government revenue, improve the functioning of the public sector and maintain fiscal consolidation in the medium-term, while minimising the impact on disadvantaged people and preserving the good implementation of Structural and other Union Funds. The third pillar should consist of an ambitious structural reform agenda, with a view to supporting competitiveness and sustainable and balanced growth, allowing for the unwinding of macroeconomic imbalances, in particular by reforming the wage indexation system, in consultation with social partners, and removing obstacles to the smooth functioning of markets. Recalling the political agreement of 28 February 2013 on a Council Recommendation on Establishing a Youth Guarantee, opportunities for young people and their employability prospects should be maintained.

- (8) Under the Commission services' update of the 2012 winter forecast for nominal GDP growth (– 0,5 % in 2012, – 8,2 % in 2013, – 2,9 % in 2014, 2,6 % in 2015 and 3,7 % in 2016), the debt-to-GDP ratio would amount to 87 % in 2012, 109 % in 2013, 123 % in 2014, 126 % in 2015 and 122 % in 2016. The debt-to-GDP ratio would therefore increase rapidly until 2015 and move to a declining path thereafter, reaching an estimated 105 % in 2020. Debt dynamics are affected by several below-the-line operations. Under the Commission services' update of the 2013 winter forecast for nominal GDP growth, the primary general government balance is projected to attain a deficit of EUR 395 million (2,4 % of GDP) in 2013, a deficit of EUR 678 million (4,3 % of GDP) in 2014, a deficit of EUR 344 million (2,1 % of GDP) in 2015 and a surplus of EUR 204 million (1,2 % of GDP) in 2016.
- (9) Enhancing the long-term resilience of the Cypriot banking sector is critical to restoring financial stability in Cyprus and consequently, given the strong links, to preserving financial stability in the euro area as a whole. Substantial downsizing and restructuring of the Cypriot banking sector is under way. The Cypriot House of Representatives adopted legislation establishing a comprehensive framework for the recovery and resolution of credit institutions. Using that new framework, the Cypriot banking sector has been downsized immediately and significantly. To preserve the liquidity of the Cypriot banking sector, temporary administrative measures have been imposed, including capital controls.
- (10) The implementation of comprehensive and ambitious reforms in financial, fiscal and structural areas should safeguard the medium-term sustainability of the Cypriot public debt.
- (11) The Commission, in liaison with the ECB and, where appropriate, with the IMF, should verify at regular intervals the rigorous implementation of Cyprus' macroeconomic adjustment programme through missions and regular reporting, on a quarterly basis, by the Cypriot authorities.
- (12) Throughout the implementation of Cyprus' comprehensive policy package, the Commission should provide additional policy advice and technical assistance in specific areas.
- (13) The Cypriot authorities should involve, in accordance with current national rules and practices, the social partners and civil society organisations in the preparation, implementation, monitoring and evaluation of the macroeconomic adjustment programme.
- (14) Any form of financial assistance received by Cyprus to help it implement the policies under its macroeconomic adjustment programme should be in line with the legal requirements and policies of the Union, in particular the Union's economic governance framework. Any intervention in support of financial institutions should be carried out in accordance with the Union's rules on competition. The Commission should ensure that any measures laid down in a Memorandum of Understanding in the context of requested ESM financial assistance is fully consistent with this Decision,

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 a macroeconomic adjustment programme (the 'programme'), the main elements of which are laid down in Article 2 of this Decision. 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 TFEU as well as Cyprus' actions to comply with them, while aiming to broaden, strengthen and deepen the policy measures required.

2. The Commission, in liaison with the ECB and, where appropriate, with the IMF, shall monitor Cyprus' progress in implementing its 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.

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 provide 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.

#### 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.

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 disadvantaged people.

3. Cyprus shall adopt the measures specified in paragraphs 4 to 15.

4. In order to bring its deficit below 3 % of GDP as soon as possible, 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 the programme's objectives, including by reducing discretionary spending, while minimising the impact on disadvantaged people. 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.

5. Cyprus shall preserve the good implementation of Structural and other Union Funds.

6. 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. The recently-imposed temporary restrictions on the free movement of capital (inter alia, limits on cash withdrawals, electronic payments and transfers abroad) shall be closely monitored. The goal is that controls shall remain in place only for as long as is strictly necessary to prevent serious and immediate risks to financial stability. The medium-term funding and capital plans of domestic banks relying on central bank funding or receiving State aid should 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) establishing an independent valuation of the assets of Bank of Cyprus and Cyprus Popular Bank and quickly integrating the operations of Cyprus Popular Bank into Bank of Cyprus. The valuation shall be completed quickly so as to enable the completion of the deposit-equity swap at Bank of Cyprus;
- (c) adopting the necessary regulatory requirements regarding an increase in the minimum core Tier 1 capital adequacy ratio to 9 % by the end of 2013;
- (d) taking steps to minimise the cost to taxpayers of bank restructuring. 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 such State aid is provided. Commercial and cooperative credit institutions with a capital shortfall may, if other measures do not suffice, ask for recapitalisation aid from the State in line with State aid procedures;
- (e) 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;
- (f) strengthening banks' governance, including by prohibiting lending to independent board members or their connected parties;
- (g) 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. The Central Bank of Cyprus shall issue guidance on the classification as 'non-performing' all loans past due by more than 90 days;

- (h) aligning the regulation and supervision of cooperative credit institutions to those of commercial banks;
- (i) ascertaining the viability of cooperative credit institutions and developing, in consultation with the Commission, the ECB and the IMF, a strategy for the future structure, functioning and viability of the cooperative credit institution sector. The implementation of that strategy should be completed by mid-2015;
- (j) 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;
- (k) further enhancing the anti-money laundering framework and ensuring full entity (legal persons and other legal arrangements, such as trusts) transparency, in line with best practice;
- (l) introducing mandatory supervision based on capitalisation levels;
- (m) integrating stress-testing into regular off-site bank supervision; and
- (n) implementing a unified data reporting system for banks and credit institutions.

7. Over 2013, the Cypriot authorities shall rigorously implement Cyprus' 2013 Budget Law with additional permanent measures of at least EUR 351 million (2,1 % of GDP). Cyprus shall implement through legislative and other measures, including if required the amendment of its 2013 Budget Law, the additional consolidation measures. Cyprus shall adopt the following measures:

- (a) on the expenditure side, its budget shall include the reduction of expenditure on housing schemes by at least EUR 36 million, a further scaled reduction of public sector wages, and the streamlining of certain social benefits;
- (b) on the revenue side, the additional measures shall include increases in property taxes, the tax rate on statutory corporate income, the tax rate on interest income, the bank levy, and the fees for public services;
- (c) a reform of its tax system for motor vehicles, based on environmentally-friendly principles and with a view to raising additional revenue;
- (d) measures to control healthcare expenditure and improve cost efficiency in the healthcare sector by enhancing the efficiency, competitiveness and cost-effectiveness of public hospitals. In addition, Cyprus shall introduce a co-payment system for a limited number of medical services and pharmaceuticals; and
- (e) full implementation of the consolidation measures adopted since December 2012.

8. The following measures shall apply as of 1 January 2014:

- (a) on the expenditure side, the budget shall include: a reduction in total outlays for social transfers through better targeting to yield at least EUR 28,5 million; a further reduction in the public and broader public sector wages; the introduction of a fee on public transport cards for students and pensioners; and structural reform measures in the educational sector to reduce wage expenditure; and
- (b) on the revenue side, the budget for 2014 shall 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.

9. 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) reforms of the general and public sector pension system in order to put the pension system on a sustainable path, while addressing the adequacy of pensions. If necessary, reforms will be further reinforced;
- (b) control of the growth of health expenditure in order to strengthen the sustainability of the funding structure and the efficiency of public healthcare provision;
- (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, fully compliant with Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States<sup>(1)</sup> 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;
- (f) elaboration and implementation of a comprehensive reform plan to improve the effectiveness and efficiency of tax collection and administration, including measures to 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; and

<sup>(1)</sup> OJ L 306, 23.11.2011, p. 41.



- (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.

10. Cyprus shall implement a reform of the system of wage indexation, after consulting the social partners, and in accordance with the objectives of improving the economy's competitiveness and reflecting developments in labour productivity. The planned reform of public assistance should ensure that social assistance serves as a safety net to ensure a minimum income for those unable to support a basic standard of living, while safeguarding incentives to take up work. 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.

11. Cyprus shall adopt the remaining amendments to sector specific legislation required in order to fully implement Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market<sup>(1)</sup>. 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 reinforcing the independence and powers of the national regulatory authorities.

12. Cyprus shall reduce to less than 2 000 the title deed issuance backlog by the end of 2014 and shall implement guaranteed timeframes for the issuance of building certificates and title deeds.

13. By the end of 2013, 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.

14. Cyprus shall take initiatives to strengthen the competitiveness of its tourism sector. Those initiatives shall include a review of the Tourism Strategy for 2011-15, based on a study on how to improve the tourism sector business model, and a thorough analysis of the best means of achieving sufficient air connectivity for Cyprus.

15. In the energy sector, Cyprus shall transpose and fully implement the Third Energy Package. In addition, a comprehensive development plan for the rearrangement of the Cypriot energy sector shall be formulated. That plan shall encompass:

- (a) a roll-out plan for the infrastructure required for the exploitation of gas;
- (b) an outline of the regulatory regime and market organisation for the energy sector and gas exports; and
- (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.

#### *Article 3*

This Decision is addressed to the Republic of Cyprus.

Done at Brussels, 25 April 2013.

*For the Council*  
*The President*  
E. GILMORE

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<sup>(1)</sup> OJ L 376, 27.12.2006, p. 36.