

International Monetary Fund

[Cyprus](#) and the IMF

Cyprus: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

Press Release:

[IMF Completes Fifth, Sixth, and Seventh Reviews of Cyprus' EFF and Approves €278.4 Million Disbursement](#)
June 19, 2015

May 29, 2015

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Letter of Intent

Nicosia, May 29, 2015

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington DC

Dear Ms. Lagarde:

In the attached update of the Memorandum of Economic and Financial Policies (MEFP), we describe progress and policies toward the objectives of the economic program of the Cypriot government, which is being supported by an arrangement under the Extended Fund Facility (EFF).

Recent developments have been encouraging. The output contraction in 2014 was less than projected, and we expect a return to positive economic growth in the second half of 2015. Our financial system is recovering as demonstrated by the Comprehensive Assessment carried out by the European Central Bank, and more recently, by a stabilization of our deposit base and increasing banking system liquidity. This allowed us to remove the remaining external payment restrictions on April 6, 2015. Our access to market financing has improved, as reflected in the successful debt issuance on international capital markets in April, the second one since the 2013 crisis. The Cypriot economy is now much more resilient to regional and global economic shocks.

We remain fully committed to the reform program, and fiscal performance has continued to exceed expectations. We achieved a primary surplus of close to 3 percent of GDP in 2014 (excluding the recapitalization of the cooperative sector), easily surpassing the program projections and signaling that our fiscal adjustment effort is well ahead of schedule. Fiscal performance has been in line with expectations in the first part of 2015. All quantitative performance criteria (PC) for end-September 2014 and indicative targets for end-December 2014 were observed, with the exception of the PC on the ceiling on the stock of general government debt at end-September 2014. This target was missed due to a delay in completing the debt-asset swap between the government and the Central Bank of Cyprus. The delay was temporary, and we are finalizing the swap.

We have made significant progress on the structural reform agenda of the program, and most of the structural benchmarks (SB) were met. However, the political environment has remained challenging, in particular with the governing party holding a minority in the Cypriot House of Representatives. As a result, reforms to the private debt restructuring framework were delayed, which led to difficulties in completing program reviews. Notably, we regret that delays in the entry into force of the amendments to the foreclosure law resulted in the cancellation of the 5th review. In addition, preparing the insolvency legislation and the implementing regulations for the foreclosure legislation took longer than originally planned. However, all these elements are

now in place and Cyprus has now established a modernized private sector debt restructuring legal framework. This is a key step to addressing the high level of non-performing loans (NPLs) in the banking system, which is critical to getting credit flowing again in support of the economic recovery and job creation.

Looking forward, in support of our program objectives,

- In the financial sector, we will continue to prioritize addressing the high level of NPLs. Following on the reforms to date, we will make the private debt restructuring framework fully operational, including by tackling the current backlog of unissued and un-transferred title deeds, monitoring the implementation of the new insolvency and foreclosure frameworks on an ongoing basis and further improving them as needed. We will also continue to strengthen financial sector supervision and build the capacity of the banking system to restructure loans in a sustainable manner.
- We will continue to pursue a prudent fiscal policy.
- We will advance on our structural reform agenda, notably on tax administration, the management of fiscal risks, and public administration reform. We will also move forward on critical growth-enhancing reforms, including the privatization program.

Financing of our program remains adequate, and based on the above, we request the following:

- Completion of the fifth, sixth, and seventh reviews under the EFF arrangement and three purchases under this arrangement in the amount of SDR 74.25 million each.
- Waiver for non-observance of the end-September 2014 PC on the ceiling on the stock of general government debt.
- Establishment of new quantitative PCs for end-June 2015, end-September 2015, and end-December 2015 (Table 1).
- Re-phasing of the remaining undisbursed amount evenly over three reviews instead of four as per the original schedule to take into account the delays in the reviews.

We are fully committed to the policies set forth in the attached MEFP, which we believe are sufficient to achieve the objectives under the program. We stand ready to take any measures that may become appropriate for this purpose as circumstances change. We will consult with the Fund on the adoption of any such actions in advance of revisions to the policies contained in this letter and the MEFP, in accordance with the Fund's policies on such consultations.

Sincerely,

/s/

Harris Georgiades
Minister of Finance

/s/

Chrystalla Georghadji
Governor of the Central Bank of Cyprus

Attachment I. Cyprus: Memorandum of Economic and Financial Policies

A. Recent Developments and Outlook

1. The recession moderated last year. Output contracted by 2.3 percent in 2014 compared to the fourth review forecast of 4.2 percent and to 5.4 percent in 2013, as the resilience of domestic demand more than compensated for the deterioration of the external balance due to import growth. The labor market has shown signs of stabilization reflecting wage adjustment and a reduction in the foreign labor force, but unemployment remains high. The banking sector has continued on its path to recovery, with deposits stabilizing and liquidity increasing, while private sector credit continued to contract. In April, we lifted all remaining external restrictions and successfully tapped the international bond market for a second time since the banking crisis.

2. Our economy is expected to start recovering during 2015, despite headwinds from external developments. After almost four years, growth in the first quarter has been positive and we envisage growth of 0.2 percent for the year. We expect that a decline in demand from Russia will be more than offset by higher private consumption, reflecting improved purchasing power from lower energy prices. For the following years, we have kept our growth projections broadly unchanged, continuing to expect output to expand at a moderate pace, supported by a gradual recovery of private consumption and investment. Average inflation is expected to decline further this year, reflecting the pass-through of lower global oil prices. Risks to this outlook remain broadly balanced. On the external front, a stronger contraction of the Russian economy could negatively affect our exports while the depreciation of the euro could be an upside risk. Direct spillovers from Greece are expected to be manageable due to diminished trade and financial links but we remain vigilant to any possible impact from adverse shocks. On the domestic front, slower than anticipated progress in addressing NPLs could delay balance sheet repair and hold back credit growth, thereby postponing the recovery and constraining medium-term growth.

B. Financial Sector Policies

Addressing High NPL Levels

3. Addressing the high level of NPLs in our banking system is a central priority. The NPL ratio reached 59 percent for the core domestic banking sector at end-December 2014. To address this problem, we are focused on strengthening the legal framework and supervisory tools for arrears management. The establishment of functional foreclosure and insolvency regimes is expected to provide incentives to creditors and debtors to negotiate voluntary debt restructurings and expedite the clean-up of balance sheets.

Legal Framework

- **Foreclosure framework.** We have enacted amendments to the foreclosure law to streamline the foreclosure process. The changes should provide incentives for creditors and debtors to negotiate voluntary debt restructurings. To make the amended foreclosure law fully operational, we have adopted the necessary regulations. We are currently reviewing the relevant civil procedure and court rules and will adopt, by end July 2015, necessary changes, including legislative amendments if warranted. These changes will facilitate the effective implementation of the foreclosure framework and will enable the courts to process cases on a timely basis.
- **Insolvency framework.** In mid April parliament adopted a package of laws to reform our insolvency framework.
 - **Legislation.** The new legislation represents significant progress towards modernizing our corporate and personal insolvency legislation in line with our July 2014 strategy. The framework provides incentives for repayment and restructuring of debt while allowing for speedier and more efficient rescue and rehabilitation of debtors. The adopted package consists of five pieces of legislation: (1) amendments to the Company Law to allow for faster and more cost effective liquidation of insolvent, nonviable companies; (2) a Law on Examinership to facilitate the restructuring and rehabilitation of viable companies; (3) a Law and regulations on Insolvency Practitioners which establish a framework for the qualification, licensing and regulation of insolvency practitioners; (4) amendments to modernize the Bankruptcy Law to allow for a “fresh start” for insolvent debtors through their discharge after three years of bankruptcy, subject to proper safeguards; and (5) a Law on Personal Insolvency, which allows for the restructuring of secured and unsecured debts of insolvent individuals, as well as debt relief for individuals with virtually no income or assets.
 - **Implementation.** We are now taking steps to establish and launch the new Insolvency Service which will centralize the administration of the new insolvency framework. Most of the legal and institutional arrangements are in place in order to start the implementation of the new insolvency regime. Administrative acts and regulations needed to fully ensure the functioning of the Insolvency Regime will be adopted by end-August 2015 (**new structural benchmark**). The implementation of the new laws will also require substantial capacity building for the actors responsible for its implementation, including the courts. We will prepare an action plan with that objective in mind. Finally, we plan to review by end-September the relevant civil procedure and court rules to ensure that they facilitate effective functioning of the new insolvency processes and reduce the courts’ workload to increase court capacity to process cases on a timely basis.
 - **Monitoring.** We will continuously monitor implementation of the new insolvency framework, with a view to identify possible deviations from international best practices and to enhance its effectiveness. In particular, explicit provisions allowing debtors to apply to the court for suspension of enforcement, without any obligation on the part of the

debtor, could weaken incentives for non viable debtors to promptly pursue debt restructuring. In addition, provisions have been added that could shield guarantors from payment obligations without due regard to their payment capacity. To ensure that the new insolvency framework achieves its objectives, we will monitor its performance on a continuous basis.

- **Review of the framework.** In consultation with program partners, we will submit to the Council of Ministers by end September 2015 any necessary adjustments to the insolvency and foreclosure frameworks, including legislative changes (**new structural benchmark**). Moreover, we will conduct a comprehensive review of the private sector debt restructuring legal framework by early 2016, with an action plan of modifications to the framework to correct any deficiencies.
- **Title deeds.** We are taking steps to address the problem of immovable properties that were purchased without proper transfer of title to ensure, *inter alia*, smooth functioning of the foreclosure and debt restructuring processes. By end-June 2015, the Council of Ministers will adopt legislation ensuring that the ownership of titles reflects the economic ownership of the property at all times (**new structural benchmark**). The legislation will enable swift transfer of titles and the release of encumbrance while providing safeguards against abuse. It will cover future property transactions as well as legacy cases. For legacy cases, it will provide for a rule-based mechanism aimed at treating buyers, sellers, and holders of collateral in an equitable manner taking into account compliance with their obligations related to the property transaction and enabling adequate compensation if available. The legislation will be informed by a financial sector impact assessment performed by the CBC in close cooperation with the Ministry of Interior. By end-October 2015, we will present to program partners legal or contractual standards for property sales contracts and connected loan and mortgage arrangements. We will also propose further legislative and administrative measures necessary to incentivize the swift transfer of title deeds.

Banks' arrears management capacity

4. We are strengthening the capacity of the banking system to restructure loans in a sustainable manner. We are now focused on boosting incentives for banks to step up their restructuring efforts according to the following priorities:

- **Revision of the Arrears Management Framework and Code of Conduct.** We have adopted a revised Arrears Management Framework and Code of Conduct, limiting protections to individuals as well as small and micro-enterprises—all up to a pre-determined threshold—and covering issues related to the treatment of guarantors and consistent with the insolvency framework. Also, to increase borrowers' awareness of their rights and obligations, the CBC will make available on its website a comprehensive and user-friendly guide to the restructuring process under the Code of Conduct.
- **Sustainable restructuring solutions.** We will closely monitor and enforce banks' compliance with the arrears management framework and the code of conduct. To this end, the CBC will

assess the appropriateness of restructuring solutions, including by relying on the semi-annual sustainability audit that is available since end-May 2015 for the first time and will be repeated twice yearly. By end-June 2015, the CBC will provide to the SSM its findings and recommendations regarding revision of banks' internal policies and processes for follow-up.

- **Debt resolution targeting framework.** To encourage banks to reduce NPLs and ensure continuous monitoring, the CBC will agree with banks on institution- and portfolio- specific targets for the various phases of the restructuring process for at least the following two quarters, on a rolling basis. The CBC will publish the aggregate targets and the banks' past performance after each quarter, for the first time by end-July 2015 (**new structural benchmark**), explaining discrepancies between targets and actual performance, as well as any revisions of targets. The data quality and coverage of our supervisory reporting framework for NPLs and restructuring will be improved by requiring banks to submit data in line with revised requirements starting with the third quarter of 2015.
- **Financial situation of borrowers.** A comprehensive understanding of the borrowers' financial situation is critical to ensure the effectiveness of debt resolution policies and to assess the magnitude of strategic defaults. For this purpose, the CBC is carrying out a study of the financial situation of borrowers and will publish the findings by end-July 2015.
- **Banks' capital planning and budgeting.** The CBC has required core banks to submit updated condensed capital and funding plans, based on updated and consistent economic assumptions, including on the resolution of non-performing assets. These plans will be updated on a quarterly basis.
- **Secondary market for loans.** A task force is currently evaluating necessary actions to promote the development of a secondary market for distressed assets by facilitating the transfer of existing loans. Necessary changes to the legislative framework to remove existing impediments to the securitization of assets, including removal of the requirement to obtain prior consent of borrowers, will be submitted to Parliament by end-July 2015. Moreover, by end-June 2015, necessary legislation will be approved by the Council of Ministers to enable the sale of loans to non-banks, while retaining the protections of borrowers offered under the Code of Conduct.

Restructuring of the Cooperative Credit Sector

5. We are continuing to restructure the coops sector. The sector has already undergone a thorough restructuring and has successfully passed the ECB's Comprehensive Assessment. Measures have been taken to strengthen its executive management, and the sector's information technology provider has been put under the control of the Cooperative Central Bank (CCB). Nevertheless, more efforts are needed to strengthen the sector's capacity. Progress with loan restructuring has been slow, in part due to operational, staffing, and information technology deficiencies. We are focusing on three main areas:

- **Arrears management:** We have carried out a review of the sector's policies and operational capacity on debt resolution. We have required the coops to submit by end June 2015 a time-bound action plan outlining how identified deficiencies will be addressed on a timely basis and how the arrears management capacity of the sector can be strengthened through external operational support.
- **Governance:** By end June 2015, we will streamline responsibilities of the CCB's divisions and enhance the efficiency of the sector's control functions, including by centralizing them at the CCB to the extent possible. To strengthen the oversight of the CCB over the Cooperative Credit Institutions (CCIs), we will amend the affiliation directive by end-June.
- **Financial control and risk processes:** The CCB has carried out an independent audit of financial control and reporting processes, including of management information systems. It also submitted to responsible supervisors in March a time-bound action plan to address identified deficiencies in a timely manner. To this end, by July 2015, the CCB will submit an implementation strategy that ensures a smooth transition, including by enabling the CCB to manage the additional responsibilities.

Normalizing Financial Flows

6. We will continue to ensure adequate liquidity in our banking system. Following the full liberalization of deposits and external flows, the CBC continues to monitor conditions and stands ready to take appropriate measures to maintain sufficient liquidity in the system, following the procedures and rules of the Eurosystem. Although liquidity has improved, additional government guarantees in line with state aid rules for the issuance of bank bonds could be used as collateral against liquidity, but only if necessary to safeguard financial stability.

Strengthening Financial Sector Regulation and Supervision

7. We will continue strengthening banking supervision. To this end, we have two near-term priorities:

- **Transition to the SSM.** The CBC has presented a supervisory work plan of its involvement in the SSM supervisory activities in 2015. To ensure sufficient resources are available to carry out its duties, the CBC has hired ten additional staff. We will determine further staffing needs by end-June 2015, also taking into account increased responsibilities in the area of bank resolution.
- **Resolution of Laiki.** The resolution authority will finalize in June 2015 a plan for completing the resolution of Laiki. The full implementation of the plan will be completed without delay.

8. We are reinforcing insurance and pension fund supervision. By end-September 2015, we will present a report with proposals to improve the capacity and governance of the insurance and pension fund supervisors in line with international best practice. The report will set priorities for the next steps and will provide a comprehensive inventory of pension and provident funds. The corresponding legislative proposal will be submitted to Parliament by end-December 2015.

Strengthening the AML Framework

9. We are strengthening the implementation of the AML/CFT framework. We continue working on the following areas:

- **AML/CFT supervision of banks:** To maintain financial sector integrity and stability, the CBC implemented in 2014 a new risk-based AML/CFT supervision methodology. The CBC completed the remaining onsite inspections reports from the 2014 supervisory plan in March 2015 and will apply, as needed, appropriate supervisory measures. The CBC has adopted its risk based supervision plan comprising 13 credit institutions (including 4 CCIs) that will be implemented by end December 2015. The CBC also took swift action to put the local branch of FBME Bank Ltd. under resolution after its designation by the US authorities as a financial institution of primary money laundering concern and will continue taking appropriate supervisory actions.
- **AML/CFT supervision of professions:** The supervisors of lawyers, accountants, and trust and company service providers will adjust the risk-based tools by end June 2015. These will be used to develop comprehensive annual inspection programs that will be implemented by end December 2015.
- **Registrar of Companies:** Parliament adopted the amendments to the company law in mid-May to streamline the process of registration and de-registration of non-compliant companies and strengthening the Companies Registrar enforcement powers. Following the adoption of the legislation by the House of Representatives, we will start implementing its reform by the end of July 2015.

C. Fiscal Policy

10. The cash primary surplus—excluding the recapitalization of the cooperative sector—was 2.8 percent of GDP in 2014, exceeding our target by a large margin. This outcome reflects (i) stronger than anticipated economic activity which led to higher tax revenues and social security contributions; (ii) a faster than expected reduction in the number of early retirements, which lowered our wage bill; and (iii) containment of discretionary spending which led to lower outlays on intermediate consumption and capital expenditure.

11. We have revised our primary balance target for 2015 to reflect the 2014 over-performance and the downward revision to growth. We will target a cash primary balance of 1 percent of GDP. This will lock in some of the fiscal savings from 2014 while accommodating (i) a loss of revenues due to the implementation of European directives on changes to the VAT place of supply for certain services; (ii) the contribution to the National Resolution Fund; (iii) lower central bank dividends; and (iii) several one off factors including a retroactive contribution to the EU budget arising from the ESA 2010 GDP revision, compensation payments to pension funds related to bank restructuring, and other specific outlays. We have also revised our 2016 and 2017 cash primary balance targets to surpluses of 2.4 and 3 percent of GDP respectively to take into account the better than anticipated 2014 outcome and the largely one off nature of the main factors triggering the

reduction in the primary surplus in 2015 with respect to 2014. With bank capitalization and fiscal needs less than projected and a consequently improved debt path, we are targeting a primary surplus in a range of 3 to 4 percent of GDP in 2018 and thereafter instead of 4 percent previously, which is sufficient to maintain our debt on a clear downward path.

D. Structural Reforms

12. We are implementing a comprehensive welfare reform that ensures a guaranteed minimum income (GMI) for all those in need. We have set up a fully staffed unit to monitor progress with implementation of the reform and have started paying out benefits. Looking forward, we will take actions to ensure that the new welfare system is fully in place and that outcomes are promptly analyzed in order to determine possible refinements:

- By end-June 2015, we will prepare plans to consolidate disability and education benefits in line with the adopted welfare reform.
- By end-September 2015, we will require recipients of social benefits to declare all the benefits they receive (including non-GMI benefits). We will also finalize in the same timeframe an assessment report of the implementation of the GMI, including main outcomes, the number of applications, fiscal costs, targeting accuracy, and coverage. The assessment will also discuss possible refinements going forward.
- By end-December 2015, we will build a registry of benefits in line with our new welfare law including the profiles and eligibility of all beneficiaries, cross-checked with other databases.¹
- By end March 2016, and with the registry in place, we will re-examine the overall welfare reform to realize efficiency gains from the consolidation of all information on welfare programs.

13. We are advancing our tax administration reform. We have passed legislation integrating the two tax authorities into a single Department of Taxation and to enhance tax collection enforcement powers. Our efforts are concentrated on two fronts:

- **Addressing tax arrears and evasion:** In line with the newly adopted collection enforcement powers, we have finalized our tax debt recovery plan, which will form part of our wider compliance improvement strategy. On that basis, we have started implementation of our tax debt recovery plan including through the use of bank garnishing powers on a pilot basis. To monitor progress, we will prepare quarterly implementation reports specifying targeted groups, collection enforcement measures used, and recovered debt. The first quarterly progress report will be prepared by end-June 2015.

¹ The registry of benefits will entail establishing a single view of social benefits for each beneficiary via an interface which will link three registries: Ministry of Labor, Welfare and Social Insurance, the Ministry of Education and Culture and the Ministry of Interior.

- **Reforming the revenue administration:** In January, we established the new large taxpayer office (LTO) covering 40 percent of our total revenue collections. Going forward, we will establish a single registration process for all domestic taxes by end-June 2015, and by end-December 2015, the LTO will be fully functional including taxpayer services, risk assessment and compliance activities aiming to expand coverage to 50 percent of total revenue collections. In line with this goal, we will allocate appropriate human resources. We will also establish an integrated legal framework for tax procedures under a new tax procedures code, to be approved by the Council of Ministers by end September 2015.

14. We are enhancing the management of fiscal risks arising from government guarantees and finalizing the implementation of the Fiscal Responsibility and Budget Systems Law (FRBSL).

The stock of government guarantees (20 percent of GDP) may pose risks to our public finances. With a comprehensive guarantee database now in place, the Council of Ministers will approve by end June 2015 the institutional framework to monitor and manage existing and new government guarantees (**new structural benchmark**). The framework will define clear responsibilities for the MoF and other line ministries, as well as guidelines and procedures for the issuance of new guarantees, the management of existing guarantees based on their assessed risk, and the restructuring and recovery of called guarantees. We will also improve our risk assessment analysis with a view to updating our risk assessment report by end-June 2015. In order to ensure the full implementation of the FRBSL, the public investment guidelines have been finalized and submitted to the Council of Ministers. The Council of Ministers will approve the guidelines by early June. The pending FRBSL regulations will then be approved by the Council of Ministers by end-June 2015 and by the Parliament by end-September 2015.

15. We are taking actions towards the privatization of state-owned enterprises.

Privatization is expected to improve economic efficiency, help to reduce our public debt, and encourage foreign direct investment. We have established a privatization unit which is now operational. We have also selected advisors for the privatization of the telecom company (CyTA) and the commercial activities of the ports authority (CPA) in the Limassol port. Looking forward, legislation will be adopted to convert CyTA into a limited liability company by end-September 2015 and the regulatory framework will be amended as necessary for the privatization of the CPA, by end-October 2015. By end July 2015, we will hire an independent energy advisor to prepare a study for the legal unbundling and ownership structure of the electricity company (EAC) as well as the required regulatory review. The legal unbundling will be implemented by end-March 2016.

16. We are continuing reforms in other areas aimed at boosting growth prospects and strengthening the public administration.

- We are implementing the Action Plan for Growth for which a key aim is improving the business environment. To this end, we will develop a time-bound action plan to strengthen the enforcement of contracts, including streamlining judicial procedures. We will also prepare, by end-September 2015, an action plan with measures to simplify regulations and licensing requirements hampering the operation of businesses.

- To enhance the effectiveness of our public administration, while also ensuring its affordability, by end-June 2015, a reform package including a revision of the wage setting framework and the opening of promotion posts to the wider civil service, will be submitted to the Council of Ministers for adoption by Parliament by end-December 2015 (**new structural benchmark**). Salary and employment decisions will be consistent with a public wage bill as a share of GDP on a descending path over the medium term. We will complement this with reforms to enhance staff mobility to promote the efficient allocation of human resources.

E. Program Financing and Monitoring

17. Financing for our program is assured. In line with the practice in most other European countries, we will transfer the rights and liabilities associated with coins issuance from the CBC to the MoF and receive additional financing of €100 million associated with this transfer by end-December 2015. In addition, the CBC is expected to transfer an additional €100 million in central bank profits to the government during 2016, in line with CBC duties under the Treaties and the Statute. We intend to issue additional debt in the international markets in the second half of this year to smooth maturities and minimize refinancing risk after the program, in line with our debt management strategy, market conditions permitting.

18. Despite delays in completing the reviews, fiscal outturns have been very strong, and we have largely caught up with reforms. In view of this performance, we request completion of the combined fifth, sixth, and seventh reviews under the Extended Fund Facility Arrangement, and a disbursement of SDR 222.75 million. We also request that the remaining amount under the EFF (SDR 297 million) be re-phased in three equal disbursements over the remainder of the arrangement.

19. Implementation of policies under our program will continue to be monitored through quarterly PCs and reviews. Our program includes continuous performance criteria, indicative targets, and structural benchmarks defined in Tables 1 and 2 and in the Technical Memorandum of Understanding (TMU). There are also continuous performance criteria on the non-accumulation of external payment arrears, on non-imposition of restrictions of payments and transfers for current international transactions, and on non-introduction of multiple currency practices.

20. We authorize the IMF to publish the Memorandum of Economic and Financial Policies, its attachments, and the related staff report.

Table 1. Cyprus: Quantitative Conditionality 1/ (Millions of euros unless otherwise specified)										
	Performance Criteria			Indicative Targets			Performance Criteria			
	Sep-14			Dec-14			Jun-15	Sep-15	Dec-15	
	Target	Adjusted target 4/	Actual	Target	Adjusted target 4/	Actual				
Floor on the general government primary balance 2/	40	29	552	-253	-265	493	-71	232	167	
Ceiling on the general government primary expenditure 2/	4,784	4795	4,499	6,864	6,876	6,539	3124	4654	6670	
Ceiling on the stock of general government debt 5/	18,172		18,393	18,994	18,914	18,819	19966	18833	18473	
Ceiling on the accumulation of new general government guarantees 2/	207		124	312		165	40	91	131	
Ceiling on the accumulation of external arrears 2/ 3/	0		0	0		0	0	0	0	
Ceiling on the accumulation of domestic arrears 2/	0		-0.1	0		-0.1	0	0	0	
Ceiling on the accumulation of tax refund arrears by the general government 2/	10		9	10		8	33	33	33	

1/ As defined in the technical memorandum of understanding.
2/ Cumulative since January of the corresponding year.
3/ Continuous performance criterion.
4/ The primary balance and primary spending targets were adjusted down and up, respectively, by €10.8 million in September and by and €12.2 million in December to reflect compensation payments to pension funds.
5/ The December 2014 debt target was adjusted down by €80 million as only 20 million of the expected 100 million disbursement of the Cyprus Entrepreneurship Fund loan was received in Q4.

Table 2. Cyprus: Revenue Administration Indicative Targets 1/ (Cumulative number of audits since January 2014)								
	Indicative targets							
	Mar-14	Jun-14		Sep-14		Dec-14		
		Target	Actual	Target	Actual	Target	Actual	
Number of comprehensive field audits of large taxpayers 1/	0	2	2	4	4	6	6	
Number of comprehensive field audits of high risk taxpayers 2/	0	8	6	16	16	24	22	

1/ Large taxpayers are defined as those with annual turnover above a certain threshold as defined by the tax administration procedures.
2/ High risk taxpayers are defined as those that meet selection criteria set by internal tax administration procedures.

Table 3. Cyprus: Proposed Conditionality

Measures	Timing
<i>Prior Actions for the Combined Reviews</i>	
Adoption by Parliament of amendments to the Foreclosure Law	Before Board Meeting
<i>Structural Benchmarks</i>	
Adoption by the Council of Ministers of legislation ensuring that the ownership of titles reflects the economic ownership of the property at all times	End-June 2015
Adoption by the Council of Ministers of the institutional arrangements to monitor and manage government guarantees	End-June 2015
Publication by the CBC of the targets of loan restructuring, and banks and coops' aggregate performance against them	End-July 2015
Adoption of administrative acts and regulations needed to fully ensure the functioning of the insolvency regime	End-August 2015
Submission to the Council of Ministers of necessary adjustments to the insolvency and foreclosure frameworks	End-September 2015
Parliamentary approval of reform package including a revision of the wage setting framework	End-December 2015

Attachment II. Cyprus: Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) sets out the understandings regarding the definitions of the indicators subject to quantitative targets (performance criteria and indicative targets), specified in the tables annexed to the Memorandum of Economic and Financial Policies (MEFP). It also describes the methods to be used in assessing the program performance and the information requirements to ensure adequate monitoring of the targets. We will consult with the Fund, European Commission and ECB on a timely basis before modifying measures contained in this letter, or adopting new measures that would deviate from the goals of the program, and provide the European Commission, ECB and the Fund with the necessary information for program monitoring.
2. For program purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at “program exchange rates” as defined below, with the exception of the items affecting government fiscal balances, which will be measured at current exchange rates. In particular, the exchange rates for the purposes of the program are set €1 = U.S. 1.1221 dollar, €1 = 134.90 Japanese yen, €1.25403 = 1 SDR.
3. For reporting purposes, the Ministry of Finance (MOF) and the Central Bank of Cyprus (CBC) will employ the reporting standards and templates considered to be appropriate given the transmission of data covered by this TMU, unless otherwise stated or agreed with the EC, the ECB and the Fund.

A. Quantitative Performance Criteria and Indicative Targets

Floor on the General Government Primary Cash Balance (performance criterion)

4. For the purposes of the program, the general government includes the institutions listed under this category according to ESA 2010 for Excessive Deficit Procedure (EDP) reporting purposes. In particular, the general government includes:
 - *The central government.* Includes the Constitutional Powers, the Constitutional Services, the Independent services, the Independent offices, the Ministries and the departments, services, and other bodies they supervise, 21 special purpose funds, and 14 semi government organizations.
 - *The local governments.* Comprise 39 municipalities, 356 village authorities, and all agencies and institutions attached thereto which are classified as local governments according to ESA 2010.
 - *The social security funds.* These include the medical treatment scheme, the regular employees’ provident fund, the social insurance fund, the holiday fund, the redundancy fund, and the protection of the rights of employees’ fund.

- *Any newly created institution defined as general government under ESA 2010.* This includes any new budgetary institution, special fund, social security fund, semi-government organization, municipality, village authority, and any other entity created during the program period to carry out operations of a fiscal nature. The government will inform the IMF, European Commission and ECB staff of the creation or any pending reclassification of any such new funds, programs, or entities immediately. The general government, as measured for purposes of the program monitoring, for a given year shall not include entities that are re-classified from outside general government into general government during that year.

5. The performance criteria are set on the general government cash primary balance (GGPCB), defined as the general government cash balance (GGCB) minus general government interest receipts plus general government interest payments. In turn, GGCB is defined as total revenue (tax revenue, social security contributions, grants and other revenue) minus total expenditure. The payment of called guarantees will be recorded as cash expenditures. Privatization receipts, as defined below, and the proceeds from the sale of land and buildings, will be excluded from revenue. The floor on the GGPCB in each year will be measured cumulatively from the start of that calendar year.

- Privatization receipts are those receipts associated with the disposal to private owners by a government unit of the controlling equity of a public corporation or quasi-corporation.
- The floor on the GGPCB will be adjusted downwards by the payments related to bank support, when carried out under the program's banking sector support and restructuring strategy. Transactions that may be excluded from the balance include loans to financial institutions and investments in equity of financial institutions (required recapitalization); unrequited recapitalization and purchases of troubled assets. However, any financial operation by central government to support banks, including the issuance of guarantees or provision of liquidity, will be immediately reported to IMF, European Commission and ECB staff.

6. The floor on the GGPCB will be adjusted as follows:

- The 2015 targets will be adjusted downwards by the payments to compensate pension funds for the losses related to the resolution of Laiki Bank up to €4.5 million.
- The 2015 targets will be adjusted upwards by the dividends received from the CBC in excess of €133 million and in excess of €58 million from the semi-government organizations.
- The 2015 targets will be adjusted downwards by the dividends received from the CBC below €133 million and below €58 million from the semi-government organizations.
- The 2015 targets will be adjusted downwards by the payments to cover called government guarantees up to €80 million.

Ceiling on the General Government Primary Expenditure (performance criterion)

7. General government primary expenditure (GGPE) includes compensation of employees, goods and services, subsidies, social benefits, other recurrent expenditure, and capital expenditure.
- The ceiling on the GGPE will be adjusted upwards by the payments related to bank support, when carried out under the program's banking sector support and restructuring strategy. Transactions that may be excluded from the balance include loans to financial institutions and investments in equity of financial institutions (requited recapitalization); unrequited recapitalization and purchases of troubled assets. However, any financial operation by central government to support banks, including the issuance of guarantees or provision of liquidity, will be immediately reported to IMF, European Commission and ECB staff.
 - The 2015 ceilings on the GGPE will be adjusted upwards by the payments to compensate pension funds for the losses related to the resolution of Laiki bank up to €4.5 million.
 - The 2015 ceilings will be adjusted upwards by the payments to cover called government guarantees up to €80 million.

Ceiling on the stock of General Government Debt (performance criterion)

8. The general government debt constitutes total outstanding gross liabilities as defined by ESA 2010. This includes the debt of all institutions included in the general government as defined above and other ESA 2010 adjustments. Debt will be measured at nominal value. The program exchange rate will apply to all non-euro denominated debt.
9. The ceiling on the general government debt will be adjusted:
- Upwards (downward) by the amount of any upward (downward) revision to the stock of end-December 2014 general government debt.
 - Upwards (downwards) by the amount of any increase (decrease) to the disbursement of the Cyprus Entrepreneurship fund EIB loan, currently projected at €20 million for 2015.
 - Upwards, by debt arising from payments for bank restructuring carried out under the program's banking sector support and restructuring strategy. These payments may include loans to financial institutions and investments in equity of financial institutions (requited recapitalization); unrequited recapitalization and purchases of troubled assets. However, any financial operation by central government to support banks, including the issuance of guarantees or provision of liquidity, will be immediately reported to IMF, European Commission and ECB staff.
 - Upwards by the amounts disbursed under the EIB loan to finance projects authorized in the 2015 budget under the National Strategic Reference Framework.

- Upwards by €600 million if the debt-to-asset swap between the government and the central bank is not finalized according to the current timeline.
- Upwards by the size of the revision of the stock of general government debt due to methodological changes in the definition of the government sector.

Ceiling on the Accumulation of new General Government Guarantees (performance criterion)

10. The ceiling on new general government sector guarantees shall include domestic and external guarantees granted during the test period, as well as guarantees for which the maturity is being extended beyond the initial contractual provisions. The ceiling shall exclude guarantees granted under a risk sharing instrument of the EU structural funds (see COM (2011) 655 final) that do not create contingent liabilities for the Cypriot State. Government entities outside of the general government (e.g. state owned enterprises) but within the non financial public sector are not permitted to grant guarantees. The stock of guarantees at end December 2014 was €2.95 billion. For reporting purposes, the stock of guarantees within the year will be derived on the basis of material fluctuations.

11. The ceiling on the accumulation of new general government guarantees will be adjusted:

- Upwards for the issuance of government guaranteed bonds to be used in monetary policy operations to boost BoC's liquidity up to €2.9 billion.
- Upwards (downwards) by the amount of any increase (decrease) of the disbursement of EIB and/or Council of Europe Development Fund loans to be guaranteed by the government in 2015 relative to the amounts presented in Table 1 of the MEFP. The annual provision of guarantees cannot exceed €131 million.

Ceiling on the Accumulation of External Arrears (continuous performance criterion)

12. External payment arrears are defined as payments on debt to non-residents contracted or guaranteed by the general government, which have not been made within seven days after falling due. The stock of external payment arrears as of end-December 2014 was €0.

Ceiling on the Accumulation of Domestic Arrears (performance criterion)

13. Domestic expenditure arrears are defined as unpaid invoices that have past the due date by 90 days by the budgetary central government, extrabudgetary funds, semi-government organizations, and local governments excluding village communities. In case no due date is specified on the supplier contract, an unpaid commitment is considered to be in arrears 90 days after the initiation of the invoice. The stock of domestic expenditure arrears as of end 2014 was €9.6 million. Increases below €1 million will not be considered a breach of the performance criterion.

Ceiling on the Accumulation of VAT Refund Arrears by the General Government (performance criterion)

14. VAT refund arrears consist of unpaid VAT refunds that have past the due date for payment established in the tax legislation and/or the corresponding regulations. The stock of VAT refund arrears as of end-December 2014 was €117.3 million. The stock of VAT refund arrears shall not exceed 150 million euros.

B. Monitoring of Prior Actions, Structural Benchmarks and MEFP Commitments

15. Adoption by parliament of amendments to the Mortgage Law (“Foreclosure Law”, prior action)

Specification. The new foreclosure procedure will include the following elements:

- a) The only condition for the initiation of the foreclosure procedure will be a default on payment of more than 120 days past, while acknowledging that the mortgage creditor may be otherwise stayed from pursuing enforcement of its remedies by operation of other laws or rules;
- b) It will contain swift procedures for obtaining market valuation of the property by independent valuers;
- c) It will allow for an initial auction with a reserve price at 80% of the market value, with a subsequent lowering of the reserve price to no less than 50% after three months of the initial auction, and a new valuation after 12 months of unsuccessful auctions or sales after the initial auction, maintaining, a reserve price of no less than 50% of this new valuation;
- d) It will contain precise deadlines for all procedural steps and respective preclusive periods for appeals;
- e) It will contain provisions to safeguard the integrity of the foreclosure process, including through transparency and anti-fraud provisions.

Regulations issued pursuant to the new law will facilitate a swift and transparent sale process without delays or hurdles.

16. AML supervision’s implementation:

- On a quarterly basis, in the context of program reviews, the supervisory competent authorities will, on a confidential and anonymized basis grant Fund staff access to supervisory assessments and information about enforcement actions applied for non-compliance and/or violations of laws and regulations.

- With regard to the CBC, in line with the 2015 annual inspection program, onsite supervision missions will start in the first quarter and step-up during the year. The total number and quarterly profile of these inspections, as well as staffing objectives and levels will be subject to periodic review by the CBC and the Fund in light of experience.
- 17.** Exchange of financial intelligence:
- The Financial Intelligence Unit (FIU) will communicate to Fund staff, on a quarterly basis, detailed statistics on financial information exchanged with other FIUs, both upon request and spontaneously, with a breakdown by country

C. Reporting Requirements

- 18.** Performance under the program will be monitored using data supplied to the IMF by the Ministry of Finance, Cystat, and the Central Bank of Cyprus. The authorities will transmit to the IMF staff any data revisions in a timely manner. Table 1 describes the supporting data needed for monitoring of the quantitative targets, the required frequency of the data, the institution/department responsible for providing the data, and the timing for provision of the data.

Table 1. Cyprus: Reporting Requirements

Information required	Data Frequency	Institution/Department responsible for providing information	Maximum time lag for submission after the end of the reporting period
Detailed execution of revenues, expenditure and financing provided in EDP reporting format	Monthly	MOF. Budget Department/Cystat Government Financial Statistics.	27 days after the end of the month, except end-December data which will be provided 30 days after the end of the month
Debt Issuance, Amortization, and interest cost details by type of debt instrument, maturity, currency, type of debt holder (resident, non-resident). Details on any financial balance sheet transactions	Monthly	MOF. Public Debt Management Unit.	27 days after the end of the month
Central Government Debt stock by type of debt instrument, maturity, currency, type of debt holder. Interest bill for each type of debt instrument on a monthly basis for the current year and the next year, and annual for each year thereafter until 2020	Monthly	MOF. Public Debt Management Unit.	27 days after the end of the month
Budgetary Central Government deposits in the Consolidated Fund and in the Banking System.	Monthly	MOF. Public Debt Management Unit.	5 days after the end of the month
Stock of expenditure arrears and their corresponding monthly flows (i.e. inflows, outflows) by type of expenditure.	Monthly	MOF. Treasury Department.	15 days after the end of the month
Stock of VAT refund arrears	Quarterly	Tax Department.	15 days after the end of the quarter
Stock of government guarantees and their monthly flows by institution.	Quarterly	MOF. Treasury Department.	27 days after the end of the month
Stock of external arrears	Monthly	MOF. Treasury Department.	15 days after the end of the month
Assets and liabilities of the central bank	Monthly	Central Bank of Cyprus	30 days after the end of the month
Assets and liabilities of the domestic operations of the banking system – aggregate monetary balance sheet of credit institutions by institutional category	Monthly	Central Bank of Cyprus	30 days after the end of the month
Assets and liabilities of the banking system (consolidated, including foreign operations), aggregate balance monetary balance sheet of credit institutions by institutional category	Quarterly	Central Bank of Cyprus	45 days after the end of the reporting period

Table 1. Cyprus: Reporting Requirements (Concluded)

Individual operational balance sheet of the domestic operations of the largest banks and coops with detailed information on deposits (by maturity, currency, and type of depositor), central bank funding, interbank funding, debt securities, loans provided to the public and the private sector, 1/	Monthly	Central Bank of Cyprus	30 days after the end of the month
Details for the largest banks and coops on liquid assets (cash and securities), liquidity position (i.e. the pool of assets eligible for ELA but not already encumbered), other assets and liabilities 1/	Daily	Central Bank of Cyprus	Next working day
Deposits by institution, currency, and residency and end-of-day liquidity buffers	Daily	Central Bank of Cyprus	Next working day
Financial soundness indicators—core set, deposits, NPLs, capital adequacy ratios	Quarterly	Central Bank of Cyprus	60 days after the end of the month

1/ Reporting requirements for cooperative