

International Monetary Fund

[Cyprus](#) and the IMF

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

Press Release:

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Eighth Review of
Cyprus' EFF and
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September 23, 2015

September 4, 2015

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Letter of Intent

Nicosia, September 4, 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.

Our program, underpinned by the firm commitment of the authorities, is bearing results and laying the ground for sustained growth, increased employment, and improved living standards for the Cypriot population. The economic recovery that started in early 2015 has continued, despite a challenging external environment. The financial situation of the three largest banks has strengthened, with encouraging evidence that loan restructuring is proceeding at a faster pace. Fiscal performance has exceeded expectations and, as a result, we have met all end-June and continuous performance criteria (PCs). Despite some delays, we have also made significant progress on the program's structural reform agenda, with all but one of the structural benchmarks implemented in full. The sole exception was the end-June SB related to adoption by the Council of Ministers (COM) of legislation to accelerate the transfers of title deeds. This legislation, which has already been adopted by Parliament, focuses only on legacy cases. Legislation to address title deed transfer in non-legacy and new property transactions will be adopted by the COM by end-October.

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 the tools to enforce the restructuring of loans by the banking system. We are vigilant of potential external spillovers and are ready to take measures, if necessary.
- We will continue to pursue a sound fiscal policy that supports growth while improving the public debt position.

- 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 eighth review under the EFF arrangement and the purchase under this arrangement in the amount of SDR 99 million.
- Modification of performance criteria for end-September and end-December 2015.
- Establishment of new or modified SBs (Table 2).

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/

/s/

Harris Georgiades
Minister of Finance

Chrystalla Georghadji
Governor of the Central Bank of Cyprus

Attachment I. Cyprus: Memorandum of Economic and Financial Policies

A. Recent Developments and Outlook

1. Economic performance continues to exceed expectations. Economic indicators point to a moderate expansion in the second quarter of 2015, following positive growth in the first quarter after almost four years of recession. The recovery continues to be led by professional services and tourism and, on the demand side, private consumption. There have been no appreciable spillovers to the real economy from events in Greece. However, the unemployment rate is still high, hovering at around 16 percent. Prices continued declining through June, largely reflecting declines in the energy and tourism sectors. The three largest banks continue on the path to normalization and sovereign debt yields have declined further, benefitting from purchases by the Eurosystem under the Public Sector Purchase Program started in July.

2. We continue to expect a gradual economic recovery. Reflecting the continued positive momentum in the second quarter, we have revised our growth forecast for 2015 to 0.5 percent (from 0.2 percent). Arrivals from other origins are expected to largely offset the negative impact on tourism from a weak Russian economy, while the favorable performance of the business services sector is anticipated to continue. On the demand side, investment and private consumption are now expected to be somewhat stronger, supported in part by new bank credit. For the years ahead, the forecast remains unchanged; growth is projected at 1.4 percent in 2016 and around 2 percent thereafter, supported by a gradual recovery of private consumption and investment. Accordingly, we expect a gradual decline in unemployment. We now project inflation to be slightly more negative this year at -1 percent and return to positive territory in 2016. The outlook is subject to positive and negative risks. On the external front, direct spillovers from Greece are expected to remain contained given reduced trade links, while we continue to closely monitor links through the financial sector. There could be also indirect effects through confidence and EU external demand. A positive impact of euro depreciation on exports, further compression of yields due to the ECB's quantitative easing, and a milder contraction in Russia than assumed constitute upside risks. On the domestic front, slower than expected cleanup of NPLs and the ensuing impact on private sector balance sheets and credit growth could stymie the recovery.

B. Financial Sector Policies

Addressing High NPL Levels

3. We remain committed to addressing the high level of NPLs in our banking system as a matter of priority. The NPL ratio of the core domestic banking sector has stabilized, remaining at 59 percent at end March. We continue to attack this problem from three fronts, aimed at encouraging voluntary debt restructuring and increasing the pace of durable solutions, with the ultimate objective of expediting the cleanup of private sector balance sheets and reviving credit growth. First, we are taking steps to ensure effective implementation of the recently established

foreclosure and insolvency regimes. Second, we continue strengthening the enforcement of supervisory tools for arrears management. Finally, we are revising the legislation to facilitate banks' disposal of distressed assets. To enhance public awareness on this subject, by end-September 2015, we will issue, in collaboration with the Association of Banks, a consumer-friendly publication and launch an interactive website to explain the process of debt restructuring, including tools likely to be used by banks and the insolvency and foreclosure processes.

Legal Framework

- **Foreclosure and insolvency regimes.** The effective implementation of the adopted legal frameworks is organized along two broad workstreams. First, we are taking the actions needed to fully operationalize the new frameworks. Second, we are identifying and will make adjustments to the frameworks, including through any necessary amendments to the legislation.
 - **Implementation.** To facilitate implementation of the foreclosure framework and allow the courts to process cases on a timely basis, we revised the relevant court rules in July. With respect to the insolvency regime, we have established the new Insolvency Service, which centralizes the administration of the new framework, including by appointing staff and making it possible to initiate insolvency procedures. We have also put in place the processes to license insolvency practitioners and have started granting licenses. Moreover, we have adopted all administrative acts and regulations needed to ensure the functioning of the insolvency regime (end-August **structural benchmark**). We will prepare and implement an action plan for capacity building for the actors responsible for the implementation of the insolvency framework, including the courts. This will include training and the development of standardized materials. Going forward, by end-October 2015, we will review the relevant court rules to ensure that they facilitate effective functioning of the new insolvency processes and reduce the courts' workload, seeking to increase court capacity to process cases on a timely basis. With the aim of improving the efficiency of court processes and post-court enforcement, by end-March 2016, the Council of Ministers, following consultation with relevant stakeholders and program partners, will adopt amendments to the Civil Procedure Law and any other relevant laws, including to (i) limit interim applications and interlocutory measures in line with international best practices; and (ii) increase the availability of information on debtors' financial situation.
 - **Framework review.** To ensure that the new insolvency framework achieves its objectives, we will monitor its performance on a continuous basis and make adjustments as needed. By end-December 2015, we will conduct a comprehensive review of the private sector debt restructuring legal framework with an action plan for modifications to the framework to correct any deficiencies. Building on the recent changes, the review will also seek to identify potential tax disincentives to debt restructuring for banks, other creditors and borrowers and propose necessary

adjustments, while taking into account fiscal implications. On the basis of the review, by end-January 2016, the Council of Ministers will adopt any necessary adjustments to the insolvency and foreclosure frameworks (**modified structural benchmark**).

This will include (i) removing any impediments to the effectiveness of the procedures, in particular, the possibility of debtors to apply to the court for suspension of enforcement without any obligation on the part of the debtor; and (ii) ensuring guarantors are not shielded from their payment obligations without due regard to their payment capacity.

- **Title deeds.** We are taking steps to address the backlog of immovable properties that were purchased without proper transfer of title to, *inter alia*, restore the smooth functioning of the property market. In June, the Council of Ministers adopted legislation ensuring that for legacy cases the ownership of titles reflects the economic ownership of the property (**existing structural benchmark**), and the legislation was adopted by parliament in early September. It provides for the swift transfer of titles and the release of encumbrances, while providing safeguards against abuse and 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. To ensure that the ownership of titles reflects the economic ownership at all times, by end-October 2015, the Council of Ministers will approve legislation to deal with non-legacy and new property transactions (**new structural benchmark**). The legislation will enable swift transfer of titles once the purchase price has been paid in full, the release of encumbrances, and a system of escrow to ensure the safety of payments. 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 issuance and transfer of title deeds.

Banks' arrears management

- **Debt resolution reporting and targeting.** To encourage banks and coops to reduce NPLs and ensure continuous monitoring, the CBC has agreed with banks and coops on institution- and portfolio- specific targets for the various phases of the restructuring process for two quarters ahead. The aggregate targets and performance against them during the last quarter have been published (end-July **structural benchmark**). The results show that the pace of restructurings has increased substantially, although we will continue monitoring the sustainability of the solutions. The data quality and coverage of our supervisory reporting framework for NPLs and restructuring will be improved further by requiring banks to submit monthly data in line with specific requirements starting with September data.
- **Projected performance of loan restructuring:** Based on the actual and targeted restructuring performance of banks, the new debt restructuring legal framework, and the program's macroeconomic framework, the CBC will, by end-September 2015, analyze the estimated path of system-wide loan restructuring and recovery. We will also continue to study the financial situation of borrowers to inform macro-prudential policies and to further adjust the loan

restructuring strategy. The CBC will have preliminary findings available by end-October 2015, with the aim of publishing final results by end-December 2015.

- **Supervision of bank's management of problem assets.** The CBC needs to strengthen its capacity and skills to effectively supervise the banks' problem assets policies and operations, including with the support of external expertise.

Disposal of distressed assets

- **Secondary market for loans.** To facilitate the transfer of existing loans, the Council of Ministers approved a draft law to enable the sale of loans in line with CBC directives while retaining the protections of borrowers offered under the Code of Conduct. The law will be adopted by Parliament by end-September 2015 (**new structural benchmark**). In addition, the Council of Ministers will adopt by end-October 2015 draft legislation to remove existing impediments to the securitization of assets. The bill includes, inter alia, the removal of the requirement to obtain prior consent of borrowers and any changes to the tax system deemed necessary. The law will be adopted by Parliament by end-December 2015 (**new structural benchmark**).

Restructuring of the Cooperative Credit Sector

4. We continue making progress with the restructuring of the coops sector. Building on the thorough restructuring already undergone by the sector, our actions remain focused on strengthening the sector's capacity, including by speeding up loan restructuring. To this end, work is proceeding on the following areas:

- **Governance.** We have modified the organizational structure of the Cooperative Central Bank (CCB), taking into account the regulatory obligations and the SSM's views, with the aim of streamlining the responsibilities of the CCB's divisions. To strengthen the oversight of the CCB over the Cooperative Credit Institutions (CCIs), in June, we amended the affiliation directive. Going forward, we will continue to increase the efficiency and to simplify the structure of the sector. To this end, by end-October 2015 we will submit a time-bound action plan to centralize the sector's control functions, namely risk, audit and compliance, subject to approval by the competent supervisor.
- **Financial control and risk processes.** The CCB has embarked, since June, on a plan to strengthen its financial control and reporting processes, including by upgrading the management information systems. The implementation strategy has been designed to ensure a smooth transition and takes into account the CCB's additional responsibilities in the areas of finance and risk management. The new structure of the financial control division, including the upgrade of staffing and capabilities, will be completed by March 2016.
- By mid-October 2015, we will retain an external consultant to identify the necessary actions to enhance the sector's shareholder value and prospects, including by reviewing its structure.

Maintaining Adequate Liquidity

5. 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 following the procedures and rules of the CBC and 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 Supervision

6. We will continue strengthening banking supervision. To this end, we are making progress on three important areas:

- **Transition to the SSM.** We will ensure sufficient resources are available at the CBC to carry out its duties on supervision and resolution. Accordingly, we have already hired 10 additional staff to address resource needs in the area of banking supervision. We are also reviewing our regulatory framework against European best practice and recent experience. To this end, by end-November 2015 we will streamline our directive on loan origination.
- **Expanding credit information.** Accurate information on the payment performance of individuals and enterprises facilitates the assessment of risk and credit supply decisions. We will strengthen the credit registry by establishing a credit scoring system available to banks and other creditors. As a first step, by end-December 2015 and drawing on external expertise, we will determine the additional data needs.
- **Resolution of Laiki.** The resolution authority has finalized a plan for completing the resolution of Laiki. To this end, the Resolution Authority has appointed an investment advisor to manage the sale of Laiki's foreign assets. A second advisor will be appointed by end-October 2015 to manage the disposal of Laiki's stake in BoC.

7. We remain committed to implementing our agenda to reinforce insurance and pension fund supervision.

Strengthening the AML Framework

8. We continue strengthening the implementation of the AML/CFT framework. Work in this area is proceeding as follows:

- **AML/CFT supervision of banks:** The CBC is conducting onsite inspections according to the 2015 supervisory plan and in line with the new risk-based AML/CFT supervision methodology. It will apply, as needed, appropriate supervisory measures. In the course of 2015, the CBC will streamline the inspection procedures to reduce the time between the visit to the financial institution, the finalization of the report and the imposition of sanctions, when appropriate. To protect the integrity of the financial sector, the CBC took swift action

to put the local branch of FBME Bank Ltd. under resolution following the measures taken by its correspondent banks after its designation by the US authorities as a financial institution of primary money laundering concern. The CBC intends to swiftly take appropriate actions following the July 2014 inspection and follow up visits, and the final ruling issued by the U.S authorities in July 2015.

- **AML/CFT supervision of professions:** The Cyprus Securities and Exchange Commission will recruit additional qualified supervisors and conduct inspections according to its yearly supervisory program, and the CBA and ICPAC will continue providing training to their staff to enhance their inspections.
- **Registrar of Companies:** Work is underway to restructure the Department of the Registrar of Companies. By end-December 2015, we will strike off the registry the backlog of companies non-compliant with the requirement to submit annual reports. A reorganization of the department, with a view to modernize its operations in line with the new law, with implementation beginning by end-March 2016.

C. Fiscal Policy

9. The cash primary balance through June exceeded our target by a substantial margin.

The general government accounts had a cash primary surplus of 0.3 percent of GDP, compared with a target of a 0.4 percent of GDP deficit. This outcome reflects buoyant VAT revenues, as well as temporary factors, such as change in payment profile of airport royalties which led to higher collections earlier in the year; and lower-than-expected unemployment and redundancy benefits.

10. We have raised the cash primary balance target for 2015 to 1.3 percent. The revision of 0.3 percent reflects the lower unemployment and redundancy outlays, some revenue overperformance, and one-off non-tax revenue. Despite the favorable revenue outturn through June, we will maintain a prudent stance in light of the temporary nature of some of the factors behind this outturn and the uncertainty associated with the external environment. In this respect, we will let automatic stabilizers operate if economic activity turns out worse than forecasted, but any over-performance due to faster GDP growth would be saved. Spending on the recently adopted mortgage subsidy scheme will be contained and will not lead to increased overall expenditure outlays. The envisaged reform of the immovable property tax, combined with the recent reduction of the property transfer fee, will be fiscally neutral. In addition, we will monitor the impact of changes to tax laws introduced in 2015. These include the notional interest allowance for new equity and the defense tax exemption for non-domicile tax residents.

11. The medium term fiscal targets remain unchanged. For 2016 and 2017, we will target surpluses of 2.4 and 3 percent of GDP, respectively. The unchanged 2016 primary surplus mainly reflects expected a continued reduction in unemployment and redundancy benefits and a previously unprogrammed dividend from the telecom company (CyTA), which will offset the revenue impact from the implementation of the EU directives on changes to the VAT place of supply for certain

services and the contribution to the National Resolution Fund. For 2018 and beyond we will continue to target a primary surplus between 3 and 4 percent of GDP.

D. Structural Reforms

12. We are implementing our comprehensive welfare reform that ensures a guaranteed minimum income (GMI) for all those in need. We will take actions to ensure that the new welfare system is fully in place and that outcomes are promptly analyzed:

- In line with the adopted welfare reform, by mid-October 2015 we will prepare plans to unify the legislative and administrative framework for all disability benefits ensuring consistency with medium term budgetary targets. The plan to consolidate education benefits will be adopted by Parliament by end-October 2015.
- By end-September 2015 we will finalize 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. Our efforts are focused on finalizing the integration of the two previously existing tax authorities into the single Department of Taxation by end-June 2016 and on enhancing tax collection.

- **Addressing assessment backlogs and tax arrears:** We have identified a large backlog of un-assessed tax returns which may entail substantial collectible revenue. To address this, by end-September we will establish a project team, which will identify the size and nature of the unassessed tax returns and determine the taxes and refunds due. By end-October 2015, we will prepare an action plan to reduce this backlog. We continue to implement our tax debt recovery plan including the use of the new enforcement powers. To monitor progress, in June, we prepared the first quarterly implementation report, specifying targeted groups, collection enforcement measures used, and recovered debt.
- **Reforming the revenue administration:** We have appointed two assistant commissioners, thereby completing the senior management team. Going forward, we will establish a single registration process for all domestic taxes by end-September 2015, as well as finalize the cleansing of the taxpayer register by end-December 2015. By end-December 2015, the LTO

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.

established in January will be fully functional including taxpayer services, risk assessment and compliance activities aiming to continue to expand coverage of 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-December 2015. In order to mitigate the risk of revenue loss during the integration process the Performance and Monitoring Unit will prepare a monthly update of performance indicators, including registration, filing, payment and debt collection. Based on these indicators we will prepare a quarterly assessment report to analyze performance and identify remedial actions, as needed. The first report will be prepared by end-October 2015. We will consider possible changes to the legal framework governing the criminal tax investigation unit to introduce judicial oversight.

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 (about 20 percent of GDP) may pose risks to our public finances. In early September, the Council of Ministers approved the institutional framework to monitor and manage existing and new government guarantees (**existing structural benchmark**). Recent improvements in our risk assessment analysis will be incorporated into the updated risk assessment report we will prepare by end-October 2015. In order to ensure the full implementation of the FRBSL, the public investment guidelines have been approved by the Council of Ministers and Parliament will adopt the FRBSL regulations and the law regulating the creation and functioning of SOEs by end-October 2015.

15. We remain committed to 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 received expressions of interest in the concession of the commercial activities of the Limassol port and a significant number of bidders have been pre-qualified, paving the way for the start of the due diligence process. The regulatory framework of the Cyprus Port Authority (CPA) will be amended and implemented by end-November 2015. The concession agreement will be signed before the end of the program. Legislation to convert CyTA into a limited liability company will be adopted by parliament by end-October 2015. We are committed to finalizing CyTA's privatization by mid-2016. In July, we hired an independent energy advisor to prepare a study for the unbundling and ownership structure of the Electricity Authority of Cyprus (EAC). Any decision regarding the unbundling of EAC 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. To stimulate private investment, the Council of Ministers will adopt by end-December 2015 a framework to attract strategic investments, through fast-tracking administrative procedures for licensing. In addition,

to support the development of the tourism sector, by end-September 2015 we will produce an initial assessment of the regulatory framework governing the sector. All necessary legal amendments to modernize the framework will be approved by the Council of Ministers by end-March 2016. Finally, with a view of improving the business environment, an action plan to implement Smart Regulation will be adopted by the Council of Ministers by end-October 2015.

- To enhance the effectiveness of our public administration, while also ensuring its affordability, in early September 2015, the Council of Ministers will approve a reform package including a revision of the wage setting framework and the opening of promotion posts to the wider civil service. The package will be adopted by Parliament by end-December 2015 (**existing structural benchmark**). Salary and employment decisions will be consistent with general government compensation of employees as a share of GDP remaining 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 before the end of this year to smooth maturities, minimize refinancing risk after the program and ensuring comfortable cash buffers, in line with our debt management strategy, market conditions permitting.

18. Implementation of policies under our program will continue to be monitored through quarterly PCs and reviews. Our program includes performance criteria and structural benchmarks defined in Tables 1 and 2 and in the Technical Memorandum of Understanding (TMU). In particular, 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.

19. 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			Performance Criteria	
	Jun-15			Sep-15	Dec-15
	Target	Adjusted target 2/	Actual		
Floor on the general government primary balance 2/	-71	-75	52	300	232
Ceiling on the general government primary expenditure 2/	3,124	3,128	3,081	4,659	6,660
Ceiling on the stock of general government debt	19,966		19,214	19,269	18,532
Ceiling on the accumulation of new general government guarantees 3/	40	27	27	93	133
Ceiling on the accumulation of external arrears 2/ 4/	0		0	0	0
Ceiling on the accumulation of domestic arrears 2/	0		-2	0	0
Ceiling on the accumulation of tax refund arrears by the general government 2/	33		13	33	33
<p>1/ As defined in the technical memorandum of understanding. 2/ Cumulative since January of the corresponding year. The primary balance and primary spending targets were adjusted down and up by €4 million, respectively, reflecting compensation of pension fund payments during 2015:Q2 in line with the TMU. 3/ Adjusted downwards due to €13 million lower EIB guarantees than anticipated in line with the TMU. 4/ Continuous performance criterion.</p>					

Table 2. Structural Benchmarks

Measures	Timing
Existing structural benchmarks	
Parliamentary approval of a reform package including a revision of the wage setting framework	End-December 2015
New and modified structural benchmarks	
Adoption by Parliament of legislation to enable the sale of loans in line with CBC directives while retaining the protections of borrowers offered under the Code of Conduct	End-September 2015
Approval by the Council of Ministers of legislation for the issuance and transfer of title deeds in non-legacy and new property transactions	End-October 2015
Adoption by Parliament of legislation to remove existing impediments to the securitization of assets	End-December 2015
Adoption by the Council of Ministers of any necessary adjustments to correct deficiencies of the insolvency and foreclosure frameworks, including legislative changes	End-January 2016 (modified SB)

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 €0.5 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.
8. 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 €0.5 million.
9. 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)

10. 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.
11. 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)

12. 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. Guarantees provided by the Central Agency of Equal Distribution of Burdens (newly added to the general government) will not exceed €2 million.

13. 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.

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

14. 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)

15. 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)

16. 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 Structural Benchmarks and MEFP Commitments

17. 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.

18. 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

19. 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.