

Memorandum of Understanding on Specific Economic Policy Conditionality

The economic adjustment programme is addressing short- and medium-term financial, fiscal and structural challenges facing Cyprus. The key programme objectives are:

- to restore the soundness of the Cypriot banking sector and rebuild depositors' and market confidence by thoroughly restructuring and downsizing financial institutions and strengthening supervision;
- to continue the on-going process of fiscal consolidation in order to correct the excessive general government deficit by 2016, in particular through measures to reduce current primary expenditure, and maintain fiscal consolidation in the medium-term, in particular through measures to increase the efficiency of public spending within a medium-term budgetary framework, enhance revenue collection and improve the functioning of the public sector; and
- to implement structural reforms to support competitiveness and sustainable and balanced growth, allowing for the unwinding of macroeconomic imbalances, in particular by reforming the wage indexation system and removing obstacles to the smooth functioning of services markets.

1. Financial sector reform

Key Objectives

In the financial sector area, key objectives constitute the implementation of the restructuring plans of Bank of Cyprus (BoC) and the coop sector and the effective management of non-performing loans. At the same time, supervision and regulation should continue to be strengthened in the context of the ongoing transition to the Single Supervisory Mechanism. In addition, a reform of the debt restructuring framework will be undertaken with a view to facilitating the voluntary workout of non-performing loans, avoiding strategic defaults by borrowers. Finally, the Cypriot authorities will continue to gradually remove restrictive measures in line with their roadmap, while safeguarding financial stability.

Progress since May

The authorities continued to implement the reform of the financial sector. With respect to regulation and supervision, banks made progress towards compliance with the new directive on provisioning and disclosure. The audited consolidated accounts of the CCB were published on 2 July. The Parliament adopted the necessary amendments to the Resolution Law on 19 June. Supervisory resources of the CBC have been increased. The CBC has also issued a request to the internal audits of BoC and the coops to review their lending and debt restructuring practices with respects to loans related to former and current managers and directors on 6 June.

Despite progress with the management of arrears, the percentage of non-performing loans continued to increase. The authorities made progress in developing their strategy for a reform of the private sector debt restructuring framework. Amendments to the Law on the Financial Ombudsman were adopted on 10 July. The restructuring of the financial sector has progressed in line with the programme requirements. Most notably, both BoC and the CCB published the agreed key performance indicators on progress with implementing their restructuring plans. All restrictive measures on domestic financial transactions have been removed.

A. Regulation and supervision

Maintaining liquidity in the banking sector

1.1. Having completely removed the domestic payment restrictions, the Cypriot authorities commit to continue implementing the fourth stage of the roadmap for the gradual relaxation of restrictive measures which was published on 8 August 2013. The Cypriot authorities will ensure, in timely consultation with the EC, ECB, IMF and informing the ESM, that the gradual relaxation of the external restrictive measures is consistent with financial sector stability and preserves comfortable liquidity buffers. The CBC will conduct on-site inspections of the implementation of the restrictions, and take appropriate supervisory actions, as needed. Further liberalisation of external restrictive measures will only be considered after the successful completion of the Comprehensive Assessment and a smooth transition to the SSM. After the results of the Comprehensive Assessment, the authorities will refine and publish an updated version of their roadmap **by end-November**, based on a detailed analysis of deposit trends.

1.2. The CBC, in consultation with the ECB, will continue to closely monitor the liquidity situation of the banking sector. The CBC will stand ready to take appropriate measures to maintain sufficient liquidity in the system in line with Eurosystem rules. The additional government guarantees for the issuance of bank bonds of up to EUR 2.9 billion in nominal value could be used as collateral against liquidity, if necessary to safeguard financial stability, in line with State aid rules.

1.3. The CBC will continue to receive the updated capital and funding plans of BoC and the CCB **on a quarterly basis** and will transmit them to the ECB, the EC, the ESM and the IMF. The funding and capital plans should realistically reflect the anticipated deleveraging in the banking sector, the gradual easing of restrictive measures, and the reduction of borrowing from the central bank, with the objective to avoid asset fire sales and a credit crunch.

Regulation and supervision of banks and cooperative credit institutions

1.4. The authorities are proceeding with the establishment of the central credit register, which will be operational **by end-September** for credit assessment purposes. The CBC has received technical support on the use of the credit register for supervisory purposes and will, **by end-September**, develop options for the use of the credit register in line with best practices and finalise the content of the additional data to be collected by the credit register. The CBC has started preparations to harmonise the credit register at the euro area level, as a part of a broader process coordinated by the ECB, which is due to be completed in 2016.

1.5. Taking into account the transition to the SSM, the CBC remains committed to ensure the full implementation and enforcement of its regulatory framework with respect to loan origination, asset impairment and provisioning. The new provisioning and disclosure directive will be fully implemented by the time of the publication of the 2014 annual accounts.

1.6. BoC and the coops will continue to submit a **quarterly report** describing the progress with the implementation of the restructuring plans. The reports will contain the agreed set of key performance indicators, including selected operational and financial indicators. The CBC units responsible for the supervision of BoC and coops will assess these and subsequent reports **on a quarterly basis** and submit their conclusions and proposed actions to the CBC Board within four weeks of the receipt of the reports.

1.7. The governance directive will be revised **by end-July**, specifying, among others, the interaction between banks' internal audit units and bank supervisors, in line with European regulations and international best practices.

1.8. The internal audit departments of BoC (including transferred Laiki operations) and of coops will submit **by end-September** a special examination report on lending and debt restructuring practices of BoC and coops with respect to loans related to former and current managers, directors, members of Committee and major shareholders of the groups, with the aim to identify decisions that have led to disproportionate losses in net present value terms. The CBC will complete its assessment of internal auditors' main findings and take appropriate action, including by requiring the institutions concerned to take civil action where applicable, **by end-January 2015**.

1.9. The CBC will have sufficient staff to carry out its functions in full independence as stipulated by the Treaties. The CBC, in cooperation with the SSM, will further assess the need to increase its staff, taking into account the new tasks undertaken under this Memorandum of Understanding, tasks imposed by the creation of the SSM, and enforcement

of the existing regulatory framework **by end-October**, and address the identified needs **by end-December**.

1.10. In light of the new responsibilities taken on by the CBC, and after the review of the governance of the CBC, the Cypriot authorities will adopt the necessary amendments **by end-September**, including by ensuring a separation between resolution and supervisory functions. The authorities will begin work without delay to transpose the Single Rulebook, including the Bank Recovery and Resolution Directive and the Deposit Guarantee Scheme Directive, into national law.

Monitoring of corporate and household indebtedness

1.11. The Cypriot authorities will step up the monitoring of the indebtedness of the corporate and household sectors and prepare quarterly reports, including information on the distribution of assets and liabilities across households, and an assessment of debt-servicing capacity and refinancing activities. Data from surveys will be used until the credit register becomes fully operational. The annual Financial Stability Report, to be published **at year-end**, will include an extended analysis on corporate and household indebtedness. In addition, quarterly monitoring reports will continue to be submitted and their scope and content will be further enhanced.

1.12. Measures will be taken to strengthen the management of non-performing loans and to deal with troubled borrowers, taking into account the developments and timelines in the SSM. A framework for targeted private-sector debt restructuring is being established.

- Banks will continue to report **quarterly** on restructuring progress and management of NPLs, using the agreed specific performance indicators and targets (e.g. number of loans restructured, cash collections, etc.). Furthermore, banks will continue to report monthly on early arrears (e.g. number and amount of past due loans within 1-90 days, type of actions taken, and number and amount of cured or uncured loans).
- After completion of the review of banks' arrears management policies and practices, revisions of the Arrears Management Directive and of the Code of Conduct will be introduced as needed **by end-November**. The revised Code of Conduct will target only households and SMEs. These amendments will include, inter alia, a streamlining of the procedure including the clear determination of specific procedural steps and precise deadlines attached to them, facilitating swift procedures within an appropriate time-limit and including the identification of a start event and an end date to the restructuring procedure under the Code of Conduct. In this context, the CBC will also clarify the applicability of the Arrears Management Directive and of the Code of Conduct to backlog cases. The CBC will also incorporate in the Code of Conduct the definition for a unified measure of viability based on a reasonable standard of living as determined in the insolvency framework. The responsible CBC supervisory units will examine the implementation of the banks' action plans to correct deficiencies identified by the external expert and submit the main findings and recommendations to the CBC Board **by end-November**. In conducting their on-site inspections, the CBC will ensure effective compliance with the Arrears Management Directive and the Code of Conduct.
- To ensure that banks are held accountable for offering sustainable restructuring solutions, **by end-October**, the CBC will issue specific guidance to banks on operational and financial indicators, such as the ratios of proposed, concluded and

successful restructurings, as well as on tools to determine the capital cost of restructuring solutions. **By end-November**, the CBC will agree with banks on institution- and portfolio-specific targets to be set for the various phases of the restructuring process on a quarterly rolling basis. The aggregated performance of banks and coops against overall targets on initiated negotiations, proposed solutions and sustainable solutions will be published by **end-February 2015**.

- Following the requirements to be introduced by the CBC **by end-September**, the banks and coops will submit the agreed-upon procedure reports prepared by their external auditors on the effectiveness of their debt restructuring arrangements and strategies for the periods ending in December 2014, June 2015, December 2015, and June 2016.
- Legal amendments to the Law on the Financial Ombudsman were adopted by 10 July 2014. **By end-November**, legal amendments will be adopted in order to clarify that the responsibility for assessing compliance with the Arrears Management Directive is not transferred to the mediators but remains with the CBC.
- The Cypriot authorities, in view of financial stability considerations and on-going bank restructuring, commit not to introduce any new administrative measures which would interfere with the setting of bank lending rates. In particular no ceilings on bank lending rates would be introduced.
- The Cypriot authorities will allow for lenders to obtain adequate updated information on the financial situation of delinquent borrowers under sufficient safeguards, via court order if necessary. To achieve this, the authorities will engage an independent legal consultant to provide a report **by end-October** assessing required legal amendments, taking into account relevant international best practices in this area. The authorities will develop a time-bound action plan **by end-November**, and start its implementation **by December**.
- The Cypriot authorities will prepare, with the assistance of an independent legal consultant, a study **by end-October** and a time-bound action plan **by end-November** for removing impediments for lenders to file for, and obtain, an attachment of financial assets and earnings of delinquent borrowers, as well as to realise such attachment in order to satisfy their claim, under sufficient safeguards. The implementation of this action plan will start **by December**.
- In order to encourage a market for distressed assets and to facilitate the issuance of securities by securitisation vehicles, the authorities will allow and facilitate lenders to transfer existing individual loans together with all collateral and securities to third parties at minimal transaction costs without having to obtain the consent of the borrower. Any information obligation of the creditor should not be an impediment for the transfer and/or securitization of loans. To this end, the Cypriot authorities will establish a Task Force, consisting of relevant stakeholders from the public and private sectors, which will finalise an assessment of existing impediments and of required legislative amendments **by end-November**. This assessment will include a review of the regulatory framework for non-bank third parties. The identified impediments will be removed and legislative amendments made **by end-January 2015**.

Increasing financial transparency

1.13. Based on the findings of the April 2013 audit undertaken by MONEYVAL and an independent auditor, the Cypriot authorities have progressed in enhancing the anti-money laundering (AML) framework in line with best practices and are committed to ensuring its implementation, under the timetable set out in the agreed AML Action Plan (see Annex 2) and in particular by taking the following measures:

- Strengthen preventive measures of obliged entities with regard to customer due diligence, use of introduced business and reporting of suspicious transactions (Action Plan – sections 1, 2 and 3).
- Ensure transparency and timely access to information on beneficial ownership of trusts (Action Plan – section 4). The programme partners take note of the establishment by the Cypriot authorities' of trust registers with the supervisory authorities (Action Plan – section 4.3.1)
- The supervisory competent authorities are reviewing their off-site and on-site supervisory procedures and further implement a risk-based approach to AML supervision for financial and non-financial (lawyers, accountants and TCSPs) institutions (Action Plan – sections 5 and 6). In carrying out its onsite supervisory program, the CBC will build on its follow-up work on the April 2013 audit regarding individual financial institutions. The Cypriot authorities will finalise the application of appropriate enforcement actions **by end-August** with regard to any breaches of compliance revealed by the April 2013 audit, and will take a final decision to apply sanctions if applicable. The final decision will be made public.
- On a quarterly basis, in the context of the programme review starting **Q4-2013**, the supervisory competent authorities will, on a confidential basis, share anonymised information with the programme partners, by granting access to supervisory assessments and information about enforcement actions applied for non-compliance and/or violations of laws and regulations.

To address concerns that Cypriot corporations and trusts might be misused, the Cypriot authorities have revised the legal framework so that adequate, accurate and timely information on the beneficial ownership of Cypriot legal persons and arrangements can be provided to foreign counterparts related to money laundering and tax matters.

To ensure that adequate, accurate and current basic information on all types of legal persons registered in Cyprus could be obtained by the Registrar of Companies and be accessible by the public in a timely manner, the Cypriot authorities have committed to reform the Department of Registrar of Companies as foreseen in section 3.9.

The Cypriot authorities commit to maintain efforts to ensure that the widest possible exchange of information with other FIUs is achieved, either spontaneously or in response to requests. The Cypriot FIU has taken the initiative to provide the programme partners with a breakdown of requests made and received and spontaneous disseminations on a quarterly basis (within 14 days of the end of the quarter), starting with Q4 2013, and publish this information on the FIU website on an annual basis.

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, initiated an investigation, and will take appropriate supervisory action based on the results.

B. Recapitalisation and restructuring of financial institutions

Restoring adequate capital buffers

1.14. The authorities will finalise the transposition of CRD IV and national discretions under the CRR **by end-September**. As part of this process, the authorities will fix the Common Equity Tier 1 ratio at 8% under Pillar 1 in line with the harmonised benchmark applied under the baseline scenario of the ECB Comprehensive Assessment. In no circumstances will the implementation of CRD IV and CRR lead to any distribution of capital by the banks which were found in the PIMCO exercise to face a capital shortfall. In line with CRD IV, the CBC will request significant banks to maintain capital buffers in excess of the minimum Pillar 1 requirement based on conservative assumptions and to take prompt action if needed.

Management of legacy Laiki

1.15. In order to enhance the recovery value from the disposal of the assets of Laiki, the Resolution Authority instructed the Special Administrator to appoint a well-recognised and independent consulting or auditing firm(s) or international institution(s) to be entrusted with the voting rights associated with Laiki's shares participation in BoC. This appointment will be completed **by end-September**. The finalisation of the appointment of an advisor to provide services associated with the management of the disposal process shall be completed **by end-August**. As part of the terms of reference for the appointment of the advisor agreed in consultation with the EC, ECB and IMF and informing the ESM, an action plan for the full disposal of the assets will be developed **by end-September**, with a view to maximize value for creditors.

Restructuring of Bank of Cyprus

1.16. BoC has progressed with the implementation of the restructuring plan and has divested operations and stakes abroad ahead of schedule. Moreover, to strengthen confidence in the bank, the CBC agreed with BoC on the operational and financial indicators on progress with implementing the restructuring plan that will be communicated **quarterly** to the public, together with the financial accounts.

1.17. Going forward, the CBC will complete **by end-February 2015** a comprehensive technical assessment of BoC's restructuring plan with the aim to identify areas that require further strengthening and review, and with due consideration to the establishment of the SSM.

Restructuring and recapitalisation of cooperative credit institutions

1.18. The Cooperative Group has completed the change of the Group's company ownership and governance structure, reducing the number of CCIs to 18 with the CCB controlling and holding 99% of these CCIs and the State holding 99% in the CCB. The restructuring included the appointment of new Board members and staff at all management levels. It is acknowledged that a great effort has been undertaken by the cooperatives in this

context, as well as in reducing the number of branches. Building on these achievements, the Group will ensure timely and complete implementation of the already agreed restructuring plan and take further measures to improve its operational capacity, notably in the following areas: i) arrears management, ii) Management Information System (MIS), iii) governance and iv) strengthening management capacity. None of these measures will preclude any additional requirement under State aid rules.

1.19. As regards management of arrears, the Group will ensure all relevant units have an appropriate level of skilled and professional staff, including by redeployment of existing resources and leveraging on external expert service-providers. The CCB will assume primary responsibility for all loans in arrears. Direct reporting lines to the relevant units of the CCB will be established for all staff of the Group engaged in arrears management. Use of the appropriate legal tools and of collection methods related to collateral will be demonstrated.

1.20. In order to equip senior management with adequate decision-making tools, the MIS will be improved. The overall IT infrastructure will be updated and fully integrated into the organisational structure of the Group and put under the direct control of the CCB, with the view of providing all the necessary data on a timely and accurate basis. The quality and validity of the existing data will be verified and monitored.

1.21. To streamline execution of tasks, governance will be strengthened, avoiding parallel decision-making structures. The roles of executive and non-executive CCB board members should be separated and clearly defined. To ensure the controlling function of the CCB, the affiliation directive will be reviewed. The CCB will ensure strict compliance of the individual CCBs with all its policies. Necessary actions to strengthen the governance of the CCB over the CCBs will be implemented **by end-November**.

1.22. To strengthen the implementation of the restructuring plan, **by end-November**, the management capacity of the Group will be reinforced, including with the assistance of external experts. The staffing, policies and procedures of the Accounting and Finance departments will be enhanced to provide exact and timely information to the executive management.

1.23. To this end, the Cooperative Group will submit to the European Commission a draft action plan, covering the following four areas i) arrears management, ii) Management Information System (MIS), iii) governance and iv) strengthening management capacity, **by end-August** and a final version **by 15 September**. Moreover, if further State aid is needed, the Group will submit to the European Commission an amended restructuring plan, also incorporating the above action plan, **by end-August** and a final version **by 15 September**. The amended plan will include updated financial projections, based on the Group's actual results at end-Q1 2014, and will include detailed actions to meet the commitments that have not been achieved yet.

1.24. The CCB will commission an independent audit company to perform **by end-November** an audit of Financial Control and Reporting, including of Management Information Systems. **By end-December**, to ensure that the identified deficiencies will be efficiently addressed, the CCB will submit an action plan to the SSM, informing the EC, ECB, IMF and ESM.

1.25. The CCB will develop an effective and clear communication strategy. **By end-September**, the CCB will implement a targeted communication strategy providing information about the situation of the sector and progress on restructuring. Also **by end-September**, the CCB will have implemented a centrally coordinated marketing strategy for the Group.

1.26. Based on the new legal framework for the management of the stake of the State in the cooperative sector, a relationship framework between the State and the CCB was established, to ensure that the CCB adopts sound policies, but without interfering in commercial business decisions and undue political interference. Compliance with the relationship framework will be reviewed **on a quarterly basis** by the monitoring trustee, who will also report any breaches of the framework to the EC. The authorities will inform the ECB, the ESM, and the IMF of the conclusions of that report and the follow-up. To this end, the effectiveness of the Management Unit of the Ministry of Finance will be reinforced with financial experts **by end-September**.

1.27. To strengthen confidence in the sector, the CBC agreed with the CCB and the Ministry of Finance Management unit on the operational and financial indicators on progress with implementing the restructuring plan that will be communicated **quarterly** to the public.

1.28. To limit risks and ensure appropriate and consistent risk management practices across the sector, **by end-January 2015**, the CBC's staff will contribute to an assessment of the CCB's implementation of effective local and risk management programs for the CCIs on the basis of common policies and tools as well as a consolidated management program at the CCB level in line with the restructuring plan.

1.29. The programme buffer remains available for potential recapitalisation needs, in line with State aid rules.

C. Legal framework for private debt restructuring

1.30. All legal, administrative or other hurdles currently constraining the seizure and sale of loan collateral shall be removed so that the assets pledged as collateral can be recovered within a reasonable period deemed to be a maximum time-span of 1.5 years from the initiation of the relevant proceedings. In the case of primary residences, this time-span could be extended to 2.5 years. The authorities commit not to introduce any further impediments to the seizure of assets pledged as collateral.

1.31. The Task Force on registered, but untitled, land sales contracts will, **by end-September**, finalise a study assessing the magnitude of registered, but untitled, land sales contracts and underlying mortgages, in close cooperation with the working group reviewing the issuance of title deeds under the MoU provision 5.3. Based on this assessment and the recommendations developed so far, the Task Force will coordinate the work of the authorities involved and develop, **by end-October**, an action plan addressing at least, (1) the removal of administrative hurdles for the transfer of title, (2) the provision of tools to encourage the release of encumbrances on properties to facilitate title transfer, and (3) the development of contractual standards for land sales contracts and connected loan and mortgage arrangements.

1.32. **Prior to the granting of the sixth disbursement of financial assistance**, the Council of Ministers will, following consultation with EC and IMF and informing the ECB and ESM, adopt a comprehensive reform framework, establishing appropriate corporate and personal insolvency procedures. A quantitative analysis of various options on lenders will be completed **by end-August**, and shared with the EC, ECB, IMF and the ESM. On the basis of that framework, corporate and personal insolvency legislation will be adopted, which will include licensing and regulation of insolvency practitioners **by end-December**. The following reforms shall be made to insolvency arrangements, in line with best international practices: (i) a modernized bankruptcy process for non-viable individuals, including an effective discharge subject to proper safeguards; (ii) streamlined processes for non-viable

individuals with no assets and no income, and with relatively small unsecured debt; (iii) a repayment scheme for viable individuals; (iv) an effective restructuring procedure for legal entities, including large borrowers; (v) a modernised and effective liquidation process for companies; and (vi) regulation of insolvency practitioners. The parameters of the new repayment scheme for viable borrowers will be set and communicated once there is sufficient clarity on its impact on the financial institutions, and after consultation with the EC, ECB and IMF, and informing the ESM.

1.33. For the purpose of insolvency frameworks and processes, the authorities will develop parameters for the definition and calculation of reasonable living expenses applicable in the context of personal insolvency.

1.34. The legal framework in relation to foreclosures and the forced sales of mortgaged property will be amended in consultation with the EC and the IMF and informing the ECB and the ESM, and adopted by the House of Representatives **prior to the granting of the sixth disbursement of financial assistance**. This new legal framework will encompass the relevant legislative amendments and will have immediate effect for all mortgaged properties except primary residences (for which provisions will enter into effect by 1 January 2015, in line with the adoption of the insolvency legislation). The legal framework will establish a swift foreclosure procedure, which will allow for auctions to be conducted by mortgage creditors, without interference from government agencies.

The relevant regulations on the procedural rules for sale by auction or other methods will be adopted expeditiously.

The new foreclosure procedure will include the following key elements:

- a. it will be available for all mortgaged property;
- b. the only condition for the initiation of the foreclosure procedure will be a default of payment of more than 90 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;
- c. it will contain swift procedures for obtaining market valuation of the property by independent valuers;
- d. 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 at 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 50% of this new valuation;
- e. it will contain precise deadlines for all procedural steps and respective preclusive periods for appeals;
- f. it will contain provisions to safeguard the integrity of the foreclosure process, including through transparency and anti-fraud provisions; and
- g. the concurrent government regulation on the procedural rules for sale by auction will facilitate the swift and transparent performance of auctions without delay or hurdles.

1.35. In the context of these reforms, the authorities, **by end-October**, will formulate recommendations on the Civil Procedure Code and Court Rules in order to ensure the smooth and effective functioning of the revised foreclosure law, and implement these recommendations **by end-November**. **By end-December**, the authorities will review and

prepare an action plan to strengthen courts to ensure swift processing of appeals in the foreclosure process. **By end-January 2015**, the authorities will formulate recommendations on the Civil Procedure Code and Court Rules in order to ensure the smooth and effective functioning of the envisaged new insolvency frameworks.

1.36. The authorities will review the private sector debt restructuring legal framework **in the second half of 2015** with a view to assessing results and define additional measures as needed.

2. Fiscal policy

Key objectives

Putting public finances on a sustainable path is of overriding importance in order to stabilise the economy and to restore the confidence of companies, citizens and foreign investors in the longer-term economic prospects of Cyprus.

In this context, the objectives are: (1) to continue the on-going process of fiscal consolidation in order to achieve a 2.5% of GDP primary surplus in 2017, 4% of GDP in 2018 and maintain at least such a level thereafter; (2) to achieve the annual budgetary targets as set out in this Memorandum of Understanding (MoU) through high-quality permanent measures, and additional measures in the outer years, in particular to reduce the growth in expenditure on the public sector wage bill, social benefits and discretionary spending, while minimising the impact of consolidation on vulnerable groups; (3) to this end, to fully implement the fiscal consolidation measures for 2014, listed in Annex 1; (4) to correct the excessive general government deficit by 2016; and (5) to maintain fiscal consolidation over the medium term, converging towards Cyprus' medium-term budgetary objective of a balanced budget in structural terms, by containing expenditure growth, improving the structure of taxation and undertaking fiscal-structural measures (see Section 3), including the implementation of a Medium-Term Budgetary Framework designed in accordance with EU specifications.

The Cypriot authorities adopted a number of fiscal measures for 2012-2014 and have progressed in relation to fiscal-structural reforms. The authorities commit to the full implementation of these measures (see Annex 1) and to regularly monitor the budgetary effect of the measures taken. Any deviation from the projected budgetary effect of the measures will be evaluated and addressed accordingly in the quarterly programme reviews, taking into account macroeconomic developments. In the event of underperformance of revenues or higher social spending needs, the government should stand ready to take additional measures to preserve the programme objectives, including by reducing discretionary spending, taking into account adverse macroeconomic effects. Over the programme period, cash revenues above programme projections, including any windfall gains,¹ will be saved or used to reduce debt. To the extent that over-performance is deemed permanent, this can reduce the need for additional measures in the outer years. Measures, such as tax amnesties, that could have an adverse impact on tax compliance and foster tax fraud and evasion, thereby counteracting efforts in line with paragraph 3.6 of this Memorandum, will not be undertaken over the course of the programme period.

Sound fiscal policy and expenditure prioritisation should contribute to preserving the good implementation of Structural and other EU funds, in respect with the programme's budgetary targets. In the light of Cyprus' economic challenges, EU funds will be targeted to those areas that deliver the most important economic and social impact, in accordance with the priorities to be set in the relevant EU regulatory framework. In order to ensure the effective implementation of EU funds, the Government will ensure that the necessary national funds remain available to cover national contributions, including non-eligible expenditure, under the European Structural and Investment Funds (ERDF, ESF, Cohesion Fund, EAFRD and

¹ Windfall gains associated with hydrocarbons shall mean only the blocks' licencing fees or related signature bonuses for exploration thereof. It is noted that any streams of revenues associated with hydrocarbon exploitation are dealt with under section 5.5, second bullet-point, indent 3

EFF/EMFF) in the framework of the 2007-2013 and 2014-2020 programming periods, while taking into account available EIB funding. The authorities will ensure that the institutional capacity to implement current and future programmes is improved and the appropriate human resources of Managing Authorities and implementing bodies are available.

In accordance with Regulation 472/2013, Cyprus shall provide all the information that the programme partners consider to be necessary for the monitoring of the implementation of the economic adjustment programme. The Cypriot authorities will consult ex-ante with the European Commission, the ECB and the IMF on the adoption of policies that are not included in this Memorandum but that could have a material impact on the achievement of programme objectives.

In line with State aid rules, the Government shall not implement any measures involving State aid towards Cyprus Airways until the approval of a restructuring plan by the European Commission.

Fiscal policy in 2014

Based on the programme's current macroeconomic and fiscal projection and reflecting the 2014 Budget, the Cypriot authorities will achieve a deficit of the general government primary balance of no more than EUR 210 million (1.3% of GDP) in 2014² corresponding to a headline deficit of 4.7% of GDP (respecting the 16 May 2013 Council Recommendation with a view to bringing an end to the situation of an excessive government deficit in Cyprus). To this end, Cyprus will fully implement the permanent measures included in the 2014 Budget, amounting to at least EUR 270 million in 2014 (Annex 1).

Fiscal policy in 2015

Based on the programme's updated budgetary projection, the Cypriot authorities will achieve a deficit of the general government primary balance of no more than EUR 258 million (1.6% of GDP) in 2015, corresponding to a headline deficit of 5.2% of GDP³ (respecting the 16 May 2013 Council Recommendation on correction of the excessive deficit in Cyprus).

With a view to maintaining fiscal consolidation over the medium term, the authorities will submit for consultation with programme partners a proposal that will ensure the fiscal neutrality of the welfare system reform and the achievement of the 2015 fiscal deficit target. The final proposal will be agreed in consultation with programme partners **by end-August 2014** and will be incorporated in the draft 2015 Budget, which will be adopted by the Council of Ministers **by mid-September 2014**.

After review by and consultation with the programme partners the 2015 Budget Law will be adopted by **December 2014**. The 2014-2016 expenditure ceilings will be updated for the period 2015-2017 and will accompany the 2015 Budget Law document. Any deviation from the budgetary objectives contained in the 2014-2016 framework will be properly documented and reasons for such deviations will be provided to the programme partners.

² ESA95 budgetary targets: These targets are not directly comparable to, but remain consistent with the respective cash-based budgetary targets agreed between the authorities and the IMF in the context of the economic adjustment programme.

³ The targets for 2015-16 do not include expected dividends of EUR 100 million per year, to be distributed by the CBC in line with CBC's duties under the Treaties and the Statute.

Fiscal policy in 2016-18

In 2016 the Cypriot authorities will achieve a general government primary balance surplus of at least EUR 201 million (1.2% of GDP), corresponding to a headline deficit of 2.2% of GDP (respecting the 16 May 2013 Council Recommendation on correction of the excessive deficit in Cyprus).

These targets and the underlying updated budgetary projection will be embedded in the 2016-2018 Fiscal Strategy Statement, which will be adopted by the Council of Ministers **by Q2-2015**. After review by and consultation with the programme partners, the 2016 Budget Law will be adopted by **December 2015**.

In **Q2-2016**, the Cypriot authorities will present the programme partners with a provisional list of measures to attain a primary surplus of 2.5% of GDP in 2017 and 4% of GDP in 2018. The measures required will be included in the draft 2017 Budget Law.

3. Fiscal-structural measures

Key objectives

Cyprus enjoyed above euro-area average growth rates for more than a decade and in parallel expanded its public sector employment, support and services considerably. Looking ahead, if the public sector is to provide appropriate support for the sustainable and balanced growth of the Cypriot economy, fiscal-structural reform steps are needed to ensure the long-term sustainability of public finances, to provide the fiscal space necessary to support the diversification of the economy, and to alleviate the adverse impact on jobs and growth arising from Cyprus' exposure to external shocks. In this context, the objectives are: (1) to improve the efficiency of public spending and the budgetary process by means of an effective Medium-Term Budgetary Framework (MTBF) that is fully compliant with the Directive on requirements for budgetary frameworks and the Treaty on Stability, Coordination and Governance (TSCG); (2) take further steps to control the growth of health expenditure; (3) enhance tax revenues by improving tax compliance and collection; (4) undertake reforms of the public administration to improve its functioning and cost-effectiveness, notably by reviewing the size, employment conditions and functional organisation of public services; (5) undertake reforms of the overall benefit structure with the aim of producing an efficient use of resources and ensuring an appropriate balance between welfare assistance and incentives to take up work; and (6) elaborate a programme for improving the efficiency of state-owned and semi-public enterprises and initiate a privatisation programme.

Pension reform

3.1. While acknowledging that the Cypriot authorities have recently introduced substantial reforms (as noted in Annex 1), which, according to the results of the actuarial study which were peer reviewed in the Ageing Working Group of the Economic Policy Committee in September 2013, have adequately addressed the issue of the high projected increase in pension spending and secured the long-term financial viability of the pension system through 2060, it remains important to monitor the long term financial sustainability of the system and consider further reform steps, if needed.

Health care reform

3.2. To strengthen the sustainability of the funding structure and the efficiency of public healthcare provision, the following measures will be adopted:

- a) All necessary legislative changes related to the implementation of the Health Reform Plan will be approved by the House of Representatives **by end-November 2014** aiming at full implementation of the Plan **by Q2-2015**. The reform plan will take into account the restructuring of all public hospitals/public health facilities, the Ministry of Health, the Health Insurance Organisation (HIO), and other associated facilities/organisations. It will also take into account the findings of the functional review of the health sector public entities and the analysis of the function and structure of the Ministry of Health. The reform plan will provide for autonomisation of all public hospitals/public health facilities. Public hospitals will complete the shadow-budgeting for all inpatient cases on diagnoses-related groups **by Q3-2014** and for all in- and outpatient activities **by Q4-2014**; **by Q3-2014**, the detailed restructuring plan of the public primary healthcare centres will be submitted for consultation with programme partners;
- b) taking into account the economic conditions, the implementation of the necessary complementary reforms, the results of the updated actuarial study, and after consultation with the programme partners, implement a National Health System (NHS), to be fully in place **by mid-2016**.
 1. The NHS will be developed and implemented based on the fundamental principles of free choice of provider, social equality and solidarity, financial sustainability and universal coverage of a minimum benefit basket.
 2. Implementation will be carried out in three stages. **By mid-2015**, in the first stage of NHS, primary care consultation services will be covered. **By 1 January 2016**, outpatient specialist care and pharmaceuticals will be added to the benefits covered. Full implementation of NHS will be achieved **by mid-2016**.
 3. NHS will be initially based on a single payer agency. The system may evolve into a multiple insurance system provided that the necessary preconditions for achieving efficiency and affordability gains (i.e. consumer information and transparency, contestable markets, freedom to contract, fiscal viability of insurance agencies, competition regulation and risk-adjustment) can be ensured. While respecting the deadlines of the health care reform plan and of the NHS implementation plan, a study by an independent consultant, to be chosen in consultation with programme partners, will be undertaken to

- evaluate the functional and financial sustainability of the NHS operated by single and multi-payer system; the study will also assess how and when the preconditions for a multi payer system, as mentioned above, can be achieved.
4. **By October 2014**, submit to Parliament, the amended NHS Law. All financial parameters of the first stage of NHS, including the total budget for primary healthcare-consultation, the level of insurance premium, capitation fee level, and minimum and maximum amount of patients per general practitioner, will be provided **by 1st September** for consultation with program partners.
 5. Based on the detailed road map for the implementation of the NHS, the amended bill of NHS will also determine and clarify the respective role, governance and responsibilities (notably concerning the strategic policy, budget control, monitoring, audit and regulation) of the Ministry of Health and the HIO and will be approved by the House of Representatives **by Q4 2014**.
 6. Finalize the tendering of the IT-infrastructure necessary for implementing the NHS **by December 2014**.
 7. The policies of the Ministry of Health on pricing and reimbursement of medical goods and services, including those related to pharmaceutical expenditure, will be revised in agreement with programme partners to contain projected spending levels under NHS, **by Q3 2014**.
 8. An Implementation Support Team will be established by end-August 2014, drawing on national and international expertise, to assist the Ministry of Health with the implementation of NHS and health sector reforms.
- c) Starting in Q3-2014, prepare quarterly reports, to be submitted for consultation by program partner assessing the collection of compulsory health-care contribution for public servants and public servant pensioners and all co-payments for using public health care services against envisaged proceeds, and present suggestions for policy changes if needed;
 - d) Secure adoption by the Council of Ministers of a binding set of contingency measures (e.g. revision of the basket of publicly reimbursable medical services and products, cuts in tariffs for medical products and providers of medical services, limits to the volume of reimbursable products and services, capacity planning) **by Q4-2014**, in order to ensure that the agreed budget limits of public health expenditure are not exceeded, whilst ensuring equitable access to healthcare;
 - e) Review income thresholds for free public health care in comparison to the eligibility criteria for social assistance, while ensuring that co-payments to public health care are set so as to protect individuals/households effectively from catastrophic health expenditures, and submit **by Q3 2014** the conclusions of the review for consultations with program partners;
 - f) Continue to publish clinical and prescription guidelines and to audit their implementation; continue to establish the system for health-technology assessment.
 - g) Periodic reviews of the basket of publicly-reimbursable medical services will be conducted, based on objective, verifiable, criteria, including cost-effectiveness criteria (health technology assessment will contribute when feasible), with a report to be submitted for consultation by program partners **by Q3-2014**.

Furthermore, the Cypriot authorities will consider establishing a system of family doctors acting as gate-keepers for access to further levels of care.

Public financial management

3.3. The Cypriot authorities will:

- improve the risk-assessment analysis associated with government guarantees. To this end, submit to programme partners by **Q3-2014** the final version of the risk assessment report prepared by the Public Debt Management Office. The report shall identify guarantees that are expected to result in calls in the current and following year;
- adopt a comprehensive medium-term debt-management strategy, **by end-October 2014**, aimed at: (i) smoothing the debt redemption profile and reducing refinancing risk; (ii) diversifying across instruments and types of investors; (iii) ensuring a smooth functioning of the domestic Treasury bill market; and (iv) enhancing risk-assessment of contingent liabilities from government guarantees. This will help paving the way for a sustainable return to market access in due time.
- issue guidelines for public investment management, including project appraisals in line with the FRBSL provisions **by Q3-2014**. The authorities commit not to enter into any new tendering process and not to sign any public private partnership (PPP) contract before the issuance of the guidelines for public investment management; and
- regularly update the PPPs inventory, including contingent liabilities and include it both in the annual budget law and in the annual financial report.

State-owned enterprises and privatisation

3.4. As regards extra-budgetary funds and entities, in particular the State-Owned Enterprises (SOEs) and other state-owned assets:

- the law regulating the creation and the functioning of SOEs at the central and local levels will be adopted by the House of Representatives **by September 2014**. The law will enhance the monitoring powers of the central administration, while including reporting on SOEs in the context of the annual budgetary procedure. No additional SOEs will be created until the law has been adopted;
- each SOE under internal review will submit a strategic plan with detailed milestones and timelines to the competent minister for approval, in consultation with programme partners, and in line with the FRBSL and SOEs Law provisions, **at the latest 3 months after the completion of each internal review**.

3.5. The Cypriot authorities will implement the privatisation plan submitted to the programme partners to help improve economic efficiency by encouraging more vigorous competition and greater capital inflows and restore debt sustainability. The plan includes the privatisation of, inter alia, CyTA (telecoms), EAC (electricity), CPA (commercial activities of ports), as well as land assets. CyTA and CPA **will be privatised within the programme period and EAC by mid-2018**.

An appropriate regulatory framework is a prerequisite for the privatisation of natural monopolies. The provision of basic public goods and services by privatised industries will be

fully safeguarded, in line with the national policy goals and in compliance with the EU Treaty and the relevant secondary legislation.

In order to pursue the privatisation process in the most diligent way, the Cypriot authorities will:

- ensure that the newly-established Privatisation Unit is fully staffed **by October 2014**, in line with the provisions of the Privatisation Law;
- submit the assessment of market conditions and the evaluation of Limassol Port (competitive position, physical and operational conditions) **by October-2014**;
- appoint the CPA financial advisor **by October-2014**, who will then submit a detailed privatisation plan and a valuation of the transaction **by December-2014**;
- appoint the CPA legal advisor **by October-2014**;
- submit CPA's final method of privatisation **by November-2014**, after consultation with, and notification to, the relevant European bodies on the proposed transaction structure;
- establish CPA's appropriate regulatory framework **by December-2014**, after consultation with the relevant European bodies;
- appoint independent advisors for the privatisation of CyTA and EAC **by end-October 2014**, in accordance with the privatisation plan;
- approve, through the Council of Ministers and on the basis of the recommendations of the advisors, a detailed plan for the privatisation of CyTA, including the main characteristics of the transaction, **by Q4-2014**. CyTA will be converted into a Limited Liability company **by December 2014**;
- appoint independent advisors with relevant expertise and develop a plan with detailed intermediate steps and timings for disposing of the identified land assets **by November 2014**;
- agree the terms of reference for the independent advisors' study on the unbundling of EAC's operations in different legal entities **by Q4-2014** and complete the unbundling **by Q2-2015**. The study will comprise an international benchmarking, including cost structures, of major existing electricity producers vis-à-vis other electricity companies.

The privatisation plan identified by the Government after consultation with the programme partners will raise at least EUR 1 billion **by the end of the programme period** and an additional EUR 400 million **by 2018 at the latest**, which will be used for public debt reduction.

Revenue administration, tax compliance, and international tax cooperation

3.6. The Cypriot authorities will continue reforming the revenue administration with the objective to reinforce the efficiency and effectiveness of revenue collection and the fight against tax fraud and evasion, with a view to increasing fiscal revenue.

To ensure effective application of the recently enhanced legal powers to enforce tax collection, the authorities will adopt the necessary regulations for the seizure of movable property and issue the notification on the procedural details for the garnishing of bank accounts **by Q3-2014**.

A comprehensive compliance strategy will be put in place **by Q2-2015**. The strategy will be firmly based on analytical work on risk identification and analysis, as well as on an evaluation of different risk treatment strategies. To further progress, the authorities will

- design a new joint debt collection strategy **by Q3-2014** and complete pilot runs on each of the new powers for garnishing of bank accounts and seizure of movable and immovable assets **by Q4-2014**;
- **by Q4-2014**, complete the cleansing of the income tax and VAT registers by removing inactive cases, including through cross-checks using the new common data platform, and put in place a process to maintain the registers up-to-date;
- conduct two pilot projects aimed at enhancing voluntary compliance of large and high-risk taxpayers **by Q4-2014**, and finalise the compliance risk management module for large taxpayers **by Q3-2014**, with a view to setting up the integrated large taxpayer unit of the new tax department **by Q4-2014**; and
- **by Q3-2014**, present a first high-level draft of an integral strategy for the prosecution of tax fraud as a criminal offence, including an evaluation of the required investigative and legal resources needed in the new tax department. A final strategy will be elaborated **by Q4-2014**.

To progress with the operationalization of the newly established integrated and function-based tax agency, in line with the adopted integration plan, the authorities will

- approve organisational structures for the tax department and appoint the Commissioner on a fixed term and the two assistant Commissioners **by Q3-2014**; and
- establish a common taxpayer database **by Q3-2014**.

3.7. The Cypriot authorities will safeguard the timely and effective exchange of information on tax matters, fully ensuring the applicability of laws and standards governing international exchange of tax information. In this respect, the Cypriot authorities will enhance the practice of timely delivery of relevant and accessible tax information to other EU Member States. The authorities will:

- fully transpose and implement Council Directive 2011/16/EU on administrative cooperation in the field of taxation and abide by Art 7 of the Directive and Art 10, 19 and 21 of Council Regulation 904/2010 on administrative cooperation and combating fraud in the field of value-added tax, which prescribe specific timeframes within which Member States shall provide information to each other;
- continue improving the systematic follow-up and use of information received from other countries about savings income payments received by Cyprus resident individuals and savings income payments received by entities and legal arrangements

such as trusts under Cyprus law, notably entities and legal arrangements the beneficial owners of which are resident in other EU Member States; and

- ensure that the tax authorities have continuous access to databases of other public entities in order to facilitate and expedite the provision of the requested information **by Q4-2014**; and
- continue with the swift implementation of the commitments taken to reverse the negative opinion by the OECD Global Forum and provide an updated progress report to programme partners **by Q3-2014**.

In addition, the authorities will monitor closely further progress in responding timely to tax information requests by EU and third countries. The authorities will submit to the programme partners quarterly performance updates (within 14 days of the end of the quarter).

In the context of an effective implementation of Council Directive 2003/48/EC on taxation of savings income in the form of interest payments (the EUSD), the Cypriot authorities will continue to provide to the EC all necessary and available information/statistics extracted from the data exchanged under the FISC153. In addition, on an annual basis and starting from the tax year ending on 31 December 2013, the Cypriot authorities will provide to the EC a breakdown of the information provided under the EUSD by sector of activity of the paying agents, including possible sanctions actually claimed of paying agents for their application of the EUSD. **In 2015**, the Cypriot authorities will provide to the European Commission a report on the results of audits conducted in 2014. The Cypriot authorities (CBC) will provide on an annual basis detailed sectoral deposit statistics with a breakdown of non-resident deposits by country.

Immovable property tax reform

3.8. The Cypriot authorities will reform the immovable property tax with the objective to improve the fairness of the tax burden and to increase the efficiency of the tax administration. To this end, the authorities will:

- implement the recurrent immovable property tax for the tax year **2015** based on a General Valuation (GV) for all immovable properties, determined on the basis of tangible building- and plot related characteristics. The design of the immovable property tax should ensure a broad tax base and IPT proceeds not lower than in 2013. A draft of the proposed tax rates and thresholds will be submitted for timely consultation with programme partners **by Q4-2014**. Following consultation with programme partners, the final design of the immovable property tax will be adopted by the House of Representatives **by Q1-2015**;
- adopt legislation specifying the frequency of the mandatory update of the values in line with international best practices **by Q1-2015**, following consultation with programme partners;
- implement **by Q1-2015** the recommendations of a study on the scope for consolidating the collection and administration of the municipal and communal recurrent property tax and sewage tax. The study, to be completed **by Q3-2014**, will also review existing exemptions and derogations from property taxation. Moreover it will report on the scope for shifting revenues from transaction fees and taxes to

recurrent taxation. Furthermore, it will provide an initial review of the tax regulations relevant for the foreclosure process, with a view to minimising the cost of foreclosure and subsequent sale of foreclosed property. **By Q3-2014**, the authorities will also review the tax regulations that may impede the leasing of immovable property;

- conduct an assessment of the variance between GV assessed values and market price **by Q4-2014**, as well as an assessment of the relevance of the parameters used in the Computer Assisted Mass Appraisal (CAMA) model for the GV. Identify possible missing parameters and refine, if needed, the CAMA in light of this assessment **by Q1- 2015**;
- **by Q3-2014**, adopt a strategy to correctly identify all property owners in the property register;
- present to the programme partners **by Q1-2015** an updated communication strategy aiming at informing of the goals of the property tax reform, the implications for citizens and the procedures of the new reform, as well as an updated comprehensive objections' management strategy to effectively and timely deal with appeals.

Public administration reform

3.9. The Cypriot authorities have commissioned an independent external review of possible further reforms of the public administration. The review includes a horizontal and a sectoral element.

The horizontal element is undertaken by the World Bank and the UK public administration and will include reviews of:

- the appropriate system of remuneration and working conditions/conditions of employment in the public sector (e.g. annual vacation leave, sick leave, maternity leave, working time), in relation to the private sector and to other EU countries and based on best practices; and
- the introduction of a new performance based appraisal system in the public sector, for development and promotion purposes, linking performance with the remuneration system/ increments.

The results of the horizontal review will be presented **by October 2014**. Based on the findings of this review, the Cypriot authorities will agree on a reform plan after consultation with programme partners, which will be approved by the Council of Ministers **by January 2015**. The relevant legislation indicated as high priority will be adopted by the House of Representatives **by Q1-2015**. Full implementation will be **by Q4 2015** and, in accordance with the reform plan.

The sectoral element will examine:

- the role, competences, organisational structure, size and staffing of relevant ministries, services and independent authorities;
- the possibility of abolishing, merging or consolidating non-profit organisations or companies and state-owned enterprises; and

- the possibilities for the re-organisation and re-structuring of local government,

and comprises two batches:

- the first batch is undertaken by the World Bank and the UK public administration and covers the Ministries of Agriculture, Education and Health, as well as local government and the Department of Registrar of Companies. Based on the findings of this first batch, the Cypriot authorities will agree on a reform plan after consultation with programme partners, which will be approved by the Council of Ministers **by Q3-2014**. The relevant legislation in relation with the reforms in Agriculture, Education, local government indicated as high priority will be adopted by the House of Representatives **by Q4-2014**. The relevant legislation indicated as high priority on the Companies Registrar will be adopted **by October-2014**. The reform will start to be implemented **by Q1-2015**, in accordance with the reform plan.
- the second batch will cover all remaining Ministries (Labour, Welfare and Social Insurance, Communications and Works, Energy, Commerce, Industry and Tourism, Interior, Defence, Justice and Public Order, Foreign Affairs), and the Ministry of Finance, including the Treasury and the Directorate General for European Programmes, Coordination and Development (ex: Planning Bureau) being covered under the PFM. It will also include all SOEs (subject to the decisions taken under the provisions of 3.4 and 3.5 regarding privatisation, restructuring or liquidation). Finally, it will cover the President's Office and the Council of Ministers, as well as the Constitutional and Independent Services (see Annex 3 for a detailed list). The results of the second batch will be presented **by Q4-2015**. They will include cost estimates and implementation timelines with detailed intermediate steps. Based on the findings of this review, the Cypriot authorities will agree on a reform plan after consultation with programme partners, which will be approved by the Council of Ministers **by Q1-2016**. The relevant legislation in relation with the reforms indicated as high priority will be adopted by the House of Representatives **by Q2-2016**. The reform will start to be implemented **by Q3-2016**, in accordance with the reform plan.
- In addition, the authorities will review the impact of the changes to the public sector working hours and will present their findings to the programme partners **by Q4 2014**.

Welfare system

3.10. The Cypriot authorities have reformed the welfare system by introducing a Guaranteed Minimum Income (GMI) aimed at strengthening the protection of vulnerable households while ensuring an appropriate balance between welfare benefits and work incentives (as further specified in section 4.3 below). The Cypriot authorities have started implementing the new GMI as of mid-July 2014. Besides the introduction of the GMI, the reform plan also includes measures aimed at consolidating and streamlining other social benefits, and at improving the targeting of these benefits.

To ensure efficient use of public funds within the welfare system and the consistency of the reformed welfare system with the fiscal targets defined in this MoU, the Cypriot authorities will take the following steps:

- **by end-September 2014**, the monitoring unit will make a preliminary assessment of the reform's outcome, including the number of applications and costs and provide an update of the costing of the GMI;
- build a national registry of benefits, including the profiles and eligibility of all beneficiaries, cross-checked with other databases, to be completed by **end-November 2014**.
- on the basis of the national registry of benefits, by **end-March 2015**, the monitoring unit will finalize an assessment report of the welfare reform, including possible refinements in administrative structures and benefits.
- ensure that a comprehensive database and the necessary IT requirements, including all required interfaces with different databases to allow for the comprehensive verification of eligibility criteria, are in place to support the administration of the reformed welfare system **by mid-September 2014**.

4. Labour market

Key objectives

While the Cypriot labour market was characterised by high employment rates and low unemployment in the years leading up to the crisis, the unwinding of unsustainable imbalances and worsening of macroeconomic conditions and prospects have resulted in rapidly rising unemployment and important labour market challenges over the medium-term. Labour market reforms can mitigate the impact of the crisis on employment, limit the occurrence of long-term and youth unemployment, facilitate occupational mobility and contribute to improving the future resilience of the Cypriot economy in the face of adverse economic shocks. In this context, the objectives are: (1) to implement a reform of the system of wage indexation commensurate with ensuring a sustainable improvement in the competitiveness of the economy and allowing wage formation to better reflect productivity developments; (2) to implement a comprehensive reform of public assistance in order to achieve an appropriate balance between public assistance and incentives to take up work, target income support to the most vulnerable, strengthen activation policies and contain the public finance impact of rising unemployment; and (3) to help attenuate adverse competitiveness and employment effects by linking any change in the minimum wage to economic conditions.

Cost of living adjustment (COLA) of wages and salaries

4.1. To ensure that wage growth better reflects developments in labour productivity and competitiveness, in both expansions and recessions, the Cypriot authorities are reforming the wage-setting framework. A tripartite agreement will be pursued with social partners **by Q4-2014** for the suspension of wage indexation in the private sector until 2016 and the application thereafter of the reformed wage indexation system (COLA) applicable to the public sector (lower frequency of adjustment, suspension at times of recession and partial indexation).

Minimum wage

4.2. With a view to preventing possible adverse competitiveness and employment effects, the Cypriot authorities commit that, over the programme period, any change in the minimum wage covering specific professions and categories of workers should be in line with economic and labour market developments and will take place only after consultation with the programme partners.

Activating the unemployed and combating youth unemployment

4.3. The increase in unemployment underlines the need for an overall assessment of activation policies and available instruments for income support after the expiration of unemployment insurance benefits. The implementation of the reform of the social welfare system, which ensures that social assistance serves as a safety net to ensure a minimum income for those unable to support a basic standard of living, while safeguarding incentives to take up work, should be pursued as described in section 3.10.

4.4. The Cypriot authorities will continue the implementation of measures to address the identified shortcomings of the system of activation policies, including:

- i. the development of a coherent methodology for the continuous monitoring and evaluation of activation measures, to be applied consistently across the different ALMP. A comprehensive report will be presented **by Q3-2014** and as of then the new methodology will be applied, thereby enabling the assessment of the performance and effectiveness of all measures;
- ii. measures to enhance the administrative capacity of the public employment services via increased staff mobility and/or outsourcing of specific tasks **by Q3-2014**; and
- iii. measures to ensure the effective cooperation between the public employment services, the social welfare services and the benefit-paying institutions in the activation of the unemployed who are recipients of social assistance, including by establishing clear procedures for the automatic exchange of information and a transparent system linking benefit receiving with job-search efforts.

4.5. With one of the steepest increases in the youth unemployment rate in the EU and with the rapid rise of young people not in employment, education or training (NEETs), Cyprus needs to take swift action to create employment opportunities for young people and improve their employability prospects. To this end, the Cypriot authorities will submit **by Q3-2014** the final National Action Plan for Youth Employment, which will include, *inter alia*, measures envisaged for support under the Youth Employment Initiative including also the implementation of the Youth Guarantee, in line with the conclusions of the European Council of June 2013. The design, management and implementation of these measures targeted to youth shall be well integrated within the broader system of activation policies and be coherent with the reform of the social welfare system (section 3.10) and the agreed budgetary targets. For this purpose, the authorities will submit **by Q3-2014** a comprehensive note summarising the full list of all active labour market policies (existing and envisaged) with the relevant intended aims, recipients and budgetary allocations.

5. Goods and services markets

Key objectives

Addressing issues of a structural nature is critical for rebalancing the Cypriot economy, restoring its growth potential and improving competitiveness. Removing unjustified obstacles in services markets can have a significant impact on growth, in particular for the services-intensive Cypriot economy. In addition, improving the quality and reducing the cost of regulated professional services can play an important role for the business environment and for Cyprus' competitive position. Since tourism is one of Cyprus' largest sectors and an important potential driver of future growth, a reinvigoration of the competitiveness of this sector is warranted. Improving the regulation of administration related to the real estate sector will contribute to the overall functioning of the housing market and help to foster foreign demand at a time when the prospects of this sector are affected by downside risks. Finally, the exploitation of the domestic offshore natural gas potential offers the medium- to long term prospect for reducing Cyprus' energy import dependency and the security and sustainability of energy supply. This would help to address Cyprus' sustained current account deficit and high public debt. However, these positive effects will accrue only after overcoming the challenges of financing and planning the infrastructure investments, designing efficient energy markets and an adequate regulatory regime.

Services Directive and regulated professions

5.1. The Cypriot authorities stand ready to adopt any further necessary amendments towards the full implementation of the Services Directive. Rules that refer to the calculation of fees for professional services (including those adopted by professional bodies) need to be assessed before adoption for compliance with internal market and competition principles, except as otherwise agreed with programme partners. To this end, the opinion of the Cypriot Commission for the Protection of the Competition (CPC) and of programme partners is required.

On the basis of the comprehensive review of requirements affecting the access and exercise of activity of the regulated professions sector (such as lawyers, engineers, architects), the Cypriot authorities will eliminate by law the requirements that are not justified or proportional **by Q3-2014**.

Competition, transparency and sectoral regulatory authorities

5.2. The Cypriot authorities will strengthen the independence and the effectiveness of the Commission for the Protection of Competition (CPC) by:

- continuously ensuring that CPC has sufficient and stable financial means, as well as qualified personnel, in order to enhance its effective and on-going operation; and
- continuously promoting a more active role of the CPC in the area of advocacy, with the objective of safeguarding and promoting competition.

The Cypriot authorities will continuously ensure that the General Auditor's Office has sufficient personnel to carry out its functions and increased tasks, and that it is financially independent, as originally stipulated by the European Commission's Monitoring Report on the Implementation of the Commitments made in the Accession Negotiations by Cyprus

(Chapter 28, Financial Control/External Audit) and as restated in the 2014 EU Anti-Corruption Report.

The Cypriot authorities will continuously ensure that powers and independence of the National Regulatory Authorities (NRAs) are effective in accordance with the EU Regulatory Framework.

Housing market and immovable property regulation

5.3. Action is required to ensure property market clearing, efficient seizure of collateral, and swift transfer of property rights. A particular risk arises from legal disputes, which may be due to incomplete documentation of ownership and property rights and the slow pace of judicial procedures.

The Cypriot authorities will:

- **by Q3-2014**, submit to the House of Representatives, after consultation with the programme partners, amendments to the Street and Building Permit Law to ensure the enforcement of the deadlines for issuance of certificates of completion by the supervisor engineers;
- **by end-November 2014**, the House of Representatives will adopt amendments of the Transfers and Mortgaging Property Law in order to accelerate the timeframe for banks' consent on the issuance of title deeds.
- **by August 2014**, create a working group under the responsibility of the Ministry of Interior, which, in close cooperation with the Task Force on title deeds under the MoU provision 1.31 and the Task Force for Growth, will review and streamline all procedures leading from the planning permit application to the issuance of title deed. This working group will also provide the necessary assistance to the Task Force on title deeds under the MoU provision 1.31, to allow for a quantification of this problem. **By Q3-2014**, submit for consultation with programme partners a report with recommendations on how to streamline these procedures, including a catalogue for tolerated deviations from building and planning permits as well as binding deadlines for each of those procedures and means to enforce them, with a view to their implementation **by Q1-2015**.
- ensure that the title deed issuance backlog drops to less than 2,000 cases of immovable property units with title deed issuance pending for more than one year **by Q4-2014** (backlog refers to (i) applications, (ii) units that are eligible for the "ex-officio" issuance of title deeds, required certificates and permits). The ex-officio cases will automatically be counted in the backlog from the date the certificate of final approval is being issued by the respective Local or District Authority. To that end, **by end-September 2014**, provide to programme partners granular data on the stock of backlogs of permits, deeds, certificates, and mortgages associated with the underlying properties, and a strategy identifying ways to reduce this backlog and continue publishing the quarterly progress reviews, starting **in Q3-2014**;
- implement electronic access to the registries of title deeds, mortgages, sales contracts and cadastre for the monetary financial institutions and for all government services **by Q4-2014**; and
- improve the pace of court case handling, in order to eliminate court backlogs **by Q1-2016**. To that end, provide detailed statistics on court backlogs and duration of court

proceedings to programme partners on a quarterly basis starting **in Q4-2014**, submit a draft action plan for the elimination of court backlogs, including the electronic filing of new documents **by end-October 2014**, and enact legislation to establish an Administrative Court **by Q4-2014**.

Tourism

5.4. Since tourism is one of Cyprus' largest economic sectors and a potential driver of future growth and employment, a reinvigoration of its competitiveness is necessary. To that end, the Cypriot authorities will:

- present a progress report on the implementation of the tourism action plan twice per year, including an assessment of its implementation based on performance indicators, **by Q1 and Q3** every year, starting from 2014;
- present an updated plan enhancing the coordination of the various tourism stakeholders and relevant authorities **by Q3-2014**. The plan shall include concrete actions and a roadmap with a concrete timeline leading to an effective mechanism for coordination, while specifying who is responsible for the tourism strategy and how the Council of Ministers is involved in the process;
- provide an assessment of the current CTO law in order to identify, together with programme partners, which articles may hamper competition in the tourism sector **by Q1-2015**, taking into account the public administration functional review's second batch;
- in view of the reorganisation of CTO's various units, the authorities will submit a roadmap **by Q4-2014**, including milestones needed to reach the targets set in the tourism strategy. This roadmap will provide the basis for monitoring of the tourism strategy implementation;
- start implementing an aeropolitical strategy leading to the adaptation of Cyprus' external aviation policy, taking into account the EU external aviation policy and the EU aviation agreements, while ensuring sufficient air connectivity. The action plan approved by the Council of Ministers in May 2014 will be implemented **as of Q3-2014** and will be reviewed annually by the Cypriot authorities, in consultation with the programme partners.

Energy

5.5. The Cypriot authorities will:

- ensure, without delay, that the Third Energy Package is fully and correctly implemented;
- formulate a comprehensive strategy for the rearrangement of the Cypriot energy sector. This strategy will be developed and updated under the full authority of the Cypriot Government and should include at least the following three key elements, to be presented to the programme partners for consultation according to the timeline specified below:
 1. a *roll-out plan* for the infrastructure required for the exploitation of natural gas. This plan should cover: the required investments, associated costs, financing sources and methods, ownership structure; major planning risks and bottlenecks

taking into account also technical and commercial uncertainties; a projection of the revenue streams over time; the configuration and timing for the development of the necessary transmission infrastructure, accounting for European projects of common interest; and an appropriate sales framework for the off-shore gas supply for both exports and domestic markets aimed at maximising revenues. Next update **by Q4-2014**.

Prior to finalisation of the forthcoming energy sector Government Agreement (GA) and its supplementary agreements between the Republic of Cyprus and the Contracting Parties to a Production Sharing Contract, the Cypriot authorities will undertake a financial and budgetary impact analysis of the GA and its supplementary agreements. The impact assessment will evaluate in detail the potential financial and budgetary impacts on the general government position of the envisaged LNG project and financing arrangements, with a particular focus on budgetary commitments that may arise before or at the time of taking the final investment decision. The GA and its supplementary agreements shall be consistent with the fiscal targets until 2016 and thereafter, as defined in this MoU;

2. *a comprehensive outline of the regulatory regime and market organisation* for the restructured energy and gas sector, with a view to introducing open, transparent, competitive energy markets. The outline should take into account the size of the Cypriot economy, the integration of Cyprus' energy system into regional markets, the principle of independent regulatory oversight, competition and entry dynamics on the electricity markets (also in view of the envisaged rise in electricity production from renewable energy sources), the prospects of privatisation of SOEs in the energy sector, and the EU targets for energy efficiency, renewable energy and carbon emissions. Specifically, the outline should include a description of the sequence and timing of the major changes envisaged: the institutional framework; the type and scope of the regulatory instruments; the different forms of government ownership and involvement; the setting-up of wholesale markets for gas and electricity; the customer's free choice of supplier; and the unbundling of electricity and gas networks to the benefit of suppliers and customers, taking into account the potential use of certain derogations in accordance with *acquis*. The Cyprus authorities will in this context consider and inform programme partners about: i) the intended use and duration of the available 'isolated market' and 'emergent market' derogations, ii) a preliminary assessment of the technical and economic potential for further increasing electricity production by renewable energy sources, , also accounting for the scope for improving the capability of the transmission and distribution system to integrate renewable electricity. This assessment will be followed by an analysis (**by Q3 2015**) of the cost price of different sources of renewables compared to conventional primary energy sources; iii) envisaged measures to improve the capacity and independence of CERA to carry out its functions, including sufficient staffing. An updated draft outline will be provided **by Q3-2014**, with a view to a final outline **by Q4-2014**; and
3. an institutional framework for the management of hydrocarbon resources, including a *resource fund*, which should receive and manage various types of public revenues from offshore gas exploitation and sales. In order to ensure transparency, accountability and effectiveness, the resource fund should benefit from a solid legal base and governance structure, drawing on internationally-recognized best practices. The resource fund, established in the FRBSL (see 3.3), should be based on clear rules governing inflows and outflows, coupled with clear

rules regarding dividends, fees and costs of government entities and stakes in the energy sector. These rules should be provided for in the FRBSL and detailed in implementing legislation of FRBSL, an advanced draft of which will be submitted to programme partners for consultation **by Q3-2014**, with a view to submission to the House of Representatives **by Q4-2014**. The resource fund law, which defines the governance structure of the resource fund, will be submitted to the House of Representatives **by Q4-2014**.

Since these three key elements are strongly interdependent, they need to be developed in parallel over time and collated in one summary document. For some of the technical aspects of the above key elements, technical assistance, where requested, will be provided.

6. Technical assistance

6.1. Given the nature of the structural challenges Cyprus is facing, including a lack of specific skills in some areas and scarcity of resources, the Cypriot authorities will provide an updated request for technical assistance needs during the programme period, including the on-going technical assistance projects **by end-December 2014**. This request will identify and specify the areas of technical assistance or advisory services, which the Cypriot authorities consider essential for the implementation of the MoU and where they intend to seek such technical assistance services, in coordination with the programme partners. All technical assistance provided by the European Commission, other than technical assistance provided directly under the Structural and other EU funds, will be coordinated by the Support Group for Cyprus.

7. Growth Strategy

7.1 The Cypriot authorities will develop a comprehensive and coherent growth strategy that will help the economy to move to a sustainable growth path. The growth strategy will take into account the on-going public administration reform, public financial management reform, the commitments in the Cyprus Economic Adjustment Programme and relevant Union initiatives. The growth strategy will aim at, inter alia, creating a more attractive business environment, addressing administrative complexity, implementing more streamlined and simpler procedures, and it will also take into account the Partnership Agreement for the implementation of the European Structural and Investment Funds. The growth strategy will be developed, coordinated and enforced through the single body that will evolve out of the Task Force for Growth already established and will be anchored in the national institutional framework.

By Q3-2014, the authorities will provide, in consultation with the programme partners, an action plan for the development, and implementation of the growth strategy. The Cypriot authorities may request technical assistance to further develop this strategy.

Annex 1**Budgetary measures adopted by Cyprus in or after December 2012****Fiscal measures with effect in 2012****Expenditure measures**

I.1 Implement a scaled reduction in emoluments of public and broader public sector pensioners and employees as follows: EUR 0-1000: 0%; EUR 1001-1500: 6.5%; EUR 1501-2000: 8.5%; EUR 2001-3000: 9.5%; EUR 3001-4000: 11.5%; above EUR 4001: 12.5%.

I.2 Extend the suspension of the practice of COLA for the public and broader public sector until the end of the programme (Q1-2016) (see 4.1).

I.3 Extend the freeze of increments and general wage increases in the public and broader public sector and temporary contribution in the public, broader public and private sectors on gross earnings and pensions by three additional years until 31 December 2016.

I.4 Reduce the number of public sector employees by at least four thousand five hundred over the period of 2012-16 by: i) freezing the hiring of new personnel on first entry posts in the broader public sector for three additional years until 31 December 2016; ii) implementing a policy of recruiting one person for every four retirees (horizontal); iii) introducing measures to increase the mobility of civil servants within and across line ministries (see 3.10); and iv) implementing a four-year plan aimed at the abolition of at least 1880 permanent posts (see I.16).

I.5 Freeze the hiring of new hourly paid employees and enforce immediate application of mobility within and across ministries and other government entities. In the case of health and security posts, recruitment of one person for every five retirees will be possible to meet urgent needs.

Revenue measures

I.6 Appropriate a one-off additional dividend income collected from semi-governmental organisations.

I.7 Increase the bank levy on deposits raised by banks and credit institutions in Cyprus from 0.095% to 0.11% with 25/60 of the revenue earmarked for a special account for a Financial Stability Fund.

I.8 Introduce a mechanism for a regular review of excise taxes to secure the real value of excise tax revenue. Such a mechanism should be non-recurring and should, by no means lead to an automatic indexation mechanism of excise taxes to price developments.

Fiscal measures with effect in 2013**Expenditure measures**

I.9 Ensure a reduction in total outlays for social transfers by at least EUR 113 million through: (a) the abolition of a number of redundant and overlapping schemes such as the

mothers allowance, other family allowances and educational allowances; and (b) the abolition of supplementary allowances under public assistance, the abolition of the special grant and the streamlining of the Easter allowance for pensioners.

I.10 Ensure a reduction of at least EUR 29 million in the total outlays of allowances for employees in the public and broader public sector by:

- i. taxing pensionable allowances provided to senior government officials and employees (secretarial services, representation, and hospitality allowances) in the public and broader public sector;
- ii. reducing the allowances provided to broader public sector employees and reducing all other allowances of broader public sector employees, government officials and hourly paid employees by 15%; and
- iii. reducing the daily overseas subsistence allowance for business trips by 15%. Ensure a further reduction the subsistence allowance of the current allowance when lunch/dinner is offered by 50% (20% - 45% of overseas subsistence allowance instead of 40% - 90% currently paid).

I.11 Reduce certain benefits and privileges for state officials and senior government officials, in particular by:

- i. suspending the right to travel first/business class by state officials, senior government officials and employees with the exception of transatlantic travel. The right to business class travel shall be maintained for the President of the Republic of Cyprus and the President of the House of Representatives;
- ii. abolishing the right to duty free vehicles for employed and retired senior public sector officials; and
- iii. extending the wage freeze and temporary contribution on gross earnings to cover all state officials and permanent secretaries (129 individuals) for 2013-2016, including members of the House of Representatives. Include pensionable and tax-free allowances of these individuals in the calculation of their taxable income. Introduce a contribution of 6.8% on the pensionable earnings of these individuals.

I.12 Implement the following measures regarding the Government Pension Scheme (GEPS):

- i. freeze public sector pensions;
- ii. increase the statutory retirement age by 2 years for the various categories of employees; increase the minimum age for entitlement to an unreduced pension (by 6 months per year) to be in line with the statutory retirement age; while preserving acquired rights, introduce an early retirement penalty of 0.5% per month of early retirement so as to make early retirement actuarially neutral;
- iii. reduce preferential treatment of specific groups of employees, like members of the army and police force, in the occupational pension plans, in particular concerning the contribution to the lump-sum benefits;
- iv. introduce a permanent contribution of 3% on pensionable earnings to Widows and Orphans Fund by state officials who are entitled to a pension and gratuity. Introduce a contribution of 6.8% on pensionable earnings by officials, who are entitled to a

pension and gratuity but are not covered by the government's pension scheme or any other similar plan;

v. amend Article 37 of the Pensions Law to abolish the provision according to which, in the case of death of an employee, if the deceased had a wife/husband at the time of his/her retirement and thereafter he/she remarried, his/her last wife/husband is considered a widow/widower. With the abolition of this provision, the second wife/husband will not be considered a widow/widower and thus she/he will not be entitled to pension;

vi. increase the contribution rate on the pensionable earnings of the members of the Tax Tribunal Council and the Tender Review Authority from 3.4% to 6.8%; and

vii. the contributions to the Widows and Orphans Fund will no longer be reimbursable.

viii. introduce an automatic adjustment of the statutory retirement age every 5 years in line with changes in life expectancy at the statutory retirement age, to be applied for the first time in 2018; ix. introduce a change of indexation of all benefits from wages to prices; and

x. pension benefits will be calculated on a pro-rata basis taking into account life-time service as of January 2013 (in place since January 2013).

I.13 Implement further reform steps under the General Social Insurance Scheme by:

i. actuarially reducing pension entitlements from the General Social Insurance Scheme by 0.5% per month for retirements earlier than the statutory retirement age at the latest from January 2013, in line with the planned increase in the minimum age for entitlement to an unreduced pension to reach 65 (by 6 months per year), between 2013 and 2016;

ii. freezing pensions under the Social Security Fund for the period 2013-2016;

iii. abolishing the increase of pensions for a working dependent spouse under the General Social Insurance Scheme at the latest from January 2013 onwards.

iv. increase the minimum age for entitlement to an unreduced pension by 6 months per year to be brought in line with the statutory retirement age;

v. introduce an early retirement penalty of 0.5% per month of early retirement so as to make early retirement actuarially neutral;

vi. introduce an automatic adjustment of the statutory retirement age every 5 years in line with changes in life expectancy at the statutory retirement age, to be applied for the first time in 2018;

vii. gradually (1 year per year) extend the minimum contributory period in the system from the current 10 years to at least 15 years over the period 2013-17 (in place since December 2012); and

viii. ensure that pension entitlements that will accrue after 1 January 2013 are considered as personal income, thus becoming fully taxable also in the case in which they are received as a lump-sum payment. At the same time, employees will be granted the option of converting all or part of the lump-sum into an actuarially neutral annuity (in place since January 2013).

I.14 Reduce transfers by EUR 25 million from central government to state-owned enterprises and semi-public institutions.

I.15 Ensure a targeted reduction of budgetary appropriations for a series of semi-governmental organisations in the 2013 Budget Law, supported by well-defined activity-reducing measures.

I.16 Implement a four-year plan as prepared by the Public Administration and Personnel Department aimed at the abolition of at least 1880 permanent posts over the period 2013-2016.

The additional permanent expenditure measures for 2013, which were adopted by Cyprus **prior to the granting** of the first disbursement of financial assistance:

I.17 Introduce the following measures to control healthcare expenditure:.

a. abolish the category of beneficiaries class "B" and all exemptions for access to free public health care based on all non-income related categories except for persons suffering from certain chronic diseases depending on illness severity. Introduce as a first step towards a system of universal coverage a compulsory health care contribution for public servants and public servant pensioners of 1.5% of gross salaries and pensions. The measure will be reviewed **by Q2-2014** with the programme partners. For families with three or more dependent children, the participation in this health care scheme will be voluntary;

b. increase fees for medical services for non-beneficiaries by 30% to reflect the associated costs of medical services and create a co-payment formula with zero or low admission fees for visiting general practitioners, and increase fees for using higher levels of care for all patients irrespective of age;

c. introduce effective financial disincentives for using emergency care services in non-urgent situations;

d. introduce financial disincentives (co-payment) to minimise the provision of medically unnecessary laboratory test and pharmaceuticals; and

e. adopt a new decision by the Council of Ministers concerning a restructuring plan for public hospitals, improving quality and optimising costs and redesigning the organisational structure of the hospital management, by putting into practice recommendations from the 2009 "Public Hospital Roadmap".

I.18 Reduce the expenditure on various housing schemes by at least EUR 36 million by consolidating and streamlining the schemes for the displaced and the Comprehensive Housing Scheme, discontinuing the special grant for acquiring a first residence and ceasing the provision of loans and loan guarantees related to house construction and acquisition under all government-administered housing schemes.

I.19 Further streamline the Easter allowance to pensioners by limiting the benefit to pensioners with a monthly per household income of at most EUR 500.

I.20 Implement a scaled reduction in emoluments of public and broader public sector pensioners and employees as follows: EUR 0-2.000: 0.8%; EUR 2.001-3.000: 1%; EUR 3.001-4.000: 1.5%; above EUR 4001: 2.0 %.

In addition:

A compensation scheme for provident and retirement funds in Cyprus Popular Bank. The scheme should meet the following criteria: (i) ensure comparable treatment with such funds in Bank of Cyprus, (ii) take into account the cash-flow and actuarial position of each fund in determining timing by which the compensation will take place, (iii) minimise the impact on the general government deficit and ensuring its one-off nature. Given the social welfare nature of provident and retirement funds, the Cypriot authorities will earmark an amount of up to EUR 299 million out of the state budget, for such compensation, of which up to a maximum of EUR 154 million can be released, before the second review of the adjustment programme.

Revenue measures

- I.21 Increase excise duties on tobacco products, in particular on fine-cut smoking tobacco, from EUR 60/kg to EUR 150/kg. Increase excise duties on cigarettes by EUR 0.20/per packet of 20 cigarettes.
- I.22 Increase excise duties on beer by 25% from EUR 4.78 per hl to EUR 6.00 per hl per degree of pure alcohol of final product. Increase excise duties on ethyl alcohol from EUR 598.01 to EUR 956.82 per hl of pure alcohol.
- I.23 Increase excise duties on energy, i.e., on oil products, by increasing tax rate on motor fuels (petrol and gasoil) by EUR 0.07.
- I.24 Increase the standard VAT rate from 17% to 18%.
- I.25 Introduce a tax of 20% on gains distributed to winners of betting by the Greek Organisation of Football Prognostics S.A. (OPAP) and the National Lottery for winnings of EUR 5,000 or more.
- I.26 Abolish all exceptions currently in place for paying the annual company levy of EUR 350.

The additional permanent revenue measures for 2013, which were adopted by Cyprus **prior to the granting** of the first disbursement of financial assistance:

- I.27 Ensure additional revenues from property taxation of at least EUR 75 million by: (i) updating the 1980 prices through application of the CPI index for the period 1980 to 2012; and/or (ii) amending tax rates and/or (iii) amending value bands.
- I.28 Increase the statutory corporate income tax rate to 12.5%.
- I.29 Increase the tax rate on interest income to 30%.
- I.30 Increase the bank levy on deposits raised by banks and credit institutions in Cyprus from 0.11% to 0.15% with 25/60 of the revenue earmarked for a special account for a Financial Stability Fund.
- I.31 Complete the increase in fees for public services by at least 17% of the current values

Fiscal measures with effect in 2014

Expenditure measures

I.32 Ensure a reduction in total outlays for social transfers by a at least EUR 28.5 million to be achieved through streamlining and better targeting of child benefits and educational grants, and abolition of social cohesion benefits provided by the welfare services.

I.33 Implement a further reduction in emoluments of public and broader public sector employees and pensioners by a flat rate reduction of 3% on all wages.

I.34 Introduce a fee on monthly transportation cards for the use of public transportation services by students and pensioners.

I.35 Introduce as of the budget year 2014 structural reform measures in the educational system, notably, a reduction of the number of teachers seconded to the Ministry of Education and Culture, the removal of 1:1.5 teaching time ratio from evening schools of general and technical and vocational education, the elimination of teaching time concession to teachers for being placed in two or more educational districts, the elimination of mentoring components for pre-service and in-service training for newly appointed teachers and the reduction of the cost of afternoon and evening programmes.

I.36 Ensure additional expenditure savings by a further reduction of public sector allowances and streamlining of overtime compensation, including by revising the formula for calculating overtime compensation on weekdays and in weekends for state officers and apply the revision pro rata in the case of hourly paid employees;

I.37 A further targeting of social pensions;

I.38 An abolition of income tax exemption for certain pension schemes;

I.39 A reduction in the tax-free threshold for lottery gains;

Revenue measures

I.40 Extend the application of the temporary contribution on gross earnings and pensions of public and private sector employees up to 31 December 2016 as follows: EUR 0 – 1,500: 0%; EUR 1,501 – 2,500: 2.5%; EUR 2,501 – 3,500: 3.0%; and > EUR 3,501 - : 3.5%.

I.41 Increase the standard VAT rate from 18% in 2013 to 19% in 2014.

I.42 Increase the reduced VAT rate from 8% to 9%.

I.42 Increase excise duties on energy, i.e., on oil products, by increasing the tax rate on motor fuels (petrol and gasoil) by EUR 0.05.

I.43 Increase the contributions, as of 1.1.2014, of salaried employees and employers to the GSIS by an additional 1 percentage point on pensionable earnings, i.e. 0.5 of a percentage point from employees and 0.5 of a percentage point from employers and 1 percentage point in the case of self-employed persons.

I.44 A reform of the tax system for motor vehicles with effect from budget year 2014, based on environmentally-friendly principles, with a view to raising additional revenues in the medium-term, through the annual road tax, the registration fee and excise duties, including motor fuel duties. The reform will take into account the related study of the University of Cyprus.

I.45 An introduction of a contribution of 3% on salaries of casual employees servicing on a contract basis, who receive gratuity including volunteers of 5 years services and police constables.

Annex 2**The AML Action Plan by Cyprus on customer due diligence and entity transparency**

	<i>Heading/Deficiency</i>	<i>Action</i>	<i>Timeline</i>
1	<u>Customer Due Diligence</u>		
1.1	<u>Business profile</u>		
	Business profiles not always properly established.	1.1.1 CBC to provide guidance to ensure that obliged entities engage in adequate training of all staff involved in establishing customer business relationships and opening accounts, so that business profiles are properly determined and assigned.	Compliant
1.2	<u>Customer risk profile</u>		
	Lack of understanding of cumulative risks in complex ownership structures / introduced business.	1.2.1 CBC to provide sufficient guidance to ensure that obliged entities have sound and effective risk management systems in place to identify and understand ML/TF risks within their customers, products and services, geographical locations/areas, and delivery channels. Risk management systems should include an overall policy for identifying and understanding, measuring, controlling, and monitoring ML/TF risks. The risk management policies, procedures and measures should be submitted to the board for approval on an annual basis, or as required by changes in the business model.	Compliant Ongoing
	New legislative measures.	1.2.2 CBC and other supervisory authorities to issue guidance to obliged entities in order to explain the new provisions on the introduction of tax crimes (including tax evasion) as predicate offences.	Compliant
	Particular issues relating to PEPs.	1.2.3 CBC to issue additional guidance to obliged entities to adequately identify and establish the source of wealth for PEPs or for customers that become PEPs after the business relationship has been accepted.	Compliant
1.3	<u>Ongoing CDD</u>		
	Higher risk customers/changes in risk not dealt with appropriately on an ongoing basis. Particular issues relating to PEPs.	1.3.1 CBC to issue additional guidance to ensure that financial institutions have sound and effective systems and measures in place to demonstrate enhanced ongoing monitoring for higher risk clients, including PEPs. 1.3.2. CBC to ensure that financial institutions have sound and effective systems and measures including updated CDD measures.	Compliant Ongoing

2	<u>Reliance/introduced business</u>		
	Use of introducers allowed by CY legislation and is widespread.	2.1 CBC to review, strengthen, and amend as needed the regulatory framework and the relevant requirements relating to the use of introducers/third parties to ensure compliance by obliged entities establishing business relationships and/or opening accounts through third parties.	Compliant
	Training/awareness in institutions.	2.2.1 CBC to reiterate and clarify the obligation under the CBC directive that obliged entities are required to establish adequate AML/CFT training programs for all staff responsible for establishing business relationships and/or opening customer accounts and updating customer information. 2.2.2 CBC to ensure that training programs are implemented and include information on current ML and TF techniques, methods and trends, and clear explanations of all aspects of the AML/CFT laws, regulations. In particular, this should include requirements concerning CDD, suspicious transaction reporting and sanctions for non-compliance.	Compliant Ongoing
	Mechanisms for coordination with supervisors of introducers	2.3 CBC to establish co-operation mechanisms with CySEC, the Cyprus Bar Association and ICPAC (for accountants) for exchanging information and ensuring supervisory coordination.	Compliant
3	<u>Suspicious Transaction Reporting</u>		
	Changes in the legal framework.	3.1 MOKAS to reiterate and clarify through further training the requirements to report STRs, including the new duty to report issues relating to tax crimes as of December 2012, in coordination with relevant supervisory authorities.	Compliant
4	<u>Transparency of beneficial ownership</u>		
4.1	<u>Access to information</u>		
	Ensure that transparency and availability of beneficial ownership information is in line with international standards and best practice.	4.1.1 Revision of Trust and Company Services Providers Law as appropriate and AML Law to ensure that adequate, accurate and timely information on the beneficial ownership of Cypriot legal persons and arrangements can be provided to the domestic competent authorities and their foreign counterparts; and revise the directives and circulars issued by supervisory authorities (CBC, CySEC, Cyprus Bar Association, ICPAC). 4.1.2. In the case of nominees, either a) require nominee directors ⁴ and nominee shareholders to disclose the identity of their nominator to the company and to the company register; or b) require that all nominee directors and nominee	Compliant Compliant

⁴ Under Cyprus law, there is no legal concept of “nominee director”, but it is used with reference to professionals who provide director services.

		shareholders be authorised or otherwise regulated (i.e. as lawyers, accountants or TCSPs) and maintain information on the identity of their nominator, which is to be made available to the competent authorities upon request. A record of director's or shareholder's nominee status will be accessible through the registers under the TCSP Law, which list all regulated persons (i.e. lawyers, accountant and TCSPs).	
4.2	Company Registry		
	Efficiency of Companies' Registrar as an important aid to CDD.	4.2.1 Carry out a third party review of the functioning of the Companies' Registrar and communicate results to the programme partners. 4.2.2 Ensure the department of the registrar is appropriately resourced.	Compliant Partially compliant Q3 - 2014
4.3	Register of Trusts		
	Enhance the transparency of trusts in line with international standards and best practice.	4.3.1 CY to establish trust registries with the supervisory authorities for all express trusts established under CY law, where the name of the trust and the name and address of the trustee will be contained therein. The trust registers will be accessible by the supervisory authorities in order to facilitate them in their supervisory duties.	Compliant
5	<u>Supervision of financial institutions</u>		
5.1	Revise the AML/CFT supervisory structure within the CBC, ensuring it is adequately resourced	5.1.1 Revise and/or establish organisation structure and management within the CBC's Banking Supervision and Regulation Department (BSRD) to address AML/CFT matters, ⁵ in order to conduct adequate, timely and proactive risk-based AML/CFT supervision.	Compliant

⁵ in accordance with BCP 2 and FATF 26-27

		5.1.2 CBC to ensure adequate human resources and technical capacity to undertake effective AML/CFT supervision. The level of resources should be commensurate with the size, complexity, and risk profiles of the financial institutions operating in the system. ⁶ To meet this objective, if deemed necessary by the CBC, hire AML/CFT experts with the necessary professional skills and experience (e.g. foreign supervisors retired or on leave) – subject to necessary confidentiality restrictions. ⁷	Partially compliant Q3 - 2014
5.2	Develop risk-based supervisory tool(s) for offsite surveillance/monitoring activities prior to implementation	5.2.1 Design, develop, adopt and pilot, for a selected group of financial institutions, a risk assessment methodology and tool(s) that provides for: <ul style="list-style-type: none"> - a comprehensive analysis of inherent ML/TF risks within the following risk factors: customers, products & services, geographic locations/areas,⁸ and delivery channels; - an assessment of the internal control environment that should be in place to mitigate and/or control the inherent ML/TF risks, as identified and measured; - institutional risk profiles; - specific AML/CFT supervisory strategies (adapted to institutional risk profiles). 	Compliant
5.3	Develop risk-based supervisory tool(s) for onsite inspections prior to implementation	5.3.1 Design, develop, adopt and pilot, for a selected group of financial institutions, a methodology for onsite activities, including the necessary examination/verification procedures for onsite inspections. Examination procedures, should include, at a minimum: <ul style="list-style-type: none"> -Corporate Governance; -Risk Assessment Systems; -Policies & Procedures; -Compliance Function; -Internal & External Audit Functions; -Training Program. 	Compliant
5.4	Establish Formal AML/CFT Training Program	5.4.1 Establish a formal AML/CFT training program for CBC staff to ensure adequate implementation of the offsite and onsite tools. Develop and deliver customised AML/CFT training to supervisory staff in topics including, but not limited to: <ul style="list-style-type: none"> - newly developed offsite and onsite risk-based tools; - customer acceptance policies; - customer due diligence (CDD); 	Partially compliant Q4 – 2014

⁶ FATF Immediate Outcome (IO) 3

⁷ See BCP 2.6c

⁸ The off-site supervisory tool will include monthly reporting by obliged entities on the breakdown by country of origin of the main depositors and the main beneficiaries of loans (and of their beneficial owners).

		<ul style="list-style-type: none"> - monitoring of transactions; - identification and reporting of STR; - funds transfers; - correspondent banking; - recordkeeping; - compliance function; - internal controls; - audit functions; - corporate governance; - risk assessment systems 	
		5.4.2 Provide CBC supervisory staff with ongoing training to ensure adequate knowledge of risks and supervisory techniques.	Ongoing
5.5	Implement adequate supervision	5.5.1.a. CBC to establish corrective actions and follow-up on the cases revealed by Deloitte.	Compliant
		5.5.1.b. Apply appropriate enforcement actions with regard to any breaches of compliance, and apply sanctions if applicable.	Non-compliant. End-August
		5.5.2 On a quarterly basis, in the context of the programme review, starting Q4 2013 the CBC will on a confidential basis, share anonymised information with the programme partners, by granting access to supervisory assessments and information about enforcement actions applied for non-compliance and /or violations of laws and regulations.	Ongoing
		Subsequent to the successful development of the tools stipulated under 5.2 and 5.3, the CBC will undertake the following:	
		5.5.3.1 Implement and adjust the new risk-based offsite analytical tool(s) using the results of the pilot reviews, and develop an onsite supervisory program for 2014.	Compliant
		5.5.3.2 Assign institutional ML/TF risk profiles to financial institutions reviewed under the pilot exercise.	Compliant
		5.5.3.3 Develop customised supervisory strategies for financial institutions reviewed under the pilot exercise.	Ongoing
		5.5.3.4 Apply the risk-based off-site analytical tools, assign ML/TF risk profiles, and developed customised supervisory strategies to all financial institutions under its responsibility.	Ongoing
		5.5.4.1 CBC to start implementing the new examination/verification procedures in line with the inspection program for 2014, and to adjust/fine-tune the procedures using the results of the pilot inspections.	Compliant
		5.5.4.2 CBC to update the institutional risk profile and supervisory strategy based on the results of the pilot inspection.	Ongoing

6.	<u>Supervision and monitoring of lawyers, accountants and TCSPs</u>		
6.1	Align resources with risks Establish an effective monitoring structure for AML/CFT matters	6.1.1 Ensure adequate human resources and technical capacity to undertake effective AML/CFT monitoring. The level of resources should be commensurate with the size, complexity, and risk profiles of each business and professional. To meet this objective, if deemed necessary by the supervisory authorities, hire AML/CFT experts with the necessary professional skills and experience (e.g. professionals having performed monitoring or supervision of these professions abroad) – subject to necessary confidentiality restrictions.	Ongoing
6.2	Develop risk-based tool(s) for Offsite surveillance/monitoring activities prior to implementation	6.2.1 Design, develop, adopt, and pilot a risk assessment methodology and tool(s) that provides for: <ul style="list-style-type: none"> - a comprehensive analysis of inherent ML/TF risks within the following risk factors: customers, products & services, geographic locations/areas, and delivery channels; - an assessment of the internal control environment that should be in place to mitigate and/or control the inherent ML/TF risks, as identified and measured; - risk profiles; - specific AML/CFT monitoring strategies (adapted to institutional risk profiles). 	Compliant (CBA and ICPAC) Q3-2014 (CySEC)
		6.2.2.1 Implement the new offsite analytical tool(s) through pilot reviews of a selected group of business and professionals. Adjust/fine-tune the offsite analytical tool(s) using the results of the pilot reviews. 6.2.2.2 Assign ML/TF risk profiles to businesses and professionals reviewed under the pilot exercise. 6.2.2.3 Apply the risk-based off-site analytical tools, assign ML/TF risk profiles, and developed customized supervisory strategies to all business and professions under monitoring.	Compliant (CBA and ICPAC) Compliant (CBA and ICPAC) Ongoing (CBA and ICPAC) Q3-2014 (CySEC, for 6.2.2.1, 6.2.2.2. and 6.2.2.3)
6.3	Develop risk-based tool(s) for Onsite inspections prior to implementation	6.3.1 Design and develop a methodology for onsite activities, including the necessary examination/verification procedures for onsite inspections. Examination procedures, should include, at a minimum: <ul style="list-style-type: none"> - Risk Assessment Systems - Policies & Procedures - Compliance Function 	Compliant (CBA and ICPAC) Q3-2014

		- Training Program	(CySEC)
6.4	Establish Formal AML/CFT Training Program	<p>6.4.1 Establish formal AML/CFT training program and develop and deliver customised AML/CFT training courses. Develop and deliver customised AML/CFT training to supervisory staff in topics including, but not limited to:</p> <ul style="list-style-type: none"> - newly developed offsite and onsite risk-based tools - customer acceptance policies - customer due diligence (CDD) - monitoring of transactions - identification and reporting of STR - recordkeeping - compliance function - risk assessment systems etc. 	<p>Ongoing (CBA and ICPAC)</p> <p>Q4-2014 (CySEC)</p>
6.5	Implement adequate supervision	6.5.1. On a quarterly basis, in the context of the programme review, starting Q4-2013, the CySEC, CBA and ICPAC will, on a confidential basis, share anonymised information with the programme partners by granting access, to supervisory assessments and information about enforcement actions applied for non-compliance and /or violations of laws and regulations.	Ongoing
		<p>Subsequent to the successful development of the tools stipulated under 6.2 and 6.3, the Supervisory authorities will undertake the following:</p> <p>6.5.2 Implement the new offsite analytical tool(s) through pilot reviews of a selected group of lawyers, accountants and TCSPs. Adjust/fine-tune the offsite analytical tool(s) using the results of the pilot reviews, and come-up with a supervisory program for 2014</p>	<p>Q3 – 2014 (CBA and ICPAC)</p> <p>Q4-2014 (CySEC)</p>
		6.5.3 Implement the new examination/verification procedures through pilot onsite inspections of a selected group of lawyers, accountants and TCSPs. Adjust/fine-tune the procedures using the results of the pilot inspections.	<p>Q3 – 2014 (CBA and ICPAC)</p> <p>Q4-2014 (CySEC)</p>

Annex 3**The Public Administration Review: Second Batch of Studies**

The second batch of studies to be carried out in accordance to paragraph 3.9 will cover the following areas:

Ministries and the Departments/Services falling under each Ministry

- i. Ministry of Labour, Welfare and Social Insurance
- ii. Ministry of Communications and Works
- iii. Ministry of Energy, Commerce, Industry and Tourism (excluding the Companies Registrar and Official Receiver, to be covered in the first batch of studies)
- iv. Ministry of Interior
- v. Ministry of Defense (excluding the National Guard and Cyprus Army)
- vi. Ministry of Justice and Public Order
- vii. Ministry of Foreign Affairs

Note: Ministry of Finance, including Treasury and the Directorate General for European Programmes, Coordination and Development (ex Planning Bureau), is being reviewed under the PFM.

Constitutional Powers /Services

- i. President's Office and Council of Ministers
- ii. Law Office
- iii. Audit Office
- iv. Public Service Commission

Independent Services/Authorities

- i. Educational Service Commission
- ii. Internal Audit Service
- iii. Office of the Commissioner for Administration (Ombudsman)
- iv. Office for the Commissioner of Personal Character Data Protection
- v. Tender Review Body
- vi. Refugee's Review Body

Independent Services/Authorities to be excluded from the external review and justified in the Notes below

- i. Office for the Commissioner of State Aid Control ⁹
- ii. Authority for the Supervision of Cooperative Societies ¹⁰
- iii. Competition Protection Commission

⁹ It functions according to *acquis communautaire* prescriptions and it employs only a limited number of people (4 persons).

¹⁰ The relevant organisation is dealt within the context of the financial sector part of the MoU.