

# **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 further the soundness of the Cypriot banking sector and further improve depositors' and market confidence by thoroughly restructuring and downsizing credit 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 reforms

### A. Regulation and supervision

#### Maintaining liquidity in the banking sector

1.1. After the complete removal of all restrictive measures on 6 April 2015, the CBC, in consultation with the ECB, continues to closely monitor the liquidity situation of the banking sector. Banks' liquidity position remains comfortable and international risks have subsided. The CBC will stand ready to take appropriate measures to maintain sufficient liquidity in the system in line with Eurosystem rules. The government guarantees scheme for the issuance of bank bonds was prolonged until end-December 2015. If necessary to safeguard financial stability, the scheme can be used in line with State aid rules.

1.2. The CBC will continue to receive the updated condensed capital and funding plans of core banks **on a quarterly basis**, and within two months of the end of each quarter, 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 resolution of non-performing assets, 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

1.3. The credit register is already operational for credit assessment purposes. In order to implement its use for supervisory and macro-prudential purposes, the authorities produced a preliminary report in end-September. The authorities will further expand the data elements held in the register and continue to improve data quality, with a view to facilitate the assessment of risk and credit supply decisions. They will furthermore investigate the creation of a credit scoring system for natural persons available to banks and other creditors under sufficient safeguards and present an intermediate report **by end-December**.

1.4. In order to improve the loan origination process in the banks, the companies register needs to be updated on a timely basis with the regular submission of audited financial statements. To foster this process, the authorities are actively monitoring the filing obligation of companies and are updating the Register with submitted financial statements. A compliance team for monitoring the submission of annual returns and financial statements has been set up. The process of imposing administrative fines to non-compliant companies will start being implemented by end March 2016, in line with the implementation of the restructuring plan of the Companies Registrar as per par.3.9.

1.5. 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, where relevant, financial indicators.

1.6. The authorities will study the financial situation of borrowers. The study will, among other things, assess the extent of strategic default of households, with the objective of improving the effectiveness of debt resolution policies. The preliminary findings of the study were made available **in early November** and final results will be published **by end-December**.

1.7. The CBC will ensure it has sufficient staff to carry out its functions in full independence as stipulated by the Treaties. The CBC, taking into account the tasks undertaken in relation to

these policy measures, new tasks following the creation of the SSM, and enforcement of the existing regulatory framework, has already assessed the staffing needs in the micro-prudential supervisory area and the recruitment process was completed. The authorities assessed as well in October the need for additional staff in order to ensure the functioning of the Single Resolution Board by 1 January 2016. The identified staffing needs are being addressed and the recruitment of personnel should be finalised **by end-December**. The needs in other business areas of the CBC have been reviewed and the recruitment process will be completed within the framework of the review exercise undertaken by the external consultant.

1.8. Taking into account the formal letter of notice sent by the EC on 27 March 2015, the authorities will finalise without any further delay the transposition into national law of the Bank Recovery and Resolution Directive. The authorities will also ensure as a matter of priority the transposition of the Deposit Guarantee Scheme Directive. The regulatory framework is being reviewed against European best practices and recent experience. In this context, **by end-December**, banking regulations on loan origination will be further simplified.

### **Regulation and supervision of insurance companies and pension funds**

1.9. The authorities will finalise without delay the transposition of Solvency II into national law. In order to streamline non-banking supervision, the authorities will prepare an action plan for the integration of the insurance sector supervision and the pension funds supervision. The options for improving the quality of the non-banking supervision and ensuring appropriate implementation of Solvency II and also for increasing the independence and improving the governance and administrative capacity of the non-banking supervision, taking into account international best practices, was reviewed in a report prepared by the authorities in October 2015. The report sets options for the structure of the new authority and the priorities for next steps. It also presents an inventory of pension funds, their volume and composition of assets, type of pension scheme plan and composition of membership. A legislative proposal will be prepared taking into consideration the recommendations of the report and will be submitted to the House of Representatives **by end-March 2016**. In order for the authority to strengthen its adequate supervision, a review of the insurance undertakings will be conducted during 2016, including a number of on-site inspections covering a high percentage of the insurance market, in the context of the planned 2016 EIOPA EU-wide stress test exercise.

### **Addressing corporate and household indebtedness**

1.10. The Cypriot authorities will continue monitoring 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. The annual Financial Stability Report, including an extended analysis of progress made in dealing with corporate and household indebtedness, will be published **by end-December**. In addition, quarterly monitoring reports will continue to be submitted and their scope and content will be further enhanced.

1.11. Measures are being 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 has been established.

- Banks report **monthly to the CBC** on restructuring progress and management of NPLs, using the agreed specific performance indicators and targets (e.g. number of loans restructured, cash collections, etc.) and 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).
- CBC will ensure continued effective compliance with the Arrears Management Directive and the Code of Conduct.
- In order to allow distressed borrowers to make informed decisions and actively participate in resolving their situation, the authorities together with the Association of Banks, building on earlier work of the Central Bank, will create a user-friendly publication supported by an interactive website that explains the process of debt restructuring, including restructuring tools likely to be proposed by banks, as well as insolvency and foreclosure processes, **by end-December**.
- To ensure that banks offer long-term sustainable restructuring solutions, the CBC has agreed with banks and coops on institution- and portfolio-specific targets for the various phases of the restructuring process on a quarterly rolling basis. For banks under the direct supervision of the SSM, these targets are communicated to the SSM for consultation. These targets were published for the first time in September 2015. In the month following the reporting quarter, the CBC will publish these targets, on an aggregated basis and for the ongoing and following quarters together with the past performance of the banks and an explanation for any possible discrepancy between targets and actual performance, as well as for the revision of the targets. In the course of 2016 the CBC will gradually extend the horizon of the targets to four quarters. Based on the actual and targeted restructuring performance of banks, and relying on the programme's macro-economic projections, the CBC will put in place a framework to analyse the estimated path of system-wide loan restructuring and recovery. Also, **by end-February 2016**, the CBC will study the scope for an extension of the targeting framework to cover troubled assets resolution in addition to existing loan restructuring targets.
- The CBC will review the treatment of accrued interest for supervisory purposes by end-June 2016.
- Following the first reporting exercise, the banks and coops will continue to submit regularly to the CBC in the quarter following the reporting period the reports prepared by their external auditors on the effectiveness of their debt restructuring arrangements and strategies for the periods ending in December 2015, and June 2016. Relying on the finding of the reports, the CBC will assess the appropriateness of restructuring solutions including by peer comparison among the banks covered in these reports and submit to the SSM the findings and recommendations on the banks' internal policies and processes regularly.
- The Cypriot authorities, in view of financial stability considerations and on-going bank restructuring, commit not to introduce any new regulations which would interfere with the setting of bank lending rates. In particular no ceilings on bank lending rates would be introduced. The authorities are assessing the "The liberalisation of the interest rate and other related matters (amending) Law of 2015". If needed, this law will be amended **by end-December** to ensure that the provisions on penalty interest rates are not applicable retroactively.

- **By end-December**, the Ministry of Finance, in cooperation with the Central Bank, will seek to identify potential tax disincentives to debt restructurings for banks, other creditors and borrowers and propose necessary adjustments, while taking into account fiscal implications.
- In order to stimulate a market for distressed assets and to facilitate the issuance of securities by securitisation vehicles, the authorities have carried out an assessment and committed to remove existing impediments. To this end, the following actions will be undertaken.
  - **Prior to the granting of the ninth disbursement of financial assistance**, the House of Representatives will approve a legislation on the sale of loans consistent with the objectives of the draft law as submitted by the government to the Parliament on 30 July 2015 and the CBC will adopt Directives, which will ensure that the application of the law is effective and limits legal risks. Any offer by a borrower to buy back his loan will be non-binding for the seller and strictly time-bound. All procedures related to this law will be defined by the CBC Directives.
  - The identified impediments to the securitisation of assets will be removed and a legal proposal enabling securitisation of assets, in line with international best practices and EU law and in consultation with the EC, ECB and the IMF, and informing the ESM, will be adopted by the Council of Ministers **by end-December** with a view to be adopted by the House of Representatives **by end-January 2016**.

### **Legal framework for private debt restructuring**

1.12. All legal, administrative or other hurdles currently constraining the seizure and sale of loan collateral will 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.

1.13. **By end-November**, the authorities will present to programme partners revised draft legislation for all future title deeds transfers that:

- ensure that property buyers who have paid the purchase price in full, will have their title deeds transferred without delay after title deed issuance,
- put obligations on all parties involved to ensure that the procedures releasing encumbrances and transferring the title can operate without delay, legal uncertainty and as automatically as possible, and
- provide safeguards against abuse, inter-alia by introducing a mandatory escrow account system that will ensure that all payments related to a property transaction are processed in a safe manner, at low operational cost and without delay.

**By end-December**, the legislative proposals regarding all non-legacy title deeds transfers will be adopted by the Council of Ministers. **By end-January**, these will be adopted by the House of Representatives.

The authorities will assess the need for further legislative measures necessary to incentivise

the swift transfer of title deeds, including minimum standards for property sales contracts **by end-November**.

1.14. The authorities will monitor on a continuous basis the implementation and performance of the new insolvency framework and ensure that it supports its objectives and principles, notably speeding up the reduction in the stock of non-performing loans, and reflects international best practice. To this end, the authorities will:

- take steps to ensure the effective functioning of the foreclosure process, including setting-up auction locations **by end-November** and providing for an adequate number of auctioneers,
- ensure that the amendments to the regulations regarding corporate insolvency will be put in place **by end-December**,
- establish, **by mid-December**, a working group comprised of relevant Ministries (incl. Finance, Energy, Commerce, Industry and Tourism, Interior) to conduct an assessment of the functioning and of the first experiences of the private sector debt restructuring and foreclosure frameworks. An action plan of modifications to those frameworks is to be adopted **by end-January 2016** to correct any deficiencies. This assessment will include consultation with relevant stakeholders before the action plan is adopted (the stakeholders should include the Association of Cyprus Banks and the Cyprus Bar Association),
- make the priority adjustments to the insolvency and foreclosure frameworks, including legislative changes, which will be adopted by the Council of Ministers **by end-February 2016**. These adjustments will include:
  - removing any impediments to the effectiveness of the procedures, including measures that weaken incentives for non-viable debtors to promptly engage with the insolvency framework,
  - ensuring that the relief in legacy guarantees does not jeopardise the economic function of guarantees going forward and that the payment capacity of the guarantor is taken into account.

1.15. The authorities (Ministry of Energy, Commerce, Industry and Tourism) will step up efforts in order to minimise the transition period and to ensure the full functioning of the Insolvency Service, including providing adequate staffing, IT infrastructure, and the availability of trained and licenced insolvency practitioners at the earliest possible date. To this end, the action plan as submitted to program partners will be implemented.

1.16. The authorities will recommend and adopt amendments to Court Rules for the effective functioning of the new insolvency framework **by end-December**. The recommendations and action taken by the authorities should also aim at improving the pace of court handling and the reduction of backlogs in courts.

1.17. Within the competencies of the Ministry of Justice and Public Order a consultation committee, comprising of all relevant stakeholders, will be established with the purpose of examining and making recommendations aimed at: (i) the enhancement of the efficiency of court applications in civil and commercial cases (ii) improved and speedier enforcement of court decisions in civil and commercial actions, inter alia, by improved powers for enforcement agents and (iii) enhancement of the availability of financial information to Courts and enforcement agents in the context of the enforcement of court decisions. The

consultation committee will work in close cooperation with the courts service. Relevant amendments to the Civil Procedure Law and any other laws, if deemed necessary, will be adopted by the Council of Ministers **by end-March 2016**, following consultation with programme partners.

## **B. Restructuring of financial institutions**

### **Management of legacy Laiki**

1.18. The Resolution Authority has appointed an investment advisor to manage the sale of Laiki's foreign assets. The appointment of a second advisor to manage the disposal of Laiki's stake in BoC was interrupted by legal proposals to transfer the management of this stake to the creditors and to exit resolution. The authorities should ensure that the resolution process is completed in an orderly manner as originally intended, without creating any risks to the finances of the Resolution Fund and the Deposit Protection Scheme.

### **Restructuring of Bank of Cyprus**

1.19. BoC has progressed with the implementation of its restructuring plan and has continued divesting operations and stakes abroad. Moreover, 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.

### **Restructuring and recapitalisation of cooperative credit institutions**

1.20. Based on the restructuring measures already undertaken, the Cooperative Group will take further steps to improve its operational capacity, in particular with respect to arrears management, governance and efficient company structures and management information systems.

1.21. As regards management of arrears, the Group will ensure at all times an appropriate level of skilled and professional staff. The CCB will strengthen its responsibility for all loans in arrears and, where deficiencies and inconsistencies have been identified, undertake a further centralization of the arrears management of the group.

1.22. Governance will be further strengthened and decision-making processes streamlined to avoid parallel structures and increase the efficiency of the group. To simplify the group structure and further consolidate its control functions in areas such as risk, audit and compliance, further steps will be taken to centralise operations and to increase resources available to these functions. In order to reinforce its group's risk management function, the CCB will adjust its risk policies and procedures, and enhance its capacity and tools.

1.23. The CCB will further improve and upgrade its management information system to strengthen financial control and reporting processes.

1.24. With respect to efficiency enhancing measures, the branch network of the group will be reviewed with the view to a further optimisation of regional coverage and costs.

1.25. The CCB will ensure the continuing implementation of the measures already agreed on the basis of the current restructuring plan in a timely and targeted manner. Progress will continue to be communicated **quarterly** to the public.

### C. Increasing financial transparency

1.26. 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). The competent supervisory authorities are committed to take appropriate remedial and/or enforcement actions whenever breaches of compliance are revealed,
- 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. The CBC intends to swiftly take appropriate actions regarding the local branch of FBME Bank Ltd., following its July 2014 inspection and follow-up visits, and the final rule issued by the U.S. authorities in July 2015.



## **2. Fiscal policy**

### **Key objectives**

The sustainability of public finances is of overriding importance in order to maintain stability in the economy and confidence of companies, citizens and foreign investors in 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 3% of GDP primary surplus in 2017, 3% to 4% of GDP in 2018 and maintain at least such a level thereafter, also depending on debt dynamics; (2) to achieve the annual budgetary targets as set out in this Memorandum of Understanding (MoU) through high-quality permanent measures, in particular reducing 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 correct the excessive general government deficit by 2016; and (4) to maintain fiscal consolidation over the medium term, continuously meeting 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 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,<sup>1</sup> will be saved or used to reduce debt. 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 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

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<sup>1</sup> 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

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 and informing the ESM 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.

### **Fiscal policy in 2015**

Based on the programme's updated budgetary projection, the Cypriot authorities will achieve a general government primary balance of at least EUR 409 million (2.4% of GDP) in 2015, corresponding to a headline balance of -0.8% of GDP (respecting the 16 May 2013 Council Recommendation on correction of the excessive deficit in Cyprus).

The Cypriot authorities will closely monitor and report timely on the fiscal impact of amendments to tax laws that have been adopted in 2015, including,

- the notional interest allowance for new equity, and
- the defence tax exemption for non-domicile tax residents.

### **Fiscal policy in 2016-18**

In 2016 the Cypriot authorities will achieve a general government primary balance surplus of at least EUR 473 million (2.7% of GDP), corresponding to a headline balance of 0.1% of GDP (respecting the 16 May 2013 Council Recommendation on correction of the excessive deficit in Cyprus).

The Cypriot authorities will achieve a general government primary balance of 3% of GDP in 2017 and 3% to 4% of GDP in 2018, also depending on debt dynamics.

After review by and consultation with the programme partners, the 2016 Budget Law will be adopted **by December 2015**. Ceilings for the period 2016-2018 will be established and will accompany the 2016 Budget Law document. Any deviation from the budgetary objectives contained in the 2016-2018 framework will be properly documented and reasons for such deviations will be provided to the programme partners.

### 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 improve the efficiency and coverage of the healthcare system, while controlling 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:

- **by January 2016**, and taking into account the related WHO studies, the hospital autonomisation bill will be adopted by the Council of Ministers and submitted to the House of Representatives,
- a detailed road map for the implementation of hospital autonomisation will be submitted to programme partners **by January 2016**,
- **by January 2016**, the detailed restructuring plan of the public primary healthcare centres will be prepared for consultation with programme partners, based on the recommendations put forward in the respective report,
- the authorities will continue delivering quarterly reports assessing the collection of

private co-payments and compulsory health-care contribution for public servants and public servant pensioners,

- the Implementation Advisory Team will, in close cooperation with the Support Group for Cyprus, assist the Ministry of Health with the implementation of healthcare reforms and hospital autonomisation. Further, the Cypriot authorities will consult in a timely manner with programme partners and provide all necessary information.

Taking into account the economic conditions, the implementation of the necessary complementary reforms, the results of the updated actuarial study, a National Health System (NHS) will be implemented to be fully in place in 2018. 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. NHS will be initially based on a single payer system. A multiple insurance system can be implemented if and when the necessary preconditions for achieving fiscal sustainability as well as efficiency and affordability gains (i.e. consumer information and transparency, contestable markets, freedom to contract, competition regulation and risk-adjustment) can be ensured. The authorities will take a decision on the final design of NHS and adopt the relevant legislations according to a timetable that will ensure implementation of the NHS in 2018. In order to ensure that the final design of the NHS is fiscally sustainable, the Council of Ministers will adopt, after consultation with programme partners, a binding set of contingency measures under NHS (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), which will ensure that the agreed budget limits of public health expenditure are not exceeded, whilst equitable access to healthcare is guaranteed.

### **Public financial management**

3.3. The Cypriot authorities will:

- improve further the risk-assessment analysis and management associated with government guarantees. To this end, the Cypriot authorities will update **by January 2016** the risk assessment report, taking into account methodological recommendations from technical assistance provided by the ESM,
- continue with the implementation of the action plan as approved by the Council of Ministers in September 2015 for strengthening sound practice standards for the Public Debt Management Office as well as for enhancing Public Debt Management Office's market intelligence function (investor relations, communication of market information), 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**

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 Q1-2016**. 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.

## **Privatisation**

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 enhance debt sustainability. The plan includes the privatisation of, inter alia, CyTA (telecoms), EAC (electricity), the commercial activities of the port of Limassol, as well as land assets. CyTA and the commercial activities of the port of Limassol will be privatised within 2016 and EAC by mid-2018, subject to the Decision of the Council of Ministers regarding unbundling referred to in par. 5.4.

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. Privatisation will be conducted in conformity with State aid rules, as required by the Commission's Guidance Paper.<sup>2</sup>

The privatisation plan identified by the Government after consultation with the programme partners is expected to raise EUR 1 billion **by the end of 2016** and an additional EUR 400 million **by 2018 at the latest**, which will be used for public debt reduction.

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

- ensure that the Privatisation Unit is fully operational, in line with the objectives and provisions of the Privatisation Law,
- for the privatisation of Cyprus's Telecommunications Authority (CyTA):
  - **prior to the granting of the ninth disbursement of financial assistance, conclude all necessary legislative and practical arrangements**, with a view to launching the call for the expression of interest for CyTA by January 2016. To this end:
    - adopt by the House of Representatives the legislation for CyTA's corporatisation,
    - submit to the House of Representatives the legislation related to the future employment conditions of CyTA employees. This legislation will be adopted by the House of Representatives by end-January 2016,

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<sup>2</sup>[http://ec.europa.eu/competition/state\\_aid/studies\\_reports/swd\\_guidance\\_paper\\_en.pdf](http://ec.europa.eu/competition/state_aid/studies_reports/swd_guidance_paper_en.pdf)

- prepare, through the Inter-Ministerial Committee, and on the basis of the recommendations of the advisers, the privatisation structure and the transaction strategy.
- for the concession of Limassol Port's commercial activities:
  - amend CPA's newly-adopted regulatory framework **by November 2015**, after consultation with programme partners, and notification to the relevant European Commission services,
  - select the final bidder **by March 2016**, sign the concession agreement, and have the transaction approved by the House of Representatives **by April 2016**.
- for the sale of land assets:
  - the Council of Ministers will adopt the plan detailing the intermediate steps and timings for disposing of the identified land assets **by December 2015**,
  - the Council of Ministers will select, **by December 2015**, a single central government unit tasked with managing the process for the sale/ lease of the selected land assets.
- for the effective and efficient unbundling of the Electricity Authority of Cyprus, see section 5.4.

### **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.

Based on the comprehensive compliance strategy developed, the authorities will ensure its implementation **by Q4-2015**, and continue to develop thereafter. 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, as demonstrated in a preliminary risk analysis report prepared in October 2015. The final draft of the report will be communicated to the programme partners **by December 2015**. The authorities will,

- implement their new debt collection action plan, with a view to reducing collectible and unencumbered debt, while continuing the pilot run on garnishing of bank accounts, and prepare the next quarterly progress report on the action plan's implementation **by Q4-2015**, and
- implement the action plans by each of the headquarter units in the Design and Monitoring Division, outlining the steps to implement the compliance strategy in the Tax Department, including reallocating staff where necessary, training of staff, and preparing a progress report **by December 2015**.

To progress with the operationalisation of the integrated and function-based tax agency, in line with the adopted integration plan, the following steps will be taken:

- **by November 2015**, the single registration process will be fully operational, and

- the new tax procedure code, consistent with the compliance strategy and future business processes, will be submitted for legal vetting **by December 2015** and adopted by the Council of Ministers **by January 2016**.

There currently exist significant backlogs in the assessment of tax returns by the Cyprus Tax Department. The authorities will present an action plan **by Q4-2015**, in which they will present the concrete steps they will take to reduce the backlogs.

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 continue enhancing the practice of timely delivery of relevant and accessible tax information to other EU Member States. The authorities will:

- continue the good progress in administrative cooperation and combating fraud in the field of value-added tax and 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,
- 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 Q4-2015**, and

Following the reversal of the negative opinion by the OECD Global Forum in the Global Forum annual plenary meeting the authorities will continue monitoring closely the progress achieved, including in responding timely to tax information requests.

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 imposed on paying agents for their application of the EUSD. **By Q4-2015**, the Cypriot authorities will provide to the European Commission a report on the results of audits of at least 4 out of the total of 16 paying agents established in Cyprus.

### **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.

- **By Q1-2016**, the House of Representatives will adopt the legislation on the reformed recurrent immovable property tax with effect for the 2016 collection, based on the most updated General Valuation for all immovable properties. The new immovable property tax should be based on the recommendations of the study on the consolidation of property taxes, should ensure a broad tax base and should be fiscally neutral, taking also into account the reduction of the transfer fee,

- the House of Representatives will adopt **by Q1-2016**, legislation specifying the frequency of the mandatory update of the cadastral values to three years maximum from 2018 onwards,
- continue the assessment of the relevance of the parameters used in the Computer Assisted Mass Appraisal (CAMA) model for the General Valuation, on a quarterly basis.

### **Public administration reform**

3.9. The Cypriot authorities have commissioned and will commission reviews of possible further reforms of the public administration. The reviews include a horizontal and a sectoral element.

Based on the findings of the horizontal review submitted in 2014, the Council of Ministers adopted a reform plan and submitted draft legislation to the House of Representatives based on the following principles:

- safeguard the fiscal sustainability of the public sector wage bill and the consistency with the medium-term fiscal targets. This will be ensured by reforming the wage setting mechanism and make salary increases subject to overall economic and fiscal conditions on the basis of objective indicators. The mechanism will ensure that the compensation of employees in the general government as a share of GDP will remain on a descending path over the medium-term,
- introduce a new appraisal system and a new promotion system that will establish a stronger link between merit and promotion by: (i) widening the base of eligible candidates, (ii) increasing the weight of merit in promotion decisions, including by introducing objective assessment criteria, written exams and/or assessment centres, and (iii) by involving more directly the Heads of Departments in promotion decisions,
- enhance staff mobility, by: (i) opening the promotion posts to the wider civil service, (ii) introducing a system of transfers within the public sector, (iii) a wider use of secondments and duty assignments, and (iv) ensuring that mobility is taken into account in the assessment of relevant experience in promotion decisions.

The legal proposals based on the reform plan will be adopted by the House of Representatives **by December 2015**.

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 will comprise two batches:

- the first batch has consisted of the review of the Ministries of Agriculture, Education and Health, as well as local government and the Department of



Registrar of Companies. The reforms of Ministries of Agriculture, Education, and local government indicated as high priority will be implemented **by Q1-2016**. For the local governments the implementation plan will be amended by the Ministry of Interior **by December 2015**, after consultation with the programme partners so as to include a fiscal impact study.. The restructuring plan of the Companies Registrar will be finalised **by January 2016** and will start to be implemented **by March 2016**,

- the second batch covers 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 (former Planning Bureau) being covered under the PFM. The second batch includes also all SOEs, as well as the Constitutional and Independent Services (see Annex for detailed list). The results of the second batch will be presented **by December 2015** for all, except for the Constitutional and Independent Services, which will be presented **by March 2016**, with the exception of the Tender Review Authority. All results will include 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 March 2016**, except from the Constitutional and Independent Services, which will be approved by the Council of Ministers **by May 2016**. The relevant legislation in relation with the reforms indicated as high priority will be adopted by the House of Representatives **by June 2016**. The reform will start to be implemented **by September 2016**, in accordance with the reform plan. For the Tender Review Authority, the results will be presented **by Q2 2016**, they will be submitted to the Council of Ministers **by July 2016** and they will be submitted to the House of Representatives **by September 2016**.

### Welfare system

3.10. The Cypriot authorities introduced a Guaranteed Minimum Income (GMI) aimed at strengthening the protection of vulnerable households while ensuring an appropriate balance between welfare benefits and work incentives. Besides the introduction of the GMI, the adopted welfare reform plan also includes measures aimed at consolidating and streamlining other social benefits, and at improving the targeting of these benefits.

To continue the implementation of the adopted welfare reform and monitor the implementation of the GMI, including its fiscal impact, the Cypriot authorities will take the following steps:

- the monitoring unit will continue providing quarterly costing updates of the GMI, at the end of each quarter, next update due **in Q4-2015**,
- pursue the adoption of a unified legislative and administrative framework for all disability benefits, in line with the adopted welfare reform and the plans laid out by the Ministry of Labour and Social Insurance. The new framework will be budget neutral and consistent with the achievement of the medium-term budgetary targets. Following consultation with stakeholders and programme partners the unified legislative framework will be submitted to the House of Representatives in due time for its adoption **by April 2016**. The disability benefits will be based on

clear eligibility criteria as well as an evaluation and certification of disability,

- the House of Representatives will adopt **by December 2015**, the legislation consolidating the student grant, the student package and the benefits previously administered by the Cyprus Scholarship Foundation into one scheme, with a view to implementing the single scheme for the academic year 2015-2016,
- **by November 2015**, the monitoring unit will provide an assessment report of the GMI and an analysis of the profile and coverage of beneficiaries,
- on the basis of a single view on social benefits under various ministries, drawing on their respective registries of benefits, **by Q1-2016**, the monitoring unit will finalise an assessment report of the welfare reform, including possible refinements in administrative structures and benefits.

## **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. Any legislative changes affecting existing conditions of employment or wages will be shared for consultation with programme partners.

### **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. Wage indexation has been suspended in the private sector until end-2016. A tripartite agreement will be pursued with social partners by **Q4-2015** to ensure that the reformed wage indexation system (COLA) applicable to the public sector (lower frequency of adjustment, suspension at times of recession and partial indexation) is also adopted by the private sector when the period of COLA suspension ends.

### **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:

- continuous monitoring and evaluation of all activation measures, in accordance with the newly adopted comprehensive methodology. A first report on the implementation of the monitoring system will be prepared for consultation with programme partners **by Q4-2015**,
- measures to enhance the administrative capacity of the public employment services. In this regard, as follow-up to the description of all actions taken or envisaged in the short-term to improve the provision of PES services prepared for consultation with programme partners, the project fiche for the enhancement of PES under the ESF 2014-2020 Operational Programme will be finalised **by Q4-2015**, subject to the availability of the template and guidelines. The draft fiche will be shared with program partners for consultation, prior to submission to the managing authority. In addition, the tender for the recruitment of additional staff, through the 2014-20 ESF Operational Programme budget, will be launched **by mid-December 2015**, and all staff will be operational **by May 2016**, and
- the effectiveness of the measures taken 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 will be assessed through the systematic analysis of statistics, including the number of cases referred to PES for activation, activation success rates of GMI recipients and GMI savings due to activation, as well as failure cases and reasons, starting **in Q1-2016**.

4.5. Having experienced one of the steepest increases in the youth unemployment rate in the EU, and a rapid rise of young people not in employment, education or training (NEETs), Cyprus was urged to take swift action to create employment opportunities for young people and improve their employability prospects. To this end, the Cypriot authorities have recently adopted a National Action Plan for Youth Employment, which includes, inter alia, measures envisaged for support under the Youth Employment Initiative covering 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 update for consultation with programme partners the comprehensive list of all active labour market policies for the period 2015-2017, including objectives, target group, recipients per year, budgetary allocations, and call dates, **by Q4-2015**.

## **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.

### **Competition, transparency and sectoral regulatory authorities**

5.1. 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**

5.2. 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. Resolving the backlog in issuing title deeds requires legislative action. In addition, streamlining of building and planning procedures, also in the context of local

government reform, will minimise the risk of building up new backlogs in the future.

The Cypriot authorities will:

- aim at reducing the title deed issuance backlog of immovable property units from development projects pending<sup>3</sup> for more than six months to less than 3,500 units **by Q4-2015**. To that end, the Cypriot authorities will continue to provide to programme partners analytical data on the stock of backlogs of permits, deeds, certificates, and mortgages associated with the underlying properties and continue publishing the quarterly progress reviews. From **January 2016** onwards, at least 3,000 titles will be issued per month to reduce the backlog on remaining projects,
- ensure that based on the recommendations by the working group on title deeds, the following actions will be taken on removing bottlenecks to title deed issuance, and thus
  - the Cypriot authorities will present to programme partners draft legislation on enforcement and remedy periods regarding non-certified completed buildings, as well as unauthorized works **by mid-December 2015**. Where parliamentary ratification is required, the corresponding legislation will be adopted by the House of Representatives **by mid-February 2016**,
  - the Cypriot authorities will present to programme partners draft legislation to enforce the timely issuance of building compliance certificates by the relevant authorities **by mid-December 2015**. The legislation will be adopted by the House of Representatives **by mid-February 2016**,
  - the House of Representatives will adopt **by mid-February 2016** amendments to the Streets and Building Permits law that ensure the timely issuance of certificates of completion by the supervising engineers, also with view to expand self-certification,
  - the Minister of Interior will issue ministerial decree by **mid-December 2015** that defines an exhaustive list of what constitutes unauthorized works, with retroactive effect covering also all past pending cases, ensuring that the rest of deviations will not prevent the certification process,
- moreover, the authorities will present a progress report **by Q1-2016**, on the further comprehensive streamlining of building, planning and title deed procedures from 2016.

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<sup>3</sup>Development projects refer to original titles with at least three contracts of sales deposited at DLS; pending refers to (i) applications for title deeds issuance, (ii) units that are eligible for the "ex-officio" issuance of title deeds, required certificates and permits.

## Tourism

5.3. 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 as part of the Action Plan for Growth. To that end, the Cypriot authorities will:

- present a progress report on the implementation of the tourism sector's action plan in **March** and **September 2016**,
- provide a first draft of all legal amendments to the current regulatory framework governing the tourism sector (including the CTO law), in order to remove impediments to competition in the tourism sector **by January 2016**. All relevant legal amendments will be adopted by the Council of Ministers **by March 2016**,
- in order to prepare a national tourism strategy, the interim report of the study on the tourism sector will be submitted for consultation to the programme partners **by March 2016**, with a view to conclude it **by September 2016**,
- continue implementing an aeropolitical strategy leading to the adaptation of Cyprus's external aviation policy, taking into account the EU external aviation policy and the EU aviation agreements, while ensuring sufficient air connectivity.

## Energy

5.4. The Cypriot authorities will:

- ensure that following its transposition the Third Energy Package will be fully and correctly implemented without delay,
- 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. The plan will be updated on a continuous basis to account for new developments.

Prior to approving the Field Development Plan (FDP) of the Aphrodite gas field, the Cypriot authorities will undertake a financial and budgetary impact analysis of the FDP. The impact assessment will evaluate in detail the potential financial and budgetary impacts on the general government position as well as financing arrangements of the investment project chosen, with a particular focus on budgetary commitments that may arise.

2. a *comprehensive outline of the regulatory regime and market organisation* for the restructured electricity and gas sector, with a view to introducing open, transparent, competitive energy markets. The outline was provided by Q4-2014 and lays out different options for the regulatory regime and market organisation. Based on this

document, the Cypriot authorities will take a decision on the preferred option, taking into account the latest developments and the envisaged timeline for EAC unbundling.

The authorities will:

- submit the draft final study on the unbundling and ownership structure of EAC for consultation with programme partners **by November 2015**. The study will comprise an international benchmarking, including cost structures of comparable electricity companies operating in a similar environment,
  - taking into account the study, and in consultation with programme partners, the Council of Ministers will, **prior to the granting of the ninth disbursement of financial assistance**, take a decision in principle on the preferred form of unbundling, which ensures the customer's free choice of supplier and guarantees non-discriminatory access to energy networks to the benefit of suppliers and customers in line with the principles of the Third Energy Package of effective and efficient unbundling<sup>4</sup>. The Council of Ministers' decision will take into account the overall impact on the economy, the need to introduce effective competition in the electricity market and the economic and regulatory efficiency gains of the preferred form of unbundling of EAC's operations. In consultation with programme partners, the Council of Ministers will adopt **by January 2016** an implementation plan for the effective and efficient unbundling of EAC. This plan will provide for detailed and time-bound milestones. It will also highlight the regulatory and legislative measures necessary for implementing the unbundling on time,
  - submit to the House of Representatives **in 2016** whatever legislation is necessary to implement the preferred form of unbundling of EAC with a view to full implementation of the unbundling no later than 2017.
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-recognised best practices. The resource fund, established in the FRBSL, 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 are provided for in the FRBSL, but will be detailed in implementing legislation of FRBSL, which will be submitted to the House of Representatives **by January 2016**. The resource fund law, which defines the governance structure of the resource fund, will be submitted to the House of Representatives **by January 2016**.

## 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 may provide updated requests for technical assistance needs during the programme period and thereafter, including the on-going technical assistance projects. These requests should identify and specify the areas of technical assistance or advisory services, which the Cypriot authorities consider essential, and where they intend to seek such technical assistance services. 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 Structural Reform Support Service.

## 7. Growth Strategy

7.1. Cyprus is developing a Growth Strategy in order to identify existing bottlenecks and key drivers of growth, based on the country's comparative advantages, and to provide concrete recommendations to support growth, including ways to improve the business environment. The strategy will be designed and implemented in conjunction with national stakeholders and in line with the country's National Reform Programme. To this end, the authorities will present an updated progress report to programme partners **by December 2015**, reflecting the progress in implementing the Presidency's Action Plan for Growth. As included, among others, in the Action Plan for Growth, the Council of Ministers will approve a National Policy Statement on entrepreneurship **by November 2015**. The authorities will prepare the Policy Framework for Facilitating Strategic Investments **by December 2015** and present a progress report on the implementation of the Action Plan for Smart Regulation **by May 2016**.

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<sup>4</sup> See Annex 4.

## **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 <b><u>Customer Due Diligence</u></b>		
1.1 <b>Business profile</b> 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 <b>Customer risk profile</b> 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
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 <b>Ongoing CDD</b> 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	<b><u>Reliance/introduced business</u></b> Use of introducers allowed by CY legislation and is widespread. Training/awareness in institutions.	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
		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.	Compliant
		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.	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	<b><u>Suspicious Transaction Reporting</u></b> 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	<b><u>Transparency of beneficial ownership</u></b>		
4.1	<b><u>Access to information</u></b> 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).	Compliant
		4.1.2. In the case of nominees, either a) require nominee directors <sup>5</sup> 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

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<sup>5</sup>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	<b>Company Registry</b> 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  Ongoing
4.3	<b>Register of Trusts</b> 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	<b><u>Supervision of financial institutions</u></b>		
5.1	<b>Revise the AML/CFT supervisory structure within the CBC, ensuring it is adequately resourced</b>	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, <sup>6</sup> in order to conduct adequate, timely and proactive risk-based AML/CFT supervision.  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. <sup>7</sup> 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. <sup>8</sup>	Compliant  Compliant

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<sup>6</sup> in accordance with BCP 2 and FATF 26-27

<sup>7</sup>FATF Immediate Outcome (IO) 3

<sup>8</sup>See BCP 2.6c

5.2	<b>Develop risk-based supervisory tool(s) for offsite surveillance/monitoring activities prior to implementation</b>	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"> <li>- a comprehensive analysis of inherent ML/TF risks within the following risk factors: customers, products &amp; services, geographic locations/areas,<sup>9</sup> and delivery channels;</li> <li>- 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;</li> <li>- institutional risk profiles;</li> <li>- specific AML/CFT supervisory strategies (adapted to institutional risk profiles).</li> </ul>	Compliant
5.3	<b>Develop risk-based supervisory tool(s) for onsite inspections prior to implementation</b>	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"> <li>-Corporate Governance;</li> <li>-Risk Assessment Systems;</li> <li>-Policies &amp; Procedures;</li> <li>-Compliance Function;</li> <li>-Internal &amp; External Audit Functions;</li> <li>-Training Program.</li> </ul>	Compliant
5.4	<b>Establish Formal AML/CFT Training Program</b>	5.4.1 Establish a formal AML/CFT training program for CBC staff to ensure adequate implementation of the offsite and onsite tools. <p>Develop and deliver customised AML/CFT training to supervisory staff in topics including, but not limited to:</p> <ul style="list-style-type: none"> <li>- newly developed offsite and onsite risk-based tools;</li> <li>- customer acceptance policies;</li> <li>- customer due diligence (CDD);</li> <li>- monitoring of transactions;</li> <li>- identification and reporting of STR;</li> <li>- funds transfers;</li> <li>- correspondent banking;</li> <li>- recordkeeping;</li> <li>- compliance function;</li> <li>- internal controls;</li> <li>- audit functions;</li> <li>- corporate governance;</li> <li>- risk assessment systems</li> </ul>	–Compliant

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<sup>9</sup> 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).

	5.4.2 Provide CBC supervisory staff with ongoing training to ensure adequate knowledge of risks and supervisory techniques.	Ongoing
5.5 <b>Implement adequate supervision</b>	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.	Compliant
	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. Subsequent to the successful development of the tools stipulated under 5.2 and 5.3, the CBC will undertake the following:	Ongoing
	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.	Compliant
	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.	Compliant
	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.	Compliant
6. <b><u>Supervision and monitoring of lawyers, accountants and TCSPs</u></b>		
6.1 <b>Align resources with risks</b>	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.	Compliant (CBA) Ongoing (CySEC, ICPAC)
6.2 <b>Establish an effective monitoring structure for AML/CFT matters</b>		
6.2 <b>Develop risk-based tool(s) for Offsite surveillance/monitoring</b>	6.2.1 Design, develop, adopt, and pilot a risk assessment methodology and tool(s) that provides for: <ul style="list-style-type: none"> <li>- a comprehensive analysis of inherent ML/TF risks within the following risk factors: customers, products &amp; services, geographic locations/areas, and delivery channels;</li> </ul>	Compliant

	<b>activities prior to implementation</b>	<ul style="list-style-type: none"> <li>- 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;</li> <li>- risk profiles;</li> <li>- specific AML/CFT monitoring strategies (adapted to institutional risk profiles).</li> </ul>	
		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.	Compliant
		6.2.2.2 Assign ML/TF risk profiles to businesses and professionals reviewed under the pilot exercise.	Compliant
		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
6.3	<b>Develop risk-based tool(s) for Onsite inspections prior to implementation</b>	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"> <li>- Risk Assessment Systems</li> <li>- Policies &amp; Procedures</li> <li>- Compliance Function</li> <li>- Training Program</li> </ul>	Compliant
6.4	<b>Establish Formal AML/CFT Training Program</b>	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: <ul style="list-style-type: none"> <li>- newly developed offsite and onsite risk-based tools</li> <li>- customer acceptance policies</li> <li>- customer due diligence (CDD)</li> <li>- monitoring of transactions</li> <li>- identification and reporting of STR</li> <li>- recordkeeping</li> <li>- compliance function</li> <li>- risk assessment systems etc.</li> </ul>	Compliant (CySEC) Ongoing (CBA, ICPAC)
6.5	<b>Implement adequate supervision</b>	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
		Subsequent to the successful development of the tools stipulated under 6.2 and 6.3, the Supervisory authorities will undertake the following:	Compliant

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 2015

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. Compliant

### **Annex 3**

#### **The Public Administration Review: Second Batch of Studies**

The second batch of studies will cover the following areas:

##### **Ministries and the Departments/Services falling under each Ministry**

Ministry of Labour, Welfare and Social Insurance

Ministry of Transport, Communications and Works

Ministry of Energy, Commerce, Industry and Tourism (excluding the Companies Registrar and Official Receiver, to be covered in the first batch of studies)

Ministry of Interior

Ministry of Defence (excluding the National Guard and Cyprus Army)

Ministry of Justice and Public Order

Ministry of Foreign Affairs

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

##### **Constitutional Powers/Services**

Law Office

Audit Office

Public Service Commission

##### **Independent Services/Authorities**

Educational Service Commission

Internal Audit Service

Office of the Commissioner for Administration (Ombudsman)

Office for the Commissioner of Personal Character Data Protection

Tender Review Body

Refugee's Review Body



**Annex 4: An example of effective and efficient unbundling**

