Ref. Ares(2019)7014753 - 13/11/2019

EUROPEAN COMMISSION
DIRECTORATE-GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

Brussels, 12 November 2019

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CYPRUS — REVIEW OF PROGRESS ON POLICY MEASURES RELEVANT FOR THE CORRECTION OF MACROECONOMIC IMBALANCES

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Executive summary

The 2019 Specific Monitoring Report for Cyprus reviews the policy initiatives taken to correct the macroeconomic imbalances identified by the in-depth review included in the 2019 Country Report. In February 2019, Cyprus was found to be experiencing excessive macroeconomic imbalances, in particular involving vulnerabilities from high non-performing loans and large stocks of public, private and external debt - in a context of relatively high, even though declining, unemployment and weak potential growth. The 2019 Country-Specific Recommendations to Cyprus are considered relevant for unwinding these imbalances.

Strong economic growth, albeit moderating, supported the unwinding of some imbalances, but vulnerabilities persist. After a solid 4.1% real GDP growth in 2018, growth is slowing down due to external headwinds. Domestic demand held up well. External headwinds are expected to continue, leading to a more moderate growth in 2019 (2.9%) and in 2020 (2.6%). Inflation remains subdued. Potential growth is gradually increasing and the unemployment rate is rapidly falling on the back of the current economic expansion.

External debt remains large while the current account deficit is widening. The current account deficit was 4.5% of GDP in 2018 and widened significantly to 7.8% of GDP in the second quarter of 2019, amid intense competition in the tourism sector and strong import demand. This widening of the current account deficit is expected to further accelerate in 2020. The net international investment position (NIIP) is falling, but at a moderate pace, supported mostly by nominal growth and valuation effects, the latter being rather cyclical. The NIIP, excluding the special purpose entities, improves, but the negative position is still in excess of the threshold.

Public and private debt are coming down but remain elevated. The public debt-to-GDP is projected to fall below 95% of GDP in 2019 and continue decreasing over the coming years, driven by large projected primary surpluses and a favourable interest rate-growth differential (snowball effect) supported by robust real growth. The private sector is deleveraging as well, helped by GDP growth, write-offs of bad loans, cash repayments and debt-to-asset swaps. Nevertheless, private indebtedness in Cyprus is still at very high levels – above 260% of GDP (in unconsolidated terms) as of Q2 2019.

Progress in reducing non-performing loans in the banking sector has been slow through the year, but is set to accelerate in 2020 assuming that the announced asset disposals take place. With an NPL ratio of 30.8% as of May 2019, reducing the NPLs remains a priority. The two largest banks are currently working on preparing large-scale portfolio sales, which could imply a significant decline in their NPLs in 2020, if successful. The ESTIA scheme, which aims to address the NPLs collateralised by primary residences, could also support the reduction in the stock of bad loans, if successful.

Overall, policy progress differs substantially across areas. Regarding reduction of NPLs, the government continues to follow the three-pillar strategy introduced in 2018. In particular, the authorities are working on implementing the ESTIA scheme, for which applications are open until mid-November 2019. They are also progressing, albeit slowly, with making the state-owned asset management company, KEDIPES fully operational. The foreclosure framework, which was strengthened in 2018, is crucial for enhancing the payment culture, necessary for underpinning a sustainable NPL and

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private debt reduction. The August 2019 amendments on the foreclosure legislation – which could weaken the framework – are in the 'wait-and-see' category of measures (see Table 1) as there is uncertainty on their implementation. Other measures in this category, which are ongoing, include enhancing the efficiency of the insolvency service, improving the financial information on borrowers, increasing the capacity of courts and tackling the backlog of cases. Faster progress is desired in areas such as the justice system – in particular the execution of rulings, reforming the current system for issuing and transferring title deeds, and simplifying the procedures for obtaining buildings and spatial permits (see 'action wanted' category of measures in Table 1). Furthermore, policy measures to improve the business environment and attract investment also need to be stepped up.

Table 1: Key findings on implementation of policy reforms [1]

On track	Wait-and-see	Action wanted
• Implementing the 3-pillar NPL reduction plan. • Allowing access of credit acquiring companies to the Credit Registry. • Reducing the public debt, by maintaining a strong fiscal performance and through active debt management operations. • Operation of the equity fund. • Adoption of a long-term strategy for growth.	• ESTIA scheme, which addresses the NPLs collateralised by primary. • August 2019 amendments on the foreclosure framework. • Enhancing the efficiency and effectiveness of the insolvency service. • Enhancing the existing information systems dealing with credit information on borrowers; improving the information on the financial position of borrowers. Promoting the insolvency framework • Increase the capacity of courts and create a taskforce to tackle the backlog of cases. • Creation of Commercial Courts and a Court of Appeal. • Adopt horizontal public administration reform. • Adoption of the law facilitating strategic investments. • Operation of the Deputy Ministry of Innovation and Digital Policy. • Adoption of a legal framework and strategy for PES.	• Fully operationalize the state-owned asset management company, KEDIPES. • Ensure reliable and swift systems for the issuance and transfer of title deeds. • Simplify the procedures of obtaining building and spatial permits. • Adopt an ambitious local government reform. • Strengthen the legal framework for the enforcement of Court decisions. • Implementation of e-justice • Revision of Rules of Civil Procedure. • Measures to promote mediation. • Implementation of privatisation projects.

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1 The table classifies reforms under review on the basis of their respective adoption and implementation process, uncertainty and their level of detail. "On track" are measures for which the legislative or implementation process has been completed or is progressing well according to the foreseen timeline, and which are expected to be sufficiently effective. "Wait and see" are measures for which the legislative process is on-going, but is still in a relatively early phase, or measures for which there is still uncertainty on the complete implementation and effectiveness. "Action wanted" are measures for which limited or no action has been taken, or measures that have been announced but which are not sufficiently detailed yet to be assessed.

1. Introduction

In the context of the Macroeconomic Imbalance Procedure (MIP), the European Commission published its eighth Alert Mechanism Report in November 2018, selecting Cyprus as one of the Member States for an in-depth analysis into the evolution of its macroeconomic imbalances. The In-depth Review within the 2019 Country Report on Cyprus – published on 27 February 2019 – examined the nature, origin and severity of imbalances and risks in the country. At the same time, the Commission in its Communication – published on 27 February 2019 – reconfirmed that Cyprus was experiencing excessive macroeconomic imbalances. In particular, the Commission emphasised vulnerabilities linked to the still high level of non-performing loans and the significant stock of private, public, and external debt hanging over the economy – in a context of relatively high, even though declining, unemployment and weak potential growth.

In April 2019, Cyprus submitted its Stability Programme and National Reform Programme relating to its budgetary plans and economic policy measures, respectively. Based on an assessment of these plans, and in light of the 2019 Country Report on Cyprus, the Commission proposed a set of five country-specific recommendations (CSRs), which were adopted by the Council on 9 July 2019. These recommendations concern a wide range of policy areas that are relevant to address imbalances: the public sector (CSR1), non-performing loans (CSR2), the labour market and education (CSR3), investments and the business environment (CSR4), as well as the judicial system, property rights and fight against corruption (CSR5).

The Commission's post-programme surveillance mission in Cyprus, conducted between 16-20 September 2019, served the purpose of specific monitoring under the MIP. This report assesses the latest key policy initiatives undertaken by the Cypriot authorities for addressing the identified imbalances. The cut-off date of this report is 24 October 2019.

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2. Outlook and recent developments on imbalances

While remaining strong, economic growth in Cyprus is decelerating. After a solid 4.1% real GDP growth in 2018, growth slowed down in the first half of this year, 3.4% Q1 and 3.2% Q2. The weakness came mainly from the external environment, while domestic demand held up well. External headwinds are expected to continue, leading to a more moderate growth in 2019 (2.9%) and in 2020 (2.6%). HICP inflation during the first three quarters of the year remained low as prices of non-energy industrial goods continued falling amid high competition. Regarding energy, higher oil prices pushed up energy prices in the first half of the year but are expected to decrease in the second half. As a result, HICP inflation is projected to remain low for the year as a whole, at 0.6 %.

The large net international liabilities declined somewhat, but the current account deficit is large. The current account deficit was 4.4% of GDP in 2018 and widened significantly to 7.8% of GDP in the second quarter of 2019 (based on the rolling sum of four quarters). The activities of special purpose entities (SPEs)[2] accounted for 1% of the current account deficit in 2018, according to the Central Bank of Cyprus. However, the non-SPEs part of the current account balance has recently widened due to a fall in the revenues from tourism and strong domestic demand for imports, to -3.5% of GDP in 2018 and -5% the second quarter of 2019 (based on the rolling sum of four quarters). The net international investment position (NIIP) decreased somewhat to -124% of GDP in 2018 and -118.2% of GDP in the second quarter of 2019 driven by both an increase in financial assets and a fall in loans of NFCs, supported mostly by nominal GDP growth and valuation effects. It is important to note that out of this around 83 % of GDP corresponded to the NIIP of non-financial, ship-owning SPEs.

The non-performing loans (NPLs) in the banking sector declined only marginally in 2019 compared to the large reduction in the previous year.[3] In May 2019 the stock of NPLs stood at EUR 10.1 billion (equivalent to an NPL ratio of 30.8%), remaining very close to the end of 2018 level of EUR 10.2 billion (an NPL ratio of 30.3%).[4] The largest volume of NPLs belong to households, amounting to EUR 5.1 billion or 37.7% of gross loans to households. For non-financial corporations they are lower, at EUR 4.7 billion or respectively, a NPL ratio of 31.4%. Resolving the remaining bad loans continues to be challenging as most of these NPLs are classified as 'terminated' by the banks (i.e. no feasible negotiation options remaining). In addition, many of these NPLs are collateralised by residential properties — for which foreclosures are seen as more difficult (compared to other types of collateral such as

[2] SPEs are legal entities that have limited operations. They relate to corporations, often subsidiaries, which are typically located in other jurisdictions. In Cyprus there are three major types: (i) financial companies, mainly financing and holding companies that channel funds within a worldwide group on behalf of a non-resident parent company, (ii) ship-owning companies (non-financial companies), and (iii) factoring and invoicing companies that are invoicing the sales of the worldwide group on behalf of the parent.

[3] In 2018 the NPL stock of the banking sector declined significantly due to one-off measures, such as portfolio sales and the Cyprus Cooperative Bank transfer of NPLs into the State-owned asset management company, KEDIPES.

[4] The NPL ratios (i.e. NPL stock to total gross loans) referred to in this report are based on the data and definition from the Central Bank of Cyprus (CBC). In particular, exposures of banks to central banks and credit institutions and banks' overseas operations (branches and subsidiaries situated abroad) are not taken into account in the NPL ratios. Thus, figures differ from the ratios referred to in the 2019 Cyprus country report, which is based on the European Central Bank data and definition.

land). Looking forward, progress in reducing the NPLs relies on further portfolio sales, successful loan restructurings and on the ESTIA scheme — the State support scheme for NPLs backed with primary residences. The two largest banks are currently working on preparing large-scale portfolio disposals, which could imply a significant decline in NPLs held by the banks in 2020, if successful.

While declining, the private sector debt level remains high. In consolidated terms, the private debt-to-GDP ratio has been falling in the last years, reaching 282.6% of GDP at the end of 2018, relative to an EU average of 138.3% of GDP. The source of over-indebtedness is both households and non-financial corporations (NFC). In Q2-2019, household debt to GDP stood at 93.6% while the NFC debt-to-GDP ratio was 173.5%[5], a figure that is inflated to some extent by the debt of special-purpose entities. The ongoing deleveraging takes place in both sectors driven by robust GDP growth, write-offs of bad loans, cash repayments and debt-to-asset swaps.

The real estate market is rapidly growing, supported by foreign funds from the Citizenship by Investment scheme. The number of transactions continue to increase, as well as building permits. Residential property prices increased by about 2% in 2018 (Central Bank of Cyprus statistics). However, the aggregate figures mask large differences between regions, such as Limassol, where most of the transactions in relation to the Citizenship Scheme take place, driving up prices. Due diligence checks have recently been made more stringent.

Public debt is forecast to decrease from 100.6% in 2018 to below 95% of GDP in 2019, and continue declining the coming years.[6] Following a significant increase in government debt in 2018, due to the one-off government support measures related to the Cyprus Cooperative Bank (CCB) sale, the government debt-to-GDP ratio is projected to gradually decline to 93.8% in 2019, 87.8% in 2020 and respectively to 81.8% in 2021, under the no-policy change assumption. The decrease is mainly due to strong projected primary budget surpluses, robust GDP growth, decreasing interest expenditures and active debt management by the authorities. A downside risk to the fiscal outlook is a potential slowdown of revenue collection growth in the coming years reflecting a less favourable macroeconomic environment. Thus, commitment to contain expenditure growth will be key to maintaining fiscal surpluses, which in turn, would allow the debt-to-GDP ratio to continue its downward path. Furthermore, the potential realisation of explicit and implicit contingent liabilities related to the financial sector, the implementation of the National Health System, and SOEs remain important downside risks to the performance of public finances.

Unemployment is rapidly falling. The unemployment rate fell from 8.4% in 2018 to 6.8% in August 2019 (an 8-year low). Unemployment among young people has also declined to 16.6% in 2019Q2. While unemployment is still above the pre-crisis period,

5 Figures show unconsolidated data.

6 Historical GDP series were revised in October 2019, leading to changes in the debt-to-GDP ratios, including for 2018. Before the GDP revision, public debt for 2018 was reported at 102.5%.

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positive employment expectations suggest that unemployment is set to continue falling in the near term.

Potential growth is gradually increasing. In 2018 potential growth was 2% and is expected to increase to 2.3% in 2019 and 2.5% in 2020. Labour and gross fixed capital formation continue to be the main drivers of potential growth but total factor productivity is also expected to provide a small positive contribution from 2020 onwards, after several years of negative contributions. However, the very high dependency on construction investment, the remaining debt overhang and insufficient progress with structural reforms constrain potential growth in the longer term.

3. Policy implementation and assessment

3.1 Reducing non-performing loans

The Cypriot authorities continue following the three-pillar policy strategy for NPL resolution put in place in the summer of 2018.[7] After strengthening the overall legal framework underlying NPLs workout, banks are making use of the sale of loans framework – with several portfolio sales already completed and further asset disposals being under way. The two largest banks, Bank of Cyprus and Hellenic Bank, envisage to finalise significant portfolio sales in 2020, which would reduce their NPLs stocks to much lower levels. Furthermore, the amendments to the foreclosure framework introduced in July 2018 seem to bear fruit as banks appear to be more willing to use foreclosures as an NPL workout option. The share of successfully finalised foreclosure cases has been increasing and, furthermore, there is a notable increase in the share of properties sold to the banks following unsuccessful auctions.

However, the amendments to the foreclosure framework approved by Parliament in August 2019 could weaken the reform adopted in July 2018, if implemented. The reform of 2018 was a key step forward to strengthen the enforcement of claims and the effective management of NPLs, and furthermore, it was an important component of the Commission’s state-aid decision in the context of the sale of the (back then) second largest bank. The amendments passed by the Parliament in August 2019, if implemented, can be expected to have adverse effects on progress in NPL resolution as it implies a longer and more cumbersome foreclosure procedure, weighing also on the prospects and the pricing of future NPL portfolio sales. At the request of the President, the August amendments were referred to the Supreme Court, which is expected to decide on their constitutionality in the spring of 2020. In the meantime, the foreclosure framework as adopted by Parliament in July 2018 will remain in force.

An electronic auction system for properties subject to foreclosure proceedings should be functional in 2020. To streamline the sale of collateral, Cyprus committed to set-up an e-auction system. Work intensified throughout 2019 and a pilot of the new electronic platform has been successfully tested. A ministerial decree setting the

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[7] See the Post-Programme Surveillance Report on Cyprus, Autumn 2018.

technical specifications and detailing the operation of electronic auctions has been approved at the end of October 2019.

To address the most challenging NPLs segment — NPLs collateralised with primary residence — the government launched the ESTIA scheme in September 2019. Under the scheme, the government will provide subsidies to eligible distressed borrowers to incentivise them to begin re-servicing their loans. Besides the debt relief by the creditor, the scheme provides a State subsidy amounting to one third of the borrower's repayment obligation — thus significantly lowering the debt servicing costs, including interest charges. The final ESTIA proposal was approved by the Council of Ministers on 1 November 2018, while the Commission approved the scheme in December 2018, under EU State aid rules. The Council of Ministers approved the Memorandum of Understanding (MoU) of the scheme in June 2019. Following the official announcement of the scheme in July 2019, major banks and credit acquiring companies have signed up for the scheme, including Bank of Cyprus, Hellenic Bank, AstroBank, Eurobank, National Bank of Greece, Alpha Bank, the state-owned Cyprus Land Development Corporation, KEDIPES, and Gordian Holdings. On 2 September 2019, the application period was open for borrowers. Applications can be submitted up to mid-November 2019 and will be assessed by the government by March 2020. At the time of the writing, there seem to be early indications suggesting that the uptake of the scheme would be very modest, which could be driven by the weak collateral enforcement environment as well as the disclosure requirements.

Ensuring that KEDIPES becomes a successful asset management company is essential for reducing NPLs outside the banking sector and for repaying the State. With a net book value of 20% of GDP, KEDIPES is the largest asset management company (AMC) in the EU relative to the size of the economy. Adequate capacity building, proper governance and operational independence of KEDIPES are key for achieving the objective of maximising government proceeds. So far, progress in setting-up the state-owned AMC was slower than expected. Some progress has been made on the governance – with the Board of Directors including now three independent members. Nevertheless, the organisational set-up is still to be finalized. BDO Ireland, which was appointed as the financial advisor of the AMC, is currently in the process of drafting the business plan, evaluating the organisational structure, advising on the revision of the loan servicing agreement (currently with Altamira Cyprus) and on the sale of KEDIPES shares in Altamira Cyprus. The poor quality of data on borrowers (e.g. regarding their occupation and income) renders the determination of appropriate resolution strategies difficult and potentially ineffective. Once operational, the key elements of the strategy for KEDIPES are likely to be tapping the ESTIA scheme, restructuring, foreclosures and NPL sales.

It is essential to improve the handling of NPL cases by the courts. The current inefficiencies of the judicial system, i.e. long court proceedings and weak execution of judgments, have a negative impact on contract enforcement and deter banks from using the available legal framework to reduce NPLs. All these consequently weaken the debt repayment discipline in the country. The government has given high priority to

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reforming the judicial system. Furthermore, in the context of the CCB sale, the government agreed that after the adoption of the Decision of 19 June 2018[8], it would implement measures to significantly improve the handling of NPL cases by the courts. Such measures include the revision of the rules of civil procedure, improving the administration and functioning of the courts and appointing specific judges to handle financial disputes. Furthermore, two Commercial Courts and a Court of Appeal are planned to be established. Another element, which is expected to strengthen the execution of judgements with regard to NPL cases, is the amendment to the Civil Procedure Law to facilitate the execution of court decisions related to seizure of movable property, which is under preparation. Nevertheless, the implementation of such a comprehensive reform of the judicial system will take several years and tangible improvements can be only expected in the medium-term.

3.2 Reducing private debt

The ESTIA scheme, designed to address non-performing loans collateralised by primary residences, should in turn help decrease private indebtedness. The very attractive terms of the scheme (including potential debt reductions) provide incentives to eligible defaulted borrowers to restart servicing their debts. The scheme was implemented later than expected, with the application period for the borrowers currently running until mid-November 2019. The effect on households and SMEs' debt will be seen in the medium-term; nevertheless, the first indication of the scheme's success will be its take-up. In order for the scheme to mitigate the concerns of moral hazard and ultimately, to improve the payment culture, the foreclosure procedure should be promptly initiated upon renewed default under the scheme and towards the remaining defaulting borrowers outside the scheme.

Borrowers' participation in insolvency processes should facilitate debt-workouts, but, so far, there has been limited progress with insolvency proceedings. Examinership and personal insolvency arrangements continue to be scarcely used despite last year's legislative amendments. The new Department of Insolvency, which is to be up and running by early 2020, should enhance the efficiency and effectiveness of the insolvency framework. Meanwhile, the regulation of the insolvency practitioners' profession is currently under review. In particular, the authorities are reviewing the design of the framework for licensing insolvency practitioners and will soon finalise the training programmes and certification standards for the profession.

It is of utmost importance to address the shortcomings of the current system for issuing and transferring title deeds[9] to enable liquidation of collaterals. A significant number of buyers, who have paid the full price for a property, still do not have a title deed. A collateral without a title deed cannot be liquidated, foreclosed and even deters banks from using it for debt-to-asset swaps, thus significantly preventing

[8] Commission Decision of 19.6.2018; SA.35334 (2018/N-2), available at: http://ec.europa.eu/competition/state_aid/cases/274927/274927_2013239_283_2.pdf.

[9] The legal document constituting the evidence of a right to the ownership of property.

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active deleveraging for NFCs. The authorities are making efforts to accelerate the transfer of title deeds to the legal owners by the application of the recently revised "Legacy Law"[10]. The law was revised to address concerns raised by banks and it is expected to speed up the transfer of the remaining eligible title deeds; however, concerns with regard to its constitutionality remain. To address the shortcomings of the current Specific Performance Law L.81(I)/2011 and better protect future buyers, a new system of property transactions with a transparent framework agreement between the developers and the banks, based on international good practice and due diligence is of outmost importance. The local government reform, which is expected to simplify the procedures of obtaining building and spatial permits and to help accelerating the issuance of title deeds, is still pending.

Credit information data on borrowers remains to be improved. The scope and quality of the financial information available to the Credit Registry — for credit risk assessment (including the situation with title deeds) — needs to be improved. Taking steps in ensuring better credit information on borrowers (without relying solely on declarations by the borrowers) is also in line with the Commitments undertaken by Cyprus in the summer of 2018, in the context of the State-aid case on the CCB sale. On a positive note, the credit-acquiring companies now participate in the Credit Registry, being able to have access to the data and also to provide data to the system.

3.3 Reducing general government debt

Cyprus is following an active debt management approach, making use of the favourable market conditions and windfall gains, to reduce public debt more quickly. In 2019, the government paid back in advance the Russian loan provided to Cyprus in 2011 and due only in 2021. Furthermore, Cyprus is planning to repay earlier the IMF loan in 2020. As a result, the gross financing needs over the medium term are lower, particularly for 2020 and 2021. By issuing several international benchmarks (10-year, 15-year and 30-year bonds) since September 2018, Cyprus smoothened the maturity profile of public debt and improved several risk-cost metrics of the debt portfolio. In the following months, the Council of Ministers is expected to adopt a new Medium-Term Debt Management Strategy (MTDS) covering the 2020-2022 period. The forthcoming debt strategy will be a continuation of the existing one, MTDS 2016-2020.

Efforts to strengthen the long-term sustainability of public finance should be maintained in order to contain the growth of public expenditure in the medium and long run. The mechanism signed in 2016 capping the growth of the public wage bill at nominal GDP growth through collective agreements[11] still applies but has proven insufficient to stem the strong growth the public wage bill in 2019[12]. The authorities

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[10] The Legacy Law is an amendment of Law 9/65 on Transfers and Mortgages. The Legacy Law aims to protect the 'trapped buyer', namely anyone who has submitted a contract of sale to the Land Registry up until 31 December 2014 (legacy cases).

[11] The measures mentioned in this section extend also to the broader public sector.

[12] See Cyprus — Stability programme 2018, page 8

have not yet committed to adopting a permanent legal mechanism to safeguard against the growth of the public wage bill that would secure long-term wage moderation in the public sector, and thereby would contribute to the sustainability of public finance. In 2019, wage increments, the resumption of new recruitment, and a revised Cost of Life Allowance (COLA) indexation system, as well as the gradual reversal of benefit cuts since the crisis have significantly increased public sector wage bill. Furthermore, the long-term financial sustainability of the on-going implementation of the NHS requires close financial monitoring. While the reform implementation has thus far been relatively smooth, a number of important financial risks and uncertainties remain, notably because the law stipulates the Government’s commitment to funding potential financial losses incurred during the transition process towards the autonomous financial management of public hospitals (expected over the first five years of the reform implementation).

The legislation setting up a sovereign wealth fund was approved by the House of Representatives in February 2019, but it no longer contains the provision on servicing public debt. The legislation introduces key principles on the establishment and operation of a sovereign wealth fund managing and using future resources from hydrocarbon exploitation. It stipulates general principles governing investment and reserves of the fund, among other things. The final version of the Law no longer contains a provision that the public debt will be serviced by fund revenue.

3.4 Reducing unemployment

Despite some progress, efforts to improve the efficiency and effectiveness of the public employment services (PES) need to be stepped up. In the 2019 the national reform programme, Cyprus noted the improvement in the quality of services arising from recruitment of 30 additional counsellors who started end-2018 under a 2 years contracts, and the online platform for employers has been operational since September 2018. However, the recruitment of counsellors on a permanent basis is pending. In parallel, the legal framework and strategy of the operation of PES are currently being developed to help manage the job seekers. Furthermore, the reform of the inspection service for undeclared work is advancing and it is expected to reduce the currently high level of undeclared work. More efforts are needed to apply active labour market policies to tackle skills mismatches.

Outreach and activation measures to reduce young persons not in employment education or training (NEETs) were introduced. As stated in the 2019 national reform programme, the Cyprus authorities have launched a project to identify NEETs as well as several active labour market schemes. Measures to complete a comprehensive monitoring and evaluation system need to be accelerated. The first assessment of the results has been delayed and it is now expected by the end of 2019. In parallel, training schemes to improve the skills of the workforce are ongoing.

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3.5 Increasing potential growth

Several measures are underway that would help increase potential growth in the long term. The 2019 national reform programme reconfirmed the ongoing implementation of the action plan for growth, notably with regard to e-government and entrepreneurship. In addition, progress has been made on institutional measures. The Deputy Ministry for Shipping and the Deputy Ministry for Tourism are fully operational and the Economy and Competitiveness Council has published the first competitiveness report for Cyprus with specific recommendations, among them setting-up a long-term growth strategy, which is under preparation. In addition, digital transformation and innovation also emerged as important priorities and the government has decided to establish a Deputy Ministry of Innovation and Digital Policy. This Ministry will also form the future policy of the government with regard to R&D. The draft bill is pending adoption at the House of Representatives (HoR).

Measures to improve the investment and business environment are still on hold. The 2019 national reform programme reconfirmed the authorities' commitment to a horizontal reform of public administration. Revised draft bills overhauling the procedures for recruitment, assessment and promotion in the public administration were submitted to the HoR in October 2019. Some progress was made with regard to the local government reform, as some aspects of it were revised and submitted to the HoR. However, the boldest reform, which is that of municipalities, is still under discussion. The draft bill concerning the governance of state-owned entities was withdrawn as deemed not feasible to be adopted and the government is aiming at improving governance measures by decisions of the Council of Ministers (including more strict reporting requirements). The revised law to facilitate major investments through simplified procedures was recently submitted to HoR. The ongoing reform of the justice system is also crucial with regard to the improvement of the business environment.

Limited progress has been made on privatisation. Only few privatisation projects remain active and only the privatisation of the Larnaca port is progressing, albeit slowly. The corporisation of Cyprus Telecommunications Authority has stalled at the HoR since 2017. Further progress on privatisation could attract investment and reduce the State's exposure to contingent liabilities.

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4 ANNEX 1: OVERVIEW TABLE OF MIP-RELEVANT REFORMS

Reduce non-performing loans			
Financial services			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
Complete the operationalization of KEDIPES in line with the state-aid commitments.	The Council of Ministers approved the ESTIA scheme on 1 November 2018. The Council of Ministers approved the Memorandum of Understanding of ESTIA in June 2019. Legislation on allowing credit-acquiring companies access to the Credit Registry.	Banks are pursuing strategies to reduce non-performing loans, including preparing further asset disposals. The ESTIA scheme, a state-support scheme, addressing non-performing loans collateralized by primary residences, was officially launched in September 2019, with borrowers submitting applications until mid-November. The state-owned asset management company, KEDIPES, appointed new members in its Board of Directors. However, the governance and organisational structure of the company are not yet complete. BDO, the advisor of KEDIPES, developed a new business plan for KEDIPES. The Central Bank of Cyprus started supervising the activities of licensed credit acquiring companies, including KEDIPES, through a series of reports. An electronic auction system for properties subject to foreclosure proceedings is finalized.	**CSR 2 (2019):** Facilitate the reduction of non-performing loans including by setting up an effective governance structure for the State-owned asset management company, taking steps to improve payment discipline and strengthening the supervision of credit-acquiring companies. Strengthen supervision capacities in the non-bank financial sector, including by fully integrating the insurance and pension-fund supervisors. (reinforced by the commitment 21(b) of the State aid decision of 19.6.2018 regarding the establishment of an electronic auction system for foreclosures).

Civil justice			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
Expected in 2020: Increase the capacity of courts and create a taskforce of judges to tackle the backlog of cases, including judges for the handling of financial disputes. **Expected in 2020:** Creation of two Commercial Courts and a Court of Appeal. **Expected in 2020:** Adoption of bill amending the Civil Procedure Law to strengthen the legal framework for the enforcement of Court decisions. **Expected in 2020:** Initiation of the pilot phase of the e-justice. **Expected in 2021:** Adoption of the revised Rules of Civil Procedure. **Expected in 2021:** Measures to promote mediation.	**2018:** Law for the establishment and operation of the Administrative Court of International Protection.	The Functional review study for the Courts' system and the study regarding judicial mediation and ways to incentivise it were concluded in 2018. Ongoing training for judges. Revision of recruitment criteria for judges. Six existing judges were assigned to handle financial disputes, including the ones related to NPLs. Measures to promote the use of alternative dispute resolution.	**CSR 5 (2019):** Step up efforts to improve the efficiency of the judicial system, including the functioning of administrative justice and revising civil procedures, increasing the specialisation of courts and setting up an operational e-justice system. Take measures to strengthen the legal enforcement of claims (reinforced by the commitment 21(e) of the State aid decision of 19.6.2018, relating to the reform of the judicial process).
Reduce private sector debt			
Private indebtedness – Insolvency, foreclosure and State support scheme			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
Expected in 2020: The new Department for Insolvency, under the Ministry of Energy, Commerce and Industry, is expected to begin operations in January 2020. The new Department for Insolvency is expected to operate more efficiently and effectively compared to the existing unit (Insolvency Service) under the Department of Registrar of Companies and Official Receiver. **Expected in 2020:** Strengthen the regulation of insolvency practitioners profession.	**2019:** In May 2019, the Council of Ministers approved the proposal of Ministry of Energy, Commerce and Industry to establish an independent department of insolvency.	The design of the framework for licensing of insolvency practitioners went under review. The training programs and certification standards for the profession are expected to be finalized by the end of 2019. The ESTIA scheme, a state-subsidy scheme, addressing non-performing loans collateralized by primary residences, was officially launched in September 2019, with borrowers submitting applications until mid-November.	**CSR 2 (2019):** Facilitate the reduction of non-performing loans including by setting up an effective governance structure for the State-owned asset management company, taking steps to improve payment discipline and strengthening the supervision of credit-acquiring companies. Strengthen supervision capacities in the non-bank financial sector, including by fully integrating the insurance and pension-fund supervisors. (reinforced by the

			commitment 21(b) of the State aid decision of 19.6.2018 regarding the establishment of an electronic auction system for foreclosures).
Housing market			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
Legislation to tackle non-legacy and new property transactions ensure that the buyers, who have paid the full amount, will receive their title deeds quickly and without a risk of refusal. No timeline was announced. **Expected in 2020:** Significant simplification of procedures for obtaining building and spatial planning permits.		Amendment of the "trapped buyers' law" (for cases before 2015).	**CSR 5 (2019):** Take measures to strengthen the legal enforcement of claims and ensure reliable and swift systems for the issuance and transfer of title deeds and immovable property rights.
Reduce General Government debt			
Long term sustainability of public finances			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
	2019: Adoption of the Sovereign Wealth Fund law in February 2019.	**2018:** Application of collective agreements containing the growth of the compensation of public sector employees until end-2018. In the absence of any amendments to the current agreements, the mechanism will continue to be in effect.	

Increase potential growth			
Public administration			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
Expected in 2019: Legislation modernising the recruitment, assessment and promotion in the public administration. **Expected in 2020:** Legislation for the reform of local governments. **Expected 2020:** Implementation of the adopted measures.	State-owned enterprises to prepare: (1) a three year period mid-term financial framework, (2) strategic plans linked to their budget, (3) risk reports informing the Council of Ministers. State-owned enterprises to implement the Code of Public Governance by State Organisations and State-owned enterprises.		**CSR 1 (2019):** Adopt key legislative reforms to improve efficiency in the public sector, in particular as regards the functioning of the public administration and the governance of State-owned entities and local governments.
Investments and Business environment			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
Expected in 2020: Implementation of the tourism strategy. **Expected in 2020:** Adoption of the law facilitating strategic investments. **Expected in 2020:** Operation of the Deputy Ministry of Innovation and Digital Policy. **Expected in 2020:** Operation of the equity fund. **Expected in 2020:** Implementation of a financial instrument for energy efficiency and renewable energy sources. **Expected in 2020:** Initiation of commercialisation of the operations of the port of Larnaca. **Expected in 2021:** Introduction of green tax reform.	Establishing of the Deputy Ministry of Innovation and Digital Policy. Establishing an equity fund.	Operation of the Deputy Ministry for Tourism. Operation of the Deputy Ministry for Shipping. Ongoing extension of e-government services. Publication of the national competitiveness report with specific recommendations for improving the competitiveness of Cyprus. Ongoing measures to enhance cooperation and interaction between universities and businesses. Ongoing implementation of the smart specialisation strategy and increase of the level of public and private R&D investment.	**CSR 4 (2019):** Focus investment-related economic policy on sustainable transport, environment, in particular waste and water management, energy efficiency and renewable energy, digitalisation, including digital skills, and research and innovation, taking into account territorial disparities within Cyprus. Adopt legislation to simplify the procedures for strategic investors to obtain necessary permits and licences. Improve access to finance for SMEs, and resume the implementation of privatisation projects.

Expected in 2021: Adoption of a long-term strategy for growth. **Expected in 2021:** Creation of additional equity funds. Adoption of legislation for the corporatisation of CyTA. No timeline is foreseen. Privatisation of national lottery's activities. No timeline is foreseen.			
Reduce unemployment			
Incentives to work, job creation, labour market participation			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
Expected in 2019: Adoption of a strategy setting out objectives for each process of the public employment services and a corresponding monitoring and evaluation system. **Expected in 2020:** Recruitment of 30 permanent employment advisors to reinforce personalised guidance. **Expected in 2020:** Adoption of law setting out the framework of operation of the public employment services.		The recruitment of 30 employment advisors in 2017 adequately equipped the public employment services, however only for two years. Ongoing counselling and vocational training to young people young people not in employment, education or training (NEETs). State aid scheme to NGOs and local governments to provide childcare programmes. Benefits to low-income families for childcare.	**CSR 3 (2019):** Complete reforms aimed at increasing the effectiveness of the public employment services and reinforce outreach and activation support for young people. Affordable childhood education and care.