EUROPEAN COMMISSION

Brussels, 24.02.2014
C(2014) 1202 final

ı the published version of this decision, some information has been omitted, pursuant to articles 24 and 25 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus […].		PUBLIC VERSION ͳhis document is made available for information purposes only.

Subject : State aid SA.35334 (2014/N) – Cyprus
Recapitalisation and restructuring of the Cooperative Central Bank Ltd and of the Cooperative Credit Institutions

Sir,

1. PROCEDURE

(1) Following Cyprus' request of 25 June 2012, on 24 April 2013 an Economic Adjustment Programme was agreed between the European Commission, the European Central Bank ("ECB"), the International Monetary Fund ("IMF") and the Cypriot authorities and signed by the Euro-area Member States (Euro group). Its underlying policy conditionality is set out in a Memorandum of Understanding ("MoU") which was signed by the European Commission on 26 April 2013. The MoU provides for a State-supported recapitalisation and restructuring of the Cooperative Credit Institutions ("CCIs") and their central body, the Cooperative Central Bank Ltd ("CCB"). In the present decision, the economic entity made of the CCB and the CCIs is referred to as the "Cooperative banking sector" or the "Cooperative group".

(2) On 4 June 2013 Cyprus submitted its calculation of the recapitalisation needs of the Cooperative banking sector totalling EUR 1.5 billion.

Κύριο
Ιωάννη Γ. Κασουλίδη
Υπουργό Εξωτερικών
Λεωφόρος Δημοσθένη Σεβέρη
Chypre - 1447 Λευκωσία

Commission européenne, B-1049 Bruxelles – Belgique
Europese Commissie, B-1049 Brussel – België
Τηλέφωνο: 00-32-(0)2-299.11.11.

(3) On 31 July 2013 Cyprus submitted the principal strategy for the restructuring of the Cooperative banking sector including a new governance and ownership structure. While a draft restructuring plan had been submitted on 16 October 2013, the final plan was formally notified on 31 January 2014.

(4) In addition, several meetings, conference calls and electronic mail exchanges took place between the Cypriot authorities, the Cooperative banking sector, and the Commission between June 2012 and January 2014.

(5) For reasons of urgency, Cyprus submitted, with the notification on 31 December 2014, a language waiver declaring that Cyprus accepts the adoption of this decision in English.

2. DESCRIPTION

2.1 Description of the beneficiary

(6) The Cooperative banking sector is one of the key players on the Cypriot banking market. In December 2012 it held total assets of EUR 17.1 billion corresponding to 95.5% of gross domestic product ("GDP") of Cyprus. It was, after Bank of Cyprus ("BoC"), the second-largest Cypriot bank in terms of deposits and loans, accounting for EUR 15.2 billion of deposits and for EUR 13.9 billion of loans representing a 22% share in deposits and a 19% share in loans.

Table 1 - Market shares of Cypriot banks[1] (rounded)

	Market share – Loans		Market share – Deposits	
	Dec 2012	June 2013	2012	June 2013
BoC	23%	38%	27%	32%
Cooperative banking sector	19%	20%	22%	28%
Laiki	16%	-	13%	-
Hellenic Bank	6%	7%	10%	11%
Alpha Bank Cyprus	6%	6%	4%	4%
Eurobank EFG Cyprus	3%	3%	4%	5%
Other	27%	27%	20%	20%

(7) Whereas the other Cypriot banks have tended to lend to and collect a significant amount of deposits from non-residents, the vast majority of the clients of the Cooperative banking sector are local residents. In the wake of the crisis, the difficulties of the banking sector in general and the resolution of Cyprus Popular Bank ("Laiki", whose Cypriot banking activities were transferred to BoC in 2013), the cooperatives became even more important within the Cypriot banking sector. Their market share of total deposits increased to 28% (EUR 14.2 billion) in June 2013. If only Euro-denominated deposits by residents are taken into account, their market share as of March 2013 amounted to 41% (and almost 30% in loans).[2]

[1] This covers loans and deposits both to residents and non-residents; source: notified restructuring plan, p. 20, which itself indicates as source "Central Bank of Cyprus".

[2] See notified restructuring plan, p. 19.

(8) The Cooperative banking sector employed 2,998 people and operated 409 branches throughout Cyprus (June 2013). All operations of the CCIs were until recently supervised by the CCI Supervision and Development Authority ("YEASE"). That supervision was transferred to the Central Bank of Cyprus in September 2013.

(9) Before its current restructuring, the Cooperative banking sector comprised, first, a number of legally independent retail banks, the CCIs and, secondly, their central body and central banker, the CCB, providing liquidity to the CCIs.

The Cooperative Credit Institutions ("CCIs")

(10) In line with their cooperative status, the CCIs were owned by their members who were normally also their customers[3]. However, only physical persons could be members, whereas the customers could also be legal entities such as companies. Before the current restructuring, 93 legally independent CCIs provided retail banking services, either in their respective regions or to a particular group of professions (such as the CCIs for primary teachers, members of the police force or army members). In December 2012 there were 82 so-called geographical CCIs and 11 professional CCIs. Across Cyprus there were 403,000 CCI members (September 2013). Due to the cooperative status the one-member-one-vote principle applied so that no third party could get voting shares and none of the members could exercise more than one vote, even they had bought more shares.

(11) Although some CCIs had already had share capital in the past[4], their main source of capital was retained earnings. Since all CCIs except one[5] were "affiliated" to the CCB as their central body, with the latter guaranteeing their liabilities and commitments and the CCIs guaranteeing the liabilities of the CCB, the CCIs did not have to comply individually with the capital requirements for banks but only as a 'group', on a consolidated basis with the CCB.

(12) For all CCIs their members' General Assembly is their supreme governing and decision-making body. The Board members of the CCIs are elected by its members.

The CCB

(13) The CCB has the legal status of a bank and is de facto the central banker of the CCIs. The latter have to process all their banking transactions through the CCB and to deposit their excess liquidity with it. In case of need, the CCB provides liquidity to the CCIs. In addition, the CCB has its own limited business which mostly comprises – in using surplus liquidity –lending to the government, municipalities and other local authorities as well as quasi-government organisations such as public utilities. Retail banking is predominantly carried out by the CCIs.

---

3 While customers borrowing from a cooperative have been required to be or become members, this has not been the case for depositors.

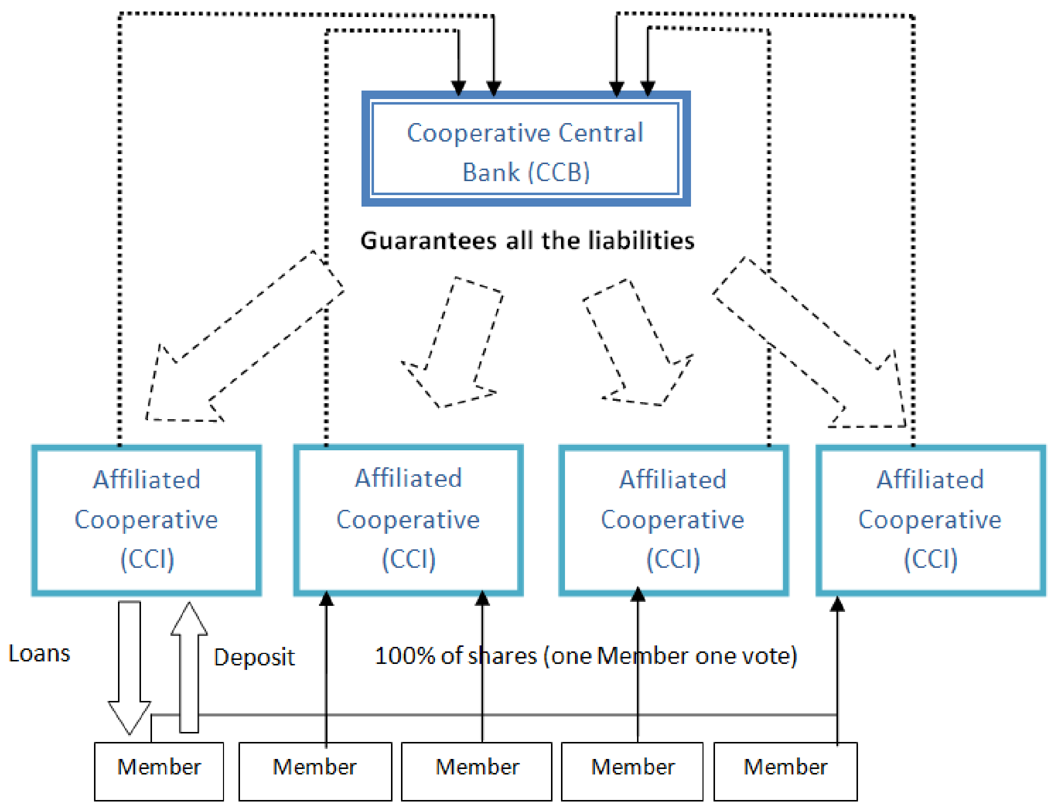
4 In the past, CCIs were structured as either limited or unlimited liability societies (and CCIs' members' liability was either limited or unlimited). As of June 2013 all CCIs have, however, been converted into limited liability companies.

5 Limassol Cooperative Savings Bank.

(14) The CCB is owned by its affiliated CCIs and other cooperative non-credit institutions. Non-cooperatives or physical persons could not be owners (or members). As a consequence, the different CCIs together hold over 90% of its shares, while the remaining shares are in the hands of non-CCIs such as agricultural cooperatives. Although those shareholders (or members) hold different amounts of CCB shares, each member is entitled to only one vote since the one-member-one-vote principle also applies to the CCB.

(15) In a nutshell, the ownership and governance structures of the Cooperative banking sector can be illustrated as shown in Graph 1:

Graph 1: Current Ownership Structure of CCB and CCIs



(16) The Cooperative banking sector focuses on domestic customers and does not carry out business abroad. Consequently, unlike BoC, Laiki, Hellenic Bank and other banks, it has not suffered losses from significant exposures to Greek government bonds or to Greek corporations and households.

2.2. Macro-economic environment

(17) The Cypriot economy, following modest recovery from the 2009 crisis during 2010 and 2011, underwent a deep downturn from 2012 onwards, with a contraction of real GDP by 2.4% in that year and by an estimated 8.7% in 2013. As a consequence unemployment rates increased and real estate demand and prices – which had been continuously increasing before the crisis[6] - came under pressure.

[6] According to the information submitted by the Cypriot authorities, the total stock of building increased by more than 44% during the past 10 years.

2.3 Capital shortfall

(18) The Cooperative banking sector needs EUR 1.5 billion capital as calculated by the Central Bank of Cyprus[7]. Without that new capital, the capital will turn negative in 2014 due to high losses.

(19) The programme for Cyprus envisages the availability of public support: "*Sufficient funds for the recapitalisation of the cooperative credit institutions will be made available from the programme following the first programme review and will be deposited in a dedicated account with the Central Bank to boost confidence in the system*".[8]

2.4 Source of the problem

(20) The key problem of the Cooperative banking sector is its large volume of overdue loans (payment arrears more than one day): measured in terms of value, almost one loan in two is in arrears with payments. In November 2013 the level of non-performing loans ("NPLs", defined as loans with payment arrears of more than 90 days[9]) accounted for over 40% of the cooperatives' total gross loans' value ("NPL ratio") according to the information submitted by Cyprus.[10]

(21) Moreover, it is estimated that the current NPL ratio will increase to 60% by 2015. Thus, the credit losses in the loan portfolio have and will continue to severely affect the capital of the Cooperative group. Under the base case of the restructuring plan, around EUR 2 billion of provisions will be booked in 2013 and 2014. Without the EUR 1.5 billion recapitalisation amount, the Cooperative group would have a projected negative equity of EUR 300 million by the end of 2014. The EUR 1.5 billion recapitalisation will enable the shareholders' equity to be at a level of EUR 1.2 billion at any point in time.

(22) The problem of a high NPL ratio did not suddenly emerge as a result of the recession of 2012-2013 but had already reached problematic levels beforehand. The NPL ratio had already been very high, at 32% of gross loans in 2011 and 29% in 2010[11]. The magnitude of the problem was however not fully visible, since at the time banks did not have to classify a loan overdue by more than 90 days as a NPL if it considered that the value of its collateral was sufficient to cover the entire exposure.

(23) The economic recession was thus an external factor worsening an existing internal problem.

(24) According to the notification, the main reason for the Cooperative banking sector' difficulties is the existing corporate governance framework. It is not appropriate for effectively monitoring and supervising operations and risks undertaken or underwritten by the CCIs.[12] Moreover, in addition to insufficient

---

7 See European Commission, Occasional Papers 161, The Economic Adjustment Programme for Cyprus, First Review Summer 2013, p. 73 (Memorandum of Understanding on Specific Economic Policy Conditionality).

8 See European Commission, Occasional Papers 149, The Economic Adjustment Programme for Cyprus, p. 76 (Memorandum of Understanding on Specific Economic Policy Conditionality).

9 As defined by the Directive on the Definitions of Non-Performing and Restructured Credit Facilities of 2013.

10 See notified restructuring plan, p. 25.

11 See notified restructuring plan, p. 14.

12 See notified restructuring plan, p. 23.

supervision there was an inability to enforce policies, procedures and executive accountability, as well as to impose sanctions when necessary.[13]

(25) For instance, supervision was not carried out by the Central Bank of Cyprus, as was the case for other Cypriot banks, but by YEASE, which falls under the competence of the Ministry of Commerce, Industry and Tourism. Moreover, required internal audits were, according to the notification, not set up by several CCIs and internal auditors appointed in some of CCIs did not meet the requirements of independence and eligibility.

(26) Finally, the CCB, although guaranteeing the CCIs' liabilities, did not exercise control over the CCIs' lending decisions, risk management and monitoring. As a consequence key decisions at the CCI level were taken independently by their Boards of Directors comprising seven to ten members elected by the CCIs' members.[14]

(27) According to the information submitted with the notification, the Board members' and managers' competences, integrity and qualifications were insufficiently evaluated.[15] In addition, the fit and properness criteria applying to the cooperatives differed from the criteria set by the Central Bank of Cyprus for other banks. According to the restructuring plan, that discrepancy raises concerns as to whether all CCI managers and Board members are highly and equally skilled for their roles.[16]

(28) Insufficiently controlled and supervised, the lending practice of the CCIs was risky. The CCIs did not pay adequate attention to borrowers' ability to repay their loan. Instead they focussed nearly exclusively on the expected value of the collateral. Although according to the notified restructuring plan, approximately 84% of outstanding loan balances of the group are secured by real estate property, cash collateral or government guarantees, CCIs have experienced a significant increase of delinquencies in their loan portfolios under the current macroeconomic conditions[17] and many borrowers stopped servicing the loans.

(29) The CCIs have historically not engaged in any loan modifications. They granted payment holidays to borrowers in difficulties or allowed them to only pay part of their instalments but did not proceed with loan restructurings which led to the creation of further NPLs.[18]

(30) The CCIs also took a "more relaxed approach to collection and work-out policies on loans with arrears less than 270 days and loans for which adequate collateral was held".[19] In that context it should be noted that until recently a loan was considered as an NPL only if it was past due for at least 270 days and not fully covered by tangible security, according to information submitted with the notification.[20] So the CCIs "historically refrained from pursuing aggressive collection and work-out strategies"[21] on those loans.

---

[13] See notified restructuring plan, p. 23.
[14] See notified restructuring plan, p. 23.
[15] See notified restructuring plan, p. 23.
[16] See notified restructuring plan, p. 23.
[17] See notified restructuring plan, p. 25.
[18] See notified restructuring plan, p. 26.
[19] See notified restructuring plan, p. 25.
[20] A new definition entered into force in July 2013 with the *Directive on the Definitions of Non-Performing and Restructured Credit Facilities* of 2013.
[21] See notified restructuring plan, p. 26.

(31) Moreover, it has been almost impossible to seize and sell property due to protective legislation (requiring an extended period of ten years for the foreclosure and forced sale of a property serving as collateral to a problematic loan[22]), which discouraged legal action against the borrower for the repossession of property. Thus, as of November 2013, for 33% of loans with arrears over 90 days (which has been the definition of a NPL since July 2013) representing a balance of EUR 1.8 billion (of which almost EUR 1 billion represent loans that are more than 360 days past due) no legal or even pre-legal action such as submitting a letter requesting payment had been initiated.[23] As of June 2013 the figure was even higher. At that point in time, no action had been initiated for 42% of loans with arrears over 90 days representing a balance of EUR 2.3 billion (of which 21% or EUR 1.2 billion represented loans with more than 360 days past due).[24]

(32) That lack of action led borrowers to prioritise other payments over servicing loans, in particular in economically difficult times. Consequently, the pledged collateral has not helped the CCIs to reduce their losses. With the change in July 2013 of the definition of NPL to more than 90 days past due, in line with the EU Capital Requirement Regulation[25], the proportion of recognised NPLs in the portfolios of the CCIs increased significantly. Loans that were past due more than 90 days as of November 2013 amounted to EUR 5.6 billion or 42% of total gross loans[26] (of which EUR 4.2 billion - representing 31% of the balance of all gross loans - are NPLs that are in arrears more than 360 days).[27]

3. THE RESTRUCTURING PLAN

3.1. The underlying strategy

(33) In July 2013 the Central Bank of Cyprus finalised the strategy for the restructuring and recapitalisation of the Cooperative banking sector ("the July 2013 strategy") including a plan to merge the individual CCIs into a maximum of 18 CCIs[28]. A key element of that strategy is that, following recapitalisation, the State will in the future have almost full ownership of the CCB, while there will also be a reform in the ownership and control by the CCB over the CCIs, i.e. an end to the current structure where the CCIs are owned and controlled by their members and they in turn control the CCB. The strategy was agreed within the Framework of the Economic Adjustment Programme for Cyprus.[29]

22 See notified restructuring plan, p. 26.

23 See notified restructuring plan, p. 26.

24 See draft restructuring plan of 16 October 2013, p. 25.

25 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 ("CRR"), OJ L 176, 27.06.2013, p. 1.

26 If one considers the exact regulatory definition of NPLs based on the Directive on the Definitions of Non-Performing and Restructured Credit Facilities the ratio is even 44% (this includes in addition to credit facilities with arrears over 90 days, some other facilities such as restructured loans that were at the time of restructuring classified as non-performing) and for which the observation period has not elapsed).

27 See recitals (20) and (22).

28 See European Commission, Occasional Papers 161, The Economic Adjustment Programme for Cyprus, First Review Summer 2013, pp. 73 and 74 (Memorandum of Understanding on Specific Economic Policy Conditionality) and European Commission, Occasional Papers 169, The Economic Adjustment Programme for Cyprus, Second Review – Autumn 2013, pp. 26 and 27 as well as p. 68 (Memorandum of Understanding on Specific Economic Policy Conditionality).

29 See footnote 28.

(34) Accordingly, the State would inject EUR 1.5 billion in the CCB in exchange for 99% of ordinary shares[30]. The July 2013 strategy is based on the assumption that the value of the Cooperative banking sector is zero or negative. It implied that the State would get all shares, i.e. 100% in the CCB. That proposed approach has now been confirmed by an independent valuation exercise ordered by the Cypriot authorities.[31]

(35) However, the July 2013 strategy sought to provide the old owners (i.e. the CCIs) a minimum level of participation in order to preserve some of the cooperative characteristics. Accordingly, it envisaged that the State would get 99% ownership and the old owners 1%, via the new CCB Holding Company, (see Graph 2). The one-member-one vote principle within the CCB would be abolished. As a result, the investor who injects money in the Cooperative banking sector and is its economic owner, namely the State, will control it.

(36) Furthermore, according to the July 2013 strategy, a minimum core tier 1 capital ratio of 4% will be required by the Central Bank of Cyprus for the individual affiliated CCIs (with the group still being subject to the general minimum core tier 1 capital requirement of 9% at consolidated level)[32]. Consequently, the CCB will inject capital in the CCIs to allow them to each reach 4% of core equity tier 1 capital. The CCB will receive 99% of the shares in each CCI with the previous owners (the individual members of the CCIs) keeping a 1% shareholding via Cooperative Holding Companies. To enable the CCB to control the CCIs, the one-member-one-vote principle will also be abolished at the CCI level.

3.2. Necessary legislative changes

(37) Since the new ownership and governance structures envisaged in the July 2013 strategy change core features of the cooperative banks, Cyprus has had to adopt a number of legislative measures that provide the legal basis for the restructuring. They deal with the new ownership structures, governance rules and issues such as the implementation of an annual auditing by an internationally recognized and independent firm or the transfer of the supervision of the Cooperative group to the Central Bank of Cyprus.

(38) Consequently, in the second half of 2013, Cyprus amended existing legislation and adopted a number of new laws, decrees and directives. They included the *Restructuring of Financial Institutions Law, the Law for the Establishment and Operation of a Management Unit for the Participation of the Republic of Cyprus in the Ownership Structure of Credit Institutions* and *the Directive to Cooperative Credit Institutions and the Central Body for the Affiliation of Cooperative Credit Institutions with the Central Body*, all of which were adopted or amended on 9 September 2013. It also adopted the *Ministerial Decree for the Recapitalisation of the Cooperative Central Bank / Central Body* on 4 October 2013 and amended it in January 2014 to fix the 99% shareholding of the State in the CCB following valuation ("Recapitalisation decree"). In

---

30 The Cypriot government will acquire 1 171 875 000 shares whose individual nominal value is EUR 1.28. These shares will represent 99% of the total number of shares.

31 The expert has reviewed the value of the assets of the Cooperative group resulting in a negative fair value adjustment of EUR 2.2 billion. That downward adjustment is higher than the consolidated equity of the CCB as of valuation date which means that the Cooperative group has a negative value.

32 See European Commission, Occasional Papers 161, The Economic Adjustment Programme for Cyprus, First Review Summer 2013, p. 74 (Memorandum of Understanding on Specific Economic Policy Conditionality).

addition, it adopted the *Relationship Framework Agreement between the Republic of Cyprus and the Cooperative Central Bank Ltd* in December 2013, the *Business of Credit Institutions Law* on 4 December 2013 and the *Cooperative Societies Law* on 31 December 2013. The latter contains, according to the information submitted by Cyprus, an amendment envisaged to dissolve the current Audit Office of the Cooperatives Societies and to establish a new process for the statutory audit of cooperative societies.

(39) Other legislative or regulatory measures have also been introduced, namely the adoption of a legislative framework for the establishment of a credit register in December 2013 and the Central Bank guidance on the recognition and re-classification of NPLs which entered into force on 1 July 2013.

3.3. Main restructuring measures

(40) The restructuring plan is based on a plan covering a five-year period ending on 31 December 2018[33]. Many measures covered by the plan are, however, supposed to be implemented early in that period. Other elements, in particular the necessary legislative amendments as well as the first CCI mergers, were implemented or launched already in the second half of 2013.

3.3.1. Recapitalisation and new ownership structures, potential exit mechanisms

(41) Cyprus will inject the EUR 1.5 billion capital into the CCB in return for ordinary shares. Instead of a payment in cash to the CCB, the State will subscribe to those new shares by a payment in kind, namely by granting European Stability Mechanism ("ESM") bonds to the CCB. As a consequence, the State will become the 99% shareholder of the CCB with the old owners, namely the CCIs, holding 1% via the CCB Holding Company.[34]

(42) The CCB will repo ESM bonds with the ECB in an amount needed to recapitalise the CCIs in order to achieve a minimum core tier 1 capital ratio of 4%. As described in recital (36) and pursuant to the Recapitalisation Decree, the CCB will inject the capital in return for ordinary shares and will hold 99% of the equity in each of the CCIs. Surplus capital will be held at the CCB which can inject additional capital in case a CCI experiences greater losses. If a CCI falls below the regulatory minimum set at 4%, it will automatically be recapitalised by the CCB.

(43) Following recapitalisation, the old owners and members of the CCIs will get a 1% shareholding in each of the CCIs which they will hold through newly established Cooperative Holding Companies, each of which will be owned by the current members of the relevant CCI.

(44) In the restructuring plan submitted by the Cypriot authorities, the core tier 1 capital ratio of the whole consolidated Cooperative banking sector is estimated to range between 10.1% and 14.2% for the period 2014 to 2018 in the base case scenario and between 9.2% and 12.2% in the pessimistic scenario.[35]

(45) As a consequence of the recapitalisation process, the State will own almost the entirety of the CCB, which will own and control the CCIs and, therefore, the

---

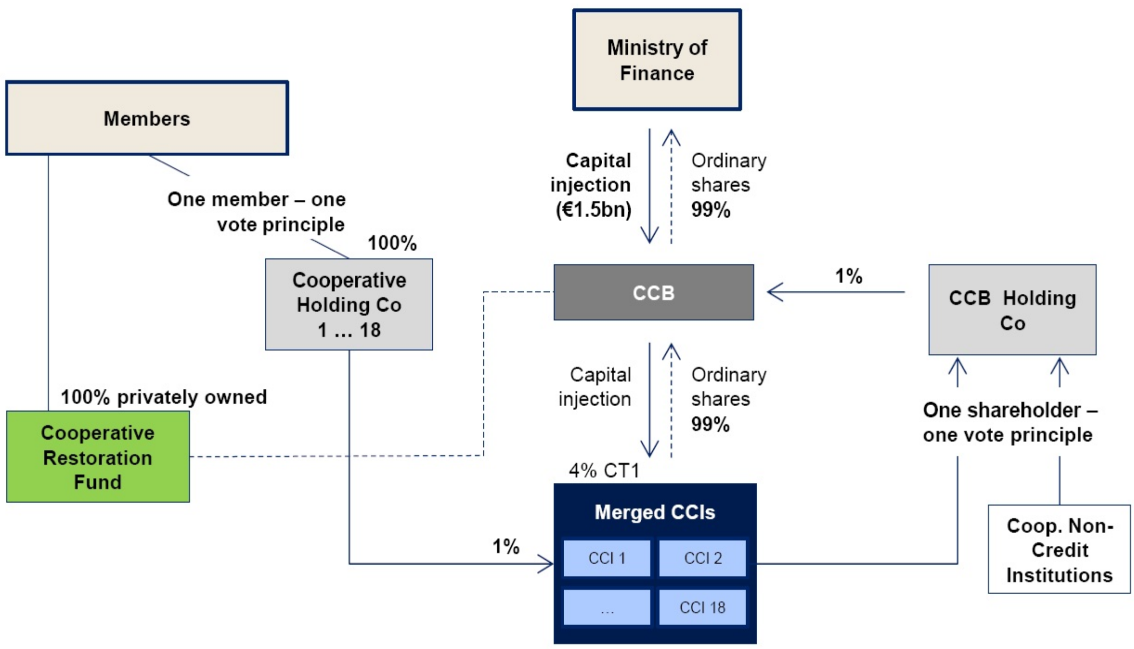
[33] See Commitments of Cyprus in the Annex to this decision, second introductory paragraph.

[34] See recitals (34) and (35).

[35] See detailed description of assumptions and projections from part 3.4., recital (61), onwards.

new group. Graph 2 gives an illustration of the new group and ownership structure:

Graph 2: Group's new Structure[36]



(46) The CCIs will not repurchase any of their own shares for the entire period during which Cyprus participates in the ownership structure of the CCB.[37]

(47) The CCB (but no other part of the group) has an option which lasts from 2014 until 2028 to repurchase part or all of the participation and voting rights of Cyprus in the ownership structure of the CCB with the repurchase price being at least equal to the EUR 1.5 billion injected increased by a cumulative and compound annual interest rate fixed at 10%, net of any dividends paid out.[38]

(48) A Cooperative Restoration Fund will be established by those CCI members that wish to participate on a voluntary basis in such a fund. The relevant CCI members may contribute into that fund which can be used to buy CCB shares from the State under specific conditions defined in recital (49).

(49) According to the submitted commitments, Cyprus may sell - in parts or as a whole - its shares in the CCB, but may not do so before December 2018. The sale shall be organised via an open, transparent, non-discriminatory and unconditional competitive tender. The sale shall take place on market terms with the shares sold to the highest bid. If there are at least two or more bidders (not including the Cooperative Restoration Fund, the CCB Holding Company or the Cooperative Holding Companies) from financial institutions, private equity firms or asset management firms, the Cooperative Restoration Fund, the CCB

---

[36] See notified restructuring plan, p. 29.
[37] See Commitments of Cyprus in the Annex to this decision, point 8.
[38] See Commitments of Cyprus in the Annex to this decision, point 9.

Holding Company or the Cooperative Holding Companies may exercise pre-emptive rights to match the best price offer and acquire the shares at that price. [39]

3.3.2. New governance rules

(50) The CCB will have a Board of Directors with two executive and seven non-executive and independent[40] and two non-executive and non-independent board members. The directors must pass the fit and properness test carried out by the Central Bank of Cyprus. According to the Recapitalisation Decree, the representative of the State as the main shareholder (Minister of Finance) - with the consent of the Central Bank of Cyprus and of the Parliamentary Committee of Finance and Budgets – will appoint the CCB's non-executive Board members who will subsequently appoint the two executive members including the General Manager/Chief Executive Officer ("CEO").[41]

(51) The CCIs will remain separate legal entities with their own Boards of Directors that will comprise two executive directors (a CEO and one other executive director) plus three independent non-executive directors (and in the case of larger CCIs with over EUR 1 billion in assets, two executive directors and five independent non- executive directors). [42] The Board members of the CCI will be appointed subject to meeting the 'fit and proper' criteria of the Central Bank of Cyprus. The Board members will be elected by the General Assembly of each CCI but their appointment will have to be approved by the CCB's Board of Directors.[43] The Boards of Directors of the CCIs will have to implement the policies, guidelines and strategies developed by the Board of Directors of the central body.[44] The CCB may remove the General Manager or other key personnel and directors from the Board of the CCIs.[45]

(52) The CCB, as the major shareholder following recapitalisation, may also issue instructions to the affiliated CCIs regarding, for instance, the management and restructuring of NPLs and the formation of approval limits for the granting of credit facilities and investments by each affiliated CCI. It will thereby act de facto as a parent company to the group. The CCB may also restrict the transactions (loans and deposits) of affiliated CCIs in agreement with the Central Bank of Cyprus as the new supervisor.

(53) A newly founded special unit in the Ministry of Finance will manage Cyprus' shareholding interest in the CCB. To that end the *Law Relating to the Establishment and Operation of a Management Unit for the Participation of the Republic of Cyprus in the Ownership Structure of Credit Institutions* requires that management unit to, inter alia, ensure the maximum possible return from

---

39 See Commitments of Cyprus in the Annex to this decision, point 11.

40 A person that has not been an employee of the institution or the group for the past five years and that does or did not maintain during the past three years a material business relationship with the institution the group either directly as a partner or as shareholder or as director or senior manager of a body which maintains such a relationship with the institutions.

41 According to the notified restructuring plan, p. 38, the directors will be elected by the General Assembly (in which the State will have 99% of the votes following capital injection); however, the restructuring plan, p. 38, also stipulates that during the period of State aid the Minister of Finance may, with the concurring opinion of the Central Bank of Cyprus and the Parliamentary Finance Committee, appoint all members of the Board of Directors of the CCB. No General Managers of the CCIs will be appointed to the CCB Board; see notified restructuring plan, p. 38.

42 See notified restructuring plan, p. 40.

43 See notified restructuring plan, p. 49.

44 See notified restructuring plan, p. 40.

45 See notified restructuring plan, p. 39.

the shareholding and to implement and monitor the restructuring of the sector including the commitments attached to any relevant State aid decision of the European Commission.

(54) A Relationship Framework Agreement was established between Cyprus and the CCB in December 2013 to ensure the adoption of sound policies by the CCB with respect to the restoration of the viability of the Cooperative banking sector[46]. That agreement clarifies the State's (Ministry of Finance) power of decision over the CCB while avoiding political interference with the day-to-day management decisions.

(55) A key part of the governance rules of the restructuring plan concerns cooperatives' risk awareness and management as well as credit review processes. Accordingly, following recapitalisation of the merged CCIs, the CCB will be empowered with the executive management of the entire group including its future risk management. The CCB's Board will be responsible for the group's risk strategy including the adoption of risk limits and will be the highest credit approving authority. It will approve and review the credit risk policy of the Cooperative group, will ensure the compliance of the CCIs with that policy and will review all significant credit exposures and non-performing loans of the CCB and the CCIs (for further details see recitals (78) et. seq.).

3.3.3. CCI mergers and reduction of branches

(56) In order to improve operational efficiency the restructuring plan envisages the reduction of the number of CCIs from 93 (as of 30 September 2013) to a maximum of 18 by means of mergers. That process has already started and by 30 January 2014 the number of the CCIs had been reduced to 36 through mergers. As agreed with Cyprus the process will be finalised by 31 March 2014.[47]

(57) Of the 18 new CCIs there will be six in Nicosia, three in each of Larnaca and Limassol and one in each of Famagusta and Paphos. Furthermore, out of the 18 CCIs, there will be four so-called professional CCIs. They are not defined by the regions in which their members are located but by their profession (e.g. teachers or police officers). If one or more of those 18 CCIs turns out to be non-viable during the restructuring period (in the sense of non-achieved cost-income ratio targets by 2017[48]), the restructuring plan foresees the merger of non-viable CCIs with viable ones and thereby a further reduction in the number of CCIs.[49]

(58) Furthermore, the restructuring plan foresees a reduction of the number of the branches of the remaining CCIs. In December 2012 the 93 CCIs still had 417 branches of which, according to the commitment submitted by Cyprus, 258 (197 of which will operate full-time) will remain by 31 December 2015.

3.3.4. Proposed divestments

[46] See European Commission, Occasional Papers 169, The Economic Adjustment Programme for Cyprus, Second Review - Autumn 2013, p. 61 (Memorandum of Understanding on Specific Economic Policy Conditionality).

[47] See European Commission, Occasional Papers 169, The Economic Adjustment Programme for Cyprus, Second Review - Autumn 2013, p. 61 (Memorandum of Understanding on Specific Economic Policy Conditionality).

[48] See Commitments of Cyprus, the Annex to this decision, point 36.

[49] See also European Commission, Occasional Papers 161, The Economic Adjustment Programme for Cyprus, First Review Summer 2013, p. 74 (Memorandum of Understanding on Specific Economic Policy Conditionality).

(59) In view of the fact that the Cooperative group carries out traditional, domestic retail and small and medium-sized enterprise ("SME") banking without expanding internationally or into other financial services markets, the CCB and the CCIs have hardly any businesses that are not related to their core retail banking with the exception of the so-called "Commercial Activities". Commercial Activities concerns the trading (import and distribution) of farming-related products, accounts for rather small turnover[50] and is overall loss-making (2013). Cyprus committed the Cooperative group to sell or wind down all of those commercial operations before 2016).[51]

(60) Apart from the (non-banking) Commercial Activities, the CCIs also hold majority and minority participations in some small companies such as an estate development and an IT company or a fund. As stipulated in the commitments provided by Cyprus, all participations of the Cooperative group that are considered as non-core business will be divested before 31 December 2018.[52]

3.4. Assumptions of the restructuring plan

(61) The restructuring plan took its basic macro-economic assumptions from the Central Bank of Cyprus. Accordingly, after a sharp decline in 2013, Cyprus' GDP is expected to further contract during 2014 but will improve slowly as of 2015. The forecast for unemployment follows the path for GDP with unemployment increasing in 2013 and 2014 and declining as of 2015. House prices are likely to recover from 2016 onwards only:

Table 2 – Key macro-economic assumptions[53]

Macroeconomic Assumptions – Cyprus (2013-2020)								
	2013	*2014*	*2015*	*2016*	*2017*	*2018*	*2019*	*2020*
GDP at constant prices (%)	*-8.7*	*-3.9*	*1.1*	*1.9*	*2.3*	*2.2*	*1.9*	*1.8*
Unemployment (%LFS)	*17.0*	*19.5*	*18.7*	*17.5*	*12.9*	*12.0*	*11.1*	*10.2*
3m Euribor	*0.2*	0.3	*0.5*	*0.6*	*0.7*	*0.8*	*0.9*	*1.0*
HICP inflation (%)	*1.0*	*1.2*	*1.6*	*1.7*	*1.7*	*1.8*	*1.9*	*2.0*
Core inflation	*0.5*	*0.8*	*1.4*	*1.5*	*1.5*	*1.6*	*1.7*	*1.8*
*[ ]**	*[ ]*	*[ ]*	*[ ]*	*[ ]*	*[ ]*	*[ ]*	*[ ]*	*[ ]*

(62) As regards key business parameters such as interest yields, income, NPL evolution and provisioning, the restructuring plan is based on the following assumptions[54]:

---

50 CCB's Commercial Services Unit accounted for roughly EUR 13 million sales and a loss of EUR 164,000 in 2013 while the CCIs' commercial activities together accounted for about EUR 6 million total income with a loss of roughly EUR 600,000 in 2013, see notified restructuring plan, pp. 84-87.

51 As to viable activities that are to be transferred at fair value to non-credit cooperative companies in return for equity participation in those non-credit cooperative companies, the latter will be sold before 2018; see Commitments of Cyprus in the Annex to this decision, point 42.

52 See Commitments of Cyprus in the Annex to this decision, point 43.

53 See notified restructuring plan, p. 33.

* Confidential information; the omissions are shown as […].

54 They are partly taken from the so-called Pimco report of February 2013, an independent due diligence report on the banking sector in Cyprus. Pimco, *Independent Due Diligence of the Banking System of Cyprus*, February 2013, prepared for the Steering Committee comprising the Central Bank of Cyprus and other Cypriot authorities, European Institutions such as the European Commission, the ECB and

(a) Decrease of gross yield on customer loans from an average yield of 6% in 2013 to 4.6% by 2016 (mainly due to not recognizing any interest income on expected losses) and of yield on customer deposits from an average yield of 3.8% in 2012 to 2.5% in 2014 and flat afterwards;

(b) No income recognition on expected losses of EUR 2.8 billion[55];

(c) Loan repayments equal new origination for the period;

(d) [ ], and

(e) The NPL ratio for the Cooperative group is estimated at 60% from 2015 (65% for CCIs only).

3.5. Financial projections (base case scenario)

(63) The projected P&L are presented in Table 3.

Table 3 - Projected P&L of the consolidated Cooperative banking sector[56]

Income statement, EUR m	2012A	2013E	2014E	2015E	2016E	2017E	2018E
Interest income from customer receivables	842.2	778.0	679.9	650.9	627.0	636.5	640.3
Interest income from investments and cash	81.0	57.9	48.5	48.2	55.2	56.0	57.2
Interest expense from customer deposits	(580.9)	(473.5)	(332.2)	(325.6)	(323.9)	(325.5)	(330.4)
Interest expense other	(4.4)	(2.1)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Net interest income	**338.0**	**360.3**	**395.2**	**372.6**	**357.4**	**366.0**	**366.1**
Net commision income	35.5	35.2	34.5	34.3	34.3	31.5	31.9
Other income	23.7	17.5	17.5	17.5	17.5	11.4	11.4
Total operating income	**397.1**	**413.0**	**447.3**	**424.4**	**409.2**	**408.9**	**409.5**
Staff costs	(123.6)	(122.2)	(98.1)	(95.2)	(95.2)	(90.7)	(90.7)
Other costs	(69.9)	(56.0)	(47.4)	(48.4)	(46.9)	(45.0)	(45.0)
Depreciation	(12.6)	(12.3)	(13.8)	(13.8)	(13.8)	(12.4)	(12.4)
Total operating expenses	**(206.1)**	**(190.5)**	**(159.3)**	**(157.5)**	**(155.9)**	**(148.2)**	**(148.2)**
Operating profit	**191.0**	**222.5**	**287.9**	**266.9**	**253.3**	**260.7**	**261.3**
Provisions	(173.5)	(1,076.4)	(861.1)	(215.3)	(53.7)	(53.7)	(53.7)
Other non-recurring costs *	(13.5)	(83.8)	(7.7)	(0.1)	(0.1)	(0.1)	(0.1)
Restructuring costs & SSD negotiation fees			(20.7)				
Profit / (Loss) before Tax	**4.0**	**(937.6)**	**(601.6)**	**51.5**	**199.5**	**206.9**	**207.6**
Tax	(20.0)	(27.9)	1.7	(23.2)	(28.7)	(28.9)	(29.0)
Net income / (Loss)	**(16.0)**	**(965.5)**	**(599.9)**	**28.3**	**170.8**	**178.0**	**178.6**

Profitability

(64) Over the coming years, it is expected that the increasing number of NPLs and the decreasing net loans [57] will result in lower yields and, consequently, in a decreased gross interest income for the consolidated Cooperative group. Interest expenses will also decrease in view of lower cost of deposits and expected deposit outflows. Overall, the total operating income is assumed to increase from roughly EUR 397 million in 2012 to EUR 410 million in 2018.

the ESM as well as the IMF; see: http://www.centralbank.gov.cy/media/pdf/CyprusIndependentDueDiligenceReport_18April.pdf.

55 Total expected losses of (1) EUR 1.4 billion as estimated in the adverse scenario of the Pimco report, which, however, only included the CCB and 16, mostly larger CCIs, plus (2) EUR 1.4 billion losses for the remaining CCIs (see submission of 4 June 2013 of Capital Need Assessment, notified restructuring plan, pp. 93-95, and Pimco report, p. 16).

56 See notified restructuring plan, p. 95; A= audited figures (not yet available for 2013), E= expected figures.

57 Net loans are gross loans minus provisions.

(65) As set out in greater detail by the commitments provided by Cyprus, the CCIs and the CCB will ensure that the pricing of deposits improves their viability and their future profitability and that the average interest rate paid on each new deposit category per month, until 31 December 2018, will not exceed the respective interest rates of the preceding month paid by the Monetary Financial Institutions in Cyprus.[58]

(66) Finally, the Cooperative group will make every effort to recover value from NPLs by, for instance, implementing recovery and legal actions and initiating systematically proceedings to seize and sell the pledged collaterals.[59]

Operational efficiency

(67) The restructuring plan envisages that by the end of the restructuring period the total operational expenses of the CCIs will be reduced by almost EUR 60 million[60] compared to 2012.

(68) The planned staff cost reductions are to be achieved by three main measures: a) general payroll cost reductions of 15%-16%; b) a Voluntary Redundancy Scheme ("VRS"); and c) a pay equalisation (harmonisation) process.

(69) The restructuring plan estimated that the general payroll cost reduction will result in EUR 17 million of staff cost reductions for 2014 and in EUR 15 million[61] annually from 2015 onwards. The VRS is expected to result in annual savings of payroll costs of EUR 11 million in 2014 and EUR 15 million annually from 2015 onwards (against a one-off cost of EUR 21 million)[62]. Further staff cost reductions are supposed to come from a planned pay-scale harmonization (currently there are significantly different remuneration levels and schemes across the CCIs).

(70) During the restructuring period the remuneration of any member of staff, including board members and senior managers, may not exceed 15 times the national average salary in Cyprus or 10 times the average salary of the employees in the Cooperative group, whichever is higher.[63]

(71) As a consequence mainly of the VRS and as set out in a commitment provided by Cyprus, the number of full-time equivalent employees ("FTE") in the Cooperative banking sector will be reduced (from almost 3,000 at the end of 2013 to not more than 2,580 from 31 December 2014 onwards until 31 December 2018)[64].

(72) The reduction of the number of CCI branches will also contribute to a reduction of costs unrelated to staff.

---

[58] See Commitments of Cyprus in the Annex to this decision, points 37 and 38; Monetary Financial Institutions" (MFIs) are central banks, resident credit institutions and other resident financial institutions whose business is to receive deposits and/or close substitutes for deposits from entities other than MFIs and, for their own account (at least in economic terms), to grant credits and/or make investments in securities.

[59] See Commitments of Cyprus in the Annex 1, points 39-41.

[60] See notified restructuring plan, p. 73.

[61] The lower annual cost savings compared to 2014 can be explained by the fact that there will be fewer employees from 2015 onwards.

[62] All figures are rounded.

[63] See Commitments of Cyprus, in the Annex to this decision point 30.

[64] See Commitments of Cyprus in the Annex to this decision point 32.

(73) As regards the total operating expenses, Cyprus submitted a commitment that certain thresholds – from EUR 160 million in the accounting year 2014 to EUR 149 million in the accounting year 2018 – are not be exceeded.[65]

(74) Based on the assumptions described in recitals (61) and (62) and the projected income and cost developments in Table 3, it is expected that after the consolidation process the Cooperative banking sector will have in the base case scenario a negative return on equity ("RoE") until 2014 and from 2015 onwards positive RoEs of between 2.4% and 13.5%. In view of the decreasing income and the non-existent to modest cost savings in 2012 and 2013 the cost-income ratio of the Cooperative group increased (to a rounded 52% in 2012 and 46% in 2013) but is estimated, due to the restructuring measures, to decrease to between roughly 36% and 38% in the period 2014-2018 in the base case scenario. Cyprus is committed to not exceed a defined cost-income ratio maximum in a given year.[66]

(75) Those projected ratios as well as the core tier 1 capital ("ct1") ratio (i.e. as a percentage of risk weighted assets, "RWA") are illustrated in Table 4.

Table 4 - Projected key ratios (base case)[67]

	2014	2015	2016	2017	2018
Ct1/RWA	10.9%	10.1%	11.6%	13.2%	14.2%
Return on Equity (RoE)	-85.0%	2.4%	13.5%	12.3%	11.0%
Cost-Income Ratio	35.6%	37.1%	38.1%	36.2%	36.2%

Risk reduction

(76) Under the notified plan, the Cooperative group will continue to provide retail and SME banking services, and will not expand in other geographical markets or into other types of financial activities[68].

(77) Within the existing scope of activities, however, risk management and monitoring including the NPL management will be improved significantly

(78) In that respect, the re-organisation of the risk management with the CCB as the highest credit approving and controlling body is an important element. The CCB will be ultimately responsible for the Cooperative group's internal control, will have the ultimate responsibility to assess and monitor the group's risks and will be the highest credit-approving authority. It will determine the risk profile, adopt risk limits, and ensure the compliance of CCIs with that policy.

(79) There will be clear assignment of tasks and responsibilities to the risk management divisions at the first (the CCB) level and at the second level (the CCI level), to the risk committee, managers and officers.

(80) In that context Cyprus has submitted a commitment to ensure that the internal audit and the risk management departments are fully independent from the

[65] See Commitments of Cyprus in the Annex to this decision point 34.

[66] The group's cost income ratio shall not exceed 42% in accounting year 2014, 43% in accounting year 2015, 44% in accounting year 2016 and 42% in the accounting years 2017 and 2018; see Commitments of Cyprus in the Annex to this decision point 35.

[67] See notified restructuring plan, p. 95.

[68] See Commitments of Cyprus in the Annex to this decision, points 4, 28 and 29.

commercial networks of the CCIs and report to the Board of Directors through the Board Audit and Risk Committee with notification to the General Manager. The Board Audit and Risk Committees will be assess all issues that are raised by those departments, and a Credit Policy enacted by the CCB will provide guidance and compulsory instructions to the CCIs regarding the granting of loans, including the pricing of loans and the restructuring of loans.[69] A commitment also ensures the definition of thresholds within that Credit Policy above which the granting of loans must be approved by higher levels of management. It also provides for a centralised decision-making process at CCB level, while safeguards will ensure a consistent implementation of the CCB's instructions within the Cooperative group.[70]

(81) Further commitments submitted by Cyprus make it obligatory that the pricing of loans and mortgages comply with strict guidelines. They include the obligation to respect, inter alia, the Cooperative group’s defined interest rate bands, the credit risk assessment of the customer and the expected recoverability of pledged collateral and a requirement that exceptions will need to be duly authorized by the Board Risk Committee (or at lower level of authority when allowed by the Credit Policy).[71]

(82) Cyprus also submitted commitments regarding connected borrowers such as employees, managers or their spouses and children as well as politically exposed individuals and parties. Those commitments aim at ensuring, inter alia, that lending to that defined circle of borrowers is based on commercial criteria and that they are no less strict than those to other, non-connected borrowers and that strict individual and aggregated limits apply at the level of the Cooperative group governing the maximum loan amount that can granted to a single credit risk[72].

(83) The other key issue is the handling of the large volume of overdue loans. As regards loans that are past due more than 90 days (NPLs that account for a balance of EUR 5.6 billion), it is planned to create a so-called Shared Services Division ("SSD") within the CCB. The task of the SSD will be to centrally manage – via five regional centres - the NPLs of the Cooperative group with the aim of restructuring and recovering value from them and of providing support to the merged CCIs.

(84) The restructuring plan initially foresees the transfer of loans with balances that are greater than EUR 200,000 and past due >180 days to the SSD (representing, as of 30 November 2013, 29% of all loan balances) and, following a review period of three months, to possibly lower the threshold for loan transfers. It should be noted that the transfer will be merely affected for the purpose of managing the arrears and thus no legal transfer of the assets between CCIs and the CCB is foreseen.[73]

[69] See Commitments of Cyprus, Annex 1, point 14; furthermore, an adequate Internal Audit Charter and Risk Management Charter will be enacted, and specify the roles, responsibilities and necessary resources of these departments. Those charters will comply with international standards and secure a full independence to the departments.

[70] See Commitments of Cyprus in the Annex to this decision, point 15.

[71] See Commitments of Cyprus in the Annex to this decision, point 17.

[72] See Commitments of Cyprus in the Annex to this decision, points 20 and 21.

[73] See notified restructuring plan, p. 74.

(85) The SSD will, furthermore, provide support to the CCIs regarding arrears management and the potential restructuring or recovery of loans.

(86) To ensure a viability-enhancing restructuring and reduction of NPLs as well as a maximisation of value recovering from those NPLs, Cyprus submitted a number of commitments - also relating to connected borrowers - that will be discussed further below. [74]

(87) The projected consolidated balance sheet is presented in Table 5.

Table 5 – Projected balance sheet in EUR million[75] (base case)

Balance sheet, EUR m	2012A	2013E	2014E	2015E	2016E	2017E	2018E
Gross customer receivables	13.924,2	13.370,4	13.639,2	13.913,4	14.193,1	14.478,3	14.769,3
Provisions	(674,0)	(1.841,3)	(2.851,8)	(3.262,2)	(3.524,2)	(3.806,5)	(4.108,8)
Net customer receivables	13.250,2	11.529,1	10.787,4	10.651,2	10.668,8	10.671,8	10.660,5
Cash & balances with CBC	1.381,7	1.161,0	686,9	629,2	603,4	577,4	551,1
Financial Assets at FVTPL and AFS	25,0	30,6	33,6	33,6	33,6	33,6	33,6
ESM bond			1.500,0				
PP&E, Investments, Property	648,2	476,3	477,4	477,4	477,4	477,4	477,4
Debt Securitiess	1.733,8	1.043,2	1.019,7	2.612,4	2.791,5	3.120,8	3.595,9
Intangible Assets	1,7	1,2	7,1	7,1	7,1	7,1	7,1
Other assets	55,6	62,3	62,3	62,3	62,3	62,3	62,3
Total assets	**17.096,1**	**14.303,7**	**14.574,3**	**14.473,2**	**14.644,1**	**14.950,3**	**15.387,8**
Customer deposits	15.264,9	13.516,5	[ ]	[ ]	[ ]	[ ]	[ ]
Central bank and government	260,2	263,3	[ ]	[ ]	[ ]	[ ]	[ ]
Other liabilities	254,7	268,2	[ ]	[ ]	[ ]	[ ]	[ ]
Total liabilities	**15.779,8**	**14.048,0**	**13.418,4**	**13.289,0**	**13.289,0**	**13.417,1**	**13.676,1**
Shareholder's equity	**1.316,3**	**255,7**	**1.155,9**	**1.184,3**	**1.355,1**	**1.533,2**	**1.711,8**
Share Capital	*17,6*	*22,1*	*1.517,6*	*1.517,6*	*1.517,6*	*1.517,6*	*1.517,6*
Share Premium	-	-	-	-	-	-	-
Revaluation Reserve	*149,4*	*29,2*	*29,2*	*29,2*	*29,2*	*29,2*	*29,2*
Retained Earnings / (Accumulated Losses)	*1.149,3*	*204,5*	*(390,9)*	*(362,5)*	*(191,7)*	*(13,6)*	*165,0*
Total liabilities and equity	**17.096,1**	**14.303,7**	**14.574,3**	**14.473,2**	**14.644,1**	**14.950,3**	**15.387,8**

A= audited figures (not yet available for 2013), E= expected figures.

(88) The projected reduction of the total assets from EUR 17.1 billion in 2012 to EUR 15 billion in 2017 and EUR 15.4 billion in 2018 amounts to 12.6% when comparing 2012 with 2017 and to 10% when comparing 2012 and 2018. The downsizing of the balance sheet will come mainly from provisioning (i.e. loan losses). The restructuring plan assumes that repayments out of existing loans would be fully used for new lending.

3.6 Stress case scenario

(89) With the restructuring plan Cyprus also provided projections for a pessimistic scenario with differences in parameters compared to the base case scenario to reflect expectations for further deterioration in deposits outflows in combination with higher deposit yields as a response to competitors' strategy.

[74] Recital (126) et. seq.
[75] See notified restructuring plan, p. 95.

(90) In comparison with the base case scenario, in the stress case pre-provision profit in 2017 as well in 2018 drops from EUR 261 million in the base case to EUR 209 million (2017 and 2018) in the pessimistic case. As Table 5 above and Table 6 below show, the return on equity decreases from 12.3% in the base case scenario in 2017 (and 11% in 2018) to 9.9% in 2017 and 9.0% in 2018 in the pessimistic case and the cost income ratio increases from 36% to 41.5% (in 2017 and 2018):

Table 6 - Projected key ratios (stress case)[76]

	2014	2015	2016	2017	2018
Ct1/RWA	10.3%	9.2%	10.3%	11.4%	12.2%
Return on Equity (RoE)	-97.7%	-2.2%	10.4%	9.9%	9.0%
Cost to Income Ratio	41.4%	42.5%	43.5%	41.5%	41.5%

(91) According to the restructuring plan, however, the Cooperative group is still profitable and generates EUR 150 million in profits before tax and the cost/income ratio remains below the committed target.

4. POSITION OF THE CYPRIOT AUTHORITIES

(92) The Cypriot authorities agree that the State recapitalisation constitutes State aid to the Cooperative banking sector in the form of the recapitalisation of the CCB, but consider that it is compatible with the internal market on the basis of Article 107(3)(b) of the Treaty on the Functioning of the European Union ("the TFEU"), as it is necessary to remedy a serious disturbance in the Cypriot economy.

(93) The Cypriot authorities view the restructuring plan as an appropriate means to ensure the restoration of the long-term viability of the CCB and the CCIs. They submit that "the strategy is to restructure the Cooperative banking sector into a viable, vital, and dynamic component of the Cypriot banking system which will maintain the diversity of the financial system and enhance the overall financial stability" and that it "is predicated on treating the sector as a single economic unit through consolidation, effective cost control, enhanced governance, and robust risk management" with "the CCB … (tackling) the issues which led to the failure of the sector".[77] It is also part of the strategy that the Cooperative group will become "a key lever for the re- engineering of the Cypriot economy and a cornerstone of a sustainable economic model for the country."[78]

(94) The Cypriot authorities have submitted a number of commitments relating to the implementation of the restructuring plan and the individual restructuring measures. Most of those commitments have already been described in parts 3 and 4. The complete list is presented in the Annex to this Decision.

---

[76] See notified restructuring plan, p. 101.
[77] See notified restructuring plan, p. 4.
[78] See notified restructuring plan, p. 37.

(95) The Cypriot authorities also submit that the beneficiaries provide appropriate own contributions to the restructuring costs, in particular by means of the almost complete dilution of the existing shareholders but also through significant cost-cutting measures, for instance, the general payroll reduction of 15%-16% and a general cap on remuneration.[79]

(96) With respect to the mitigation of distortions of competition, Cyprus refers to a number of structural and behavioural measures. The Cypriot authorities submitted, for instance, a set of commitments that provide for certain behavioural restrictions on the CCB and the CCIs, such as refraining from advertising referring to the State support, from employing of aggressive commercial strategies that would not take place without public support or from acquiring stake in companies, be it an asset or share transfer, subject to some exceptions specified in the Annex to this decision[80].

(97) As to structural measures, Cyprus committed the CCB and CCIs to wind down or sell their non-banking activities and to divest their financial stakes in companies or funds (participations) that do not belong to their core business.[81]

(98) Table 5 shows that the envisaged reduction of the balance sheet is limited to -10% by 2018 in the base case scenario. The Cypriot authorities, however, take the position that the Cooperative banking sector must continue to finance and support the Cypriot economy in view of the fact that the whole Cypriot banking sector has been shrinking fast and heavily.

5. Assessment of the Aid

5.1 Existence of State Aid

(99) According to Article 107(1) TFUE, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

(100) The qualification of a measure as State aid depends on the following criteria: (i) the measure must be financed through State resources; (ii) it must grant an advantage liable to favour certain undertakings or the production of certain goods; (iii) that advantage must be selective; and (iv) the measure must distort or threaten to distort competition and have the potential to affect trade between Member States. All of these criteria must be fulfilled for a measure to qualify as State aid.

(101) Since the Cypriot authorities are providing the Cooperative group with a EUR 1.5 billion capital injection, State resources are clearly involved.

(102) The recapitalisation strengthens the capital of the Cooperative group allowing the CCIs to comply, on a consolidated basis, with the regulatory capital requirement. Without the EUR 1.5 billion capital injection, the capital of the Cooperative group would fall below regulatory requirements and most probably turn negative in 2014, such that the Cooperative group would no longer operate as a going concern on the market.

---

[79] See notified restructuring plan, p. 108

[80] See Commitments of Cyprus in the Annex to this decision, points 5 and 6.

[81] See recital (59).

(103) Under the current circumstances no private investor would have provided the Cooperative group with such capital resources. The Governor of the Central Bank of Cyprus has confirmed that the Cooperative group "have not managed to raise these capital requirements from their existing shareholders/members or other private sources"[82]. The Commission observes that the EUR 1.5 billion recapitalisation is a risky investment, given the fact that the Cypriot economy has not yet stabilised and the fact that the return to profitability depends also on the successful implementation of the far-reaching restructuring plan. In addition, under the financial projections of the plan (Table 3) the losses will be so high that the entire existing capital will be depleted plus a part of the EUR 1.5 billion capital injected so that the shareholder equity will amount to EUR 1.15 billion by the end of 2014. The independent valuation report ordered by the authorities also confirms that pre-recapitalisation the fair value of the assets of the Cooperative group is lower than its liabilities. The Commission concludes that the capital injection by the Cypriot Republic entails an advantage to the Cooperative group. The measure has been taken for the sole benefit of the Cooperative group and is, therefore, selective.

(104) Given that the Cooperative group is and will be active in the Cypriot retail and SME banking market, where it is in competition with subsidiaries and branches of financial institutions headquartered in other Member States, the advantage from State resources affects trade between the Member States and distort competition.

(105) It is therefore confirmed that the State recapitalisation in favour of the Cooperative group constitutes State aid within the meaning of Article 107(1) TFEU.

5.2 Compatibility of the aid

5.2.1. Application of Article 107(3)(b) of the Treaty on the Functioning of European Union

(106) Under Article 107(3)(b) TFEU State aid can be found compatible with the internal market if it serves to "remedy a serious disturbance in the economy of a Member State". The Commission has acknowledged that the global financial crisis can create a serious disturbance in the economy of a Member State and that State measures supporting banks are suitable to remedy that disturbance. That position has been successively detailed and developed in the six Crisis Communications[83] as well as in the 2013 Banking Communication applicable from 1 August 2013[84].

---

82 Letter dated 31 January 2014 annexed to the notification.

83 Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis (*"2008 Banking Communication"*), OJ C 270, 25.10.2008, p. 8; Communication on the recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition (*"Recapitalisation Communication"*), OJ C 10, 15.1.2009, p. 2; Communication from the Commission on the treatment of impaired assets in the Community financial sector (*"Impaired Assets Communication"*), OJ C 72, 26.3.2009, p. 1; Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules (*"Restructuring Communication*"), OJ C 195, 19.8.2009, p. 9; Communication from the Commission on the application, from 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis ("*2010 Prolongation Communication"*), OJ C 329, 7.12.2010, p. 7 and the Communication from the Commission on the application, from 1 January

(107) The Commission's approval of the Cypriot guarantee scheme for banks which meanwhile has been prolonged three times confirms that stabilising the banking sector is necessary to remedy the ongoing disturbance in the Cypriot economy[85]. The Economic Adjustment Programme for Cyprus, as agreed by the European Commission, the ECB, the IMF and the Cypriot authorities, also underlines the key roles of stabilizing the banking sector, including the Cooperative banking sector. The Governor of the Central Bank of Cyprus also indicates that allowing the Cooperative group to continue lending "is a necessary condition for the recovery of the economy and for the restoration of confidence in local financial system".[86]

(108) Given the relevance of the Cooperative group for the Cypriot banking sector and in particular for the financing of the real economy, the Commission accepts that the Cooperative group's failure to satisfy strengthened capital requirements would have threatened financial stability and that the State intervention was therefore necessary to avoid a serious disturbance in the economy.

(109) The Commission therefore considers that the State recapitalisation in favour of the Cooperative group has to be examined under Article 107(3)(b) TFEU.

5.2.2. Compatibility of the aid: applicable communications

(110) The Restructuring Communication sets out the rules applicable to the granting of restructuring aid to financial institutions in the current crisis. According to that Communication, in order to be compatible with the internal market under Article 107(3)(b) of the Treaty, the restructuring of a financial institution in the context of the current financial crisis has to (i) lead to the restoration of the viability of the bank, (ii) include sufficient own contribution by the beneficiary (burden-sharing) and ensure that the aid is limited to the minimum necessary and (iii) contain sufficient measures limiting the distortion of competition. The Commission will examine the restructuring plan to ensure that those requirements are fulfilled as regards the State recapitalisation measure in question.

(111) Since the measure has not been granted yet and was notified in 2014, it falls within the scope of the 2013 Banking Communication, which lays down additional requirements in terms of burden-sharing and minimisation of the aid to the minimum.

5.2.2.1. Restoration of long-term viability

(112) In assessing a restructuring plan the Commission needs to determine, first, whether the bank or group in question is able to its restore long-term viability without State aid (section 2 of the Restructuring Communication).

(113) According to the Restructuring Communication, the restructuring plan should identify the causes of the bank's difficulties and the bank's own weaknesses and outline how the proposed restructuring measures remedy these problems.

2012, of State aid rules to support measures in favour of banks in the context of the financial crisis ("*2011 Prolongation Communication*"), OJ C356, 6.12.2011, p. 7..

84 OJ C 216, 30.7.2013, p. 1.

85 OJ C173, 19.6.2013, p. 6; OJ C 77, 15.3.2013, p. 10; OJ C261, 10.9.2013, p. 3. The last prolongation, adopted on 18 December 2013, has not yet been published.

86 Letter dated 31 January 2014, annexed to the notification.

(114) Long-term viability is achieved when a bank is able to compete in the marketplace for capital on its own merits in compliance with the relevant regulatory requirements. For a bank to do so, this includes covering all its costs and providing an appropriate return on equity taking into account the risk profile of the bank. The return to viability should mainly derive from internal measures.

Assumptions of the restructuring plan

(115) Point 13 of the Restructuring Communication requires that the restructuring plan is based on assumptions which are compared with appropriate sector-wide benchmarks, adequately adjusted to take account of the new elements of the current crisis in financial markets and incorporate a sufficient degree of stress.

(116) The macroeconomic assumptions described in recital (61) are in line with the macroeconomic forecasts used for the Economic Adjustment Programme for Cyprus as agreed between Cyprus and the European Commission, the ECB and the IMF.[87]

New ownership and governance structures

(117) The Commission notes positively the fact that the new ownership and governance structure will create a real group with a controlling parent (CCB) and thereby end the lack of accountability among the various cooperative bodies (in particular the risky lending policy of the CCIs which tended to act independently despite their coverage by the CCB guarantees).

(118) It is positive that the new governance rules provide for clear decisional powers and responsibilities between, first, the shareholder (i.e. the State) and the CCB and, secondly, the CCB and the CCIs regarding key areas such the right to appoint and approve Board members and senior management of the CCB and of the CCIs, to determine the group's new business and credit policy and to implement a centralised NPL management.[88] Those rules are based on a number of new or amended laws, decrees and directives[89] that have been already adopted and that precisely define the decision power of the State over the CCB, the CCB's controlling powers over the CCIs and the role and functions of the various bodies of the CCB and the CCIs. Supervision of the Cooperative group will be integrated into the Central Bank of Cyprus so that the same regulatory standards will be applied to it as for other credit institutions.

(119) The Commission notes positively that the management of the CCB will be changed. The new management of the CCB will play a key role in the successful implementation of the restructuring plan. The majority of the new CCB Board members, including some executive Board members, have already been appointed.

(120) One of the CCB's tasks is to ensure that the CCIs' Boards of Directors and Executive Committees as well as the key persons managing the CCIs have sufficient knowledge in the position they hold. To that end suitable candidates for positions such as the General Manager, Internal Auditor or Risk Management officer of the newly merged CCIs will be assessed based on a

[87] See European Commission, Occasional Papers 161, The Economic Adjustment Programme for Cyprus, First Review Summer 2013, pp. 14, 16 and 63; see also International Monetary Fund, Cyprus, First Review under the Extended Arrangement under the Extended Fund Facility and Request for Modification of performance Criteria, September 2013, pp. 14 and 37.

[88] See recitals (50) to (55) and (78) et. seq.

[89] See recital (38).

standardised approach that includes the past financial performance of the CCIs in question. The Commission observes that such an approach ensures that managers who mismanaged their CCI in the past no longer enjoy a management position and ensures that new managers are sufficiently qualified.

Loan underwriting process, risk and NPL management

(121) Since the poor loan underwriting process and the underdeveloped risk management were major causes of the cooperatives' difficulties, the Cooperative group's future risk policy will be decisive for the success of the restructuring.

(122) Regarding governance rules for risk management, the restructuring plan envisages a clear leading role for the CCB, as the highest credit-approving authority. As the central controlling body it will set, approve and review the group's credit policy and credit exposures including the CCIs' compliance with that policy. In case of non-compliance the CCB has the power to remove the CCIs' general managers, directors or other key personnel, restrict transactions and, finally, to sever – in agreement with the Central Bank - the affiliation of a CCI with the CCB.

(123) The Commission regards that new governance structure with respect to a centrally shaped and controlled risk management and monitoring as essential. In that respect the Commission finds the commitments submitted by Cyprus to ensure the compliance with loan pricing and restructuring guidelines and other set standards – such as the independence of the internal audit and risk management departments – very important elements to restore viability and profitability.[90]

(124) In the Commission's opinion it is essential for the success of the restructuring plan that the Cooperative group does not engage in new risky lending practices and that the CCB ensures proper assessment of credit risks and the valuation of collateral within the Cooperative group. In that context, the commitments Cyprus submitted regarding procedures and limits to be put in place as to lending to connected borrowers play a significant role in the Commission's positive assessment of the plan. Those commitments include the monitoring of the exposure of the Cooperative group to connected borrowers including public sector entities and political parties, the limits for new loans to connected borrowers and the pricing of those loans which should not be more advantageous than the conditions offered to similar but unconnected borrowers.[91] Furthermore, the Cooperative group may not grant loans to borrowers which aim to purchase shares or hybrid instruments of the CCIs or other credit institutions.[92]

(125) While one key element of the restructuring plan is the prevention of new risky loans and funding of troubled assets, another key element is the reduction of existing loans that are performing badly or not at all. In that respect, the Commission notes the principal effort undertaken by the Cypriot authorities

[90] See recitals (76) to (86).
[91] See Commitments of Cyprus in the Annex to this decision, points 19 to 21 and 23.
[92] See Commitments of Cyprus in the Annex to this decision, point 22.

with respect to the adoption of the necessary legal framework for the whole Cypriot banking sector.[93]

(126) Regarding the Cooperative group, the process to truly deal with NPLs - to restructure loans where possible and commercially justifiable within the limits defined in the commitments but also to recover value from troubled assets - has not started yet. However, the Commission positively notes the envisaged new structures with the proposed central management of past due loans through the SSD, which will be a central CCB division, and regards it as an important pre-condition for a successful handling of NPLs within the Cooperative group.

(127) It should be emphasised, however, that the practical implementation of the new plans for handling NPLs will be the decisive factor. In that context the Commissions pays particular attention to the commitments Cyprus submitted under which:

- clear instructions will be given on the restructuring of loans (defining which loans are eligible, under which circumstances, and indicate the terms and conditions that can be proposed to eligible customers) and that the restructuring policy will in no case jeopardize the future profitability of the Cooperative group;[94]
- the restructuring of loans involving connected borrowers will comply with the same requirements as for unconnected borrowers;[95]
- the CCB enacts a claim and litigation policy aiming at maximizing recovery and preventing any discrimination or preferential treatment in the management of litigation[96];
- recovery and legal actions will be implemented systematically and in line with the provisions of the Arrears Management Directive of 2013 and the Code of Conduct of handling of borrowers;[97]
- the CCIs will systematically initiate legal or administrative proceedings aiming at seizing and selling the pledged collateral of each and every loan that becomes non-performing (except for the loans eligible for restructuring);[98]
- a special unit will be dedicated to engage in selling foreclosed properties.[99]

(128) On the basis in particular of the implementation of those commitments the Commission regards the new governance, risk management and monitoring structures as appropriate to support the restoration of the Cooperative group's long-term viability.

Operational efficiency

(129) Since they are indispensable to restore viability and profitability, the Commission notes positively that significant rationalising and cost-cutting

[93] See, for instance, *Directive on the Definitions of Non-Performing and Restructured Credit Facilities* of 2013, *Directive on Arrears Management* of 2013 and *Code of Conduct on the Handling of Borrowers in Financial Difficulties* of 2013.
[94] See Commitments of Cyprus in the Annex to this decision, point 24.
[95] See Commitments of Cyprus in the Annex to this decision, point 25.
[96] See Commitments of Cyprus in the Annex to this decision, point 26.
[97] See Commitments of Cyprus in the Annex to this decision, point 39.
[98] See Commitments of Cyprus in the Annex to this decision, point 40.
[99] See Commitments of Cyprus in the Annex to this decision, point 41.

measures which are included in the restructuring plan, as illustrated in recitals (67) to (73). At the same time, it is positive that the services that need to be reinforced or developed to build a viable bank, such as risk management and the management of NPLs, will receive the necessary resources.

(130) The main cost-cuttings stem from the general reduction of the payroll costs of 15% to 16% and the VRS in combination with the dramatically reduced number of CCIs and their branches.

(131) Furthermore, Cyprus submitted commitments regarding defined thresholds of operating expenses that are not to be exceeded by the Cooperative group during the restructuring period and defined cost-income ratio limits, of between 42% and 44% that the group should also not be exceeded[100]. If the cost-income ratio targets are not met in two consecutive years, a new proposal for cost reduction measures including mergers of CCIs will be presented to the Commission and will implemented after approval by the Commission.[101] Those commitments ensure that if the expected cost savings are not achieved, further restructuring measures will be taken.

(132) The Commission also observes that Cyprus committed the Cooperative group to not exceed a defined maximum regarding FTE employees and to reduce branch numbers, with a target of 258 branches (197 of which will operate as full-time branches) by December 2015.[102]

(133) Pre-provision profits are planned to increase from EUR 222 million in 2013 to EUR 288 million in 2014, mainly due to the recognition of lower interest expenses which derive from a decrease in customer deposits and from a significant decrease of operating expenses from EUR 190 million in 2013 to EUR 159 million in 2014. Even though operating profits have a slight negative trend for the period 2014 – 2016 resulting from a gradual decline of the loan yield of the sector, pre-provision profitability is sustained at a satisfactory level of EUR 261 million by the end of the restructuring period.

(134) Point 13 of the Restructuring Communication indicates that long-term viability is achieved when the bank is able to provide an appropriate return on equity, taking into account the risk profile of the bank. The projected return on equity (12 % in 2017 and 11% in 2018) in the base case scenario as well as in the pessimistic scenario (10% in 2017 and 9% in 2018) appears to be appropriate, in view of the risk profile of the Cooperative group as a domestic retail bank.

(135) Point 13 of the Restructuring Communication requires that the bank is sufficiently capitalised at the end of the restructuring period. Accordingly current and prospective capital adequacy should be in line with applicable supervisory regulation based on prudent valuation[103.] Due to the recapitalisation, the consolidated group shows a core tier 1 ratio of above 10% throughout the restructuring period in the base case as well as in the pessimistic case (regarding the latter, there is an exception with a core tier 1 ratio of 9.2% in 2015, but it is the only one).[104]

---

[100] See recital (73) and (74); see Commitments of Cyprus in the Annex to this decision, points 34 and 35.
[101] See Commitments of Cyprus in the Annex to this decision, point 35.
[102] See Commitments of Cyprus in the Annex to this decision, points 32 and 33.
[103] See point 11 of the Restructuring Communication.
[104] See recitals (75) and (90).

(136) Consequently, the Commission considers that the restructuring plan fulfils the requirements of the Restructuring Communication with regard to the restoration of the long-term viability of the Cooperative group. Given the challenge of implementing such an in-depth restructuring, the Commission notes positively the commitment to appoint a monitoring trustee to monitor the correct implementation of the plan and of the associated commitments.

5.2.2.2. Own contribution (burden-sharing)

(137) As provided in the Restructuring Communication, banks need to contribute to the restructuring as much as possible in order to ensure that aid is limited to the minimum necessary. Banks should use their own resources to finance the restructuring, for instance by selling assets, while the investors in the bank should absorb the losses of the bank where possible. This includes the existing holders of shares and subordinated debt.

(138) According to the Cypriot authorities, there is no outstanding subordinated debt, junior debt or other hybrid/Tier 2 instruments issued by any of the CCIs or the CCB[105] so that the options for burden-sharing by historical shareholders and subordinated debt holders were limited to the dilution of existing shareholders.

(139) Without aid, the capital of the Cooperative group would have become negative in 2014. As a consequence of the State's capital injection in the CCB, the State will own 99% of the shares and voting rights of the CCB. Its existing shareholders, the CCIs, will be completely diluted and left with 1%.

(140) Moreover, through its recapitalisation of the CCIs, the CCB will get 99% of the shares and voting rights in each CCI. The owners of the CCIs, the individual members, will also be diluted and left with a 1% shareholding.

(141) As a consequence of that complete change of the economic ownership structure and the removal of the voting restrictions (one-man-one-vote), the members of the CCIs will lose their ownership and control on the CCIs, which, in turn, will lose their control over the CCB.

(142) Although the CCIs, via the CCB Holding, and the members, via the Cooperative Holding Companies, will still keep 1% in the CCB and the CCIs respectively, the Commission considers that outcome to be in line with the 2011 Prolongation Communication and the 2013 Banking Communication. As required by the former Communication[106] , a valuation of the non-listed Cooperative group has been carried out and resulted in a negative value. Consequently, and in line with the latter Communication,[107] the State, following recapitalisation, is normally entitled to 100% of CCB's shares. However, under the specific circumstances of the present case, the Commission accepts the 1% shareholding of the historical owners of the CCB and the CCIs because 1% is an extremely limited shareholding which results from the ownership structure agreed as the underlying strategy for the restructuring of the Cooperative group in July 2013 between Cyprus and the programme partners, namely, the European

[105] Information submitted on 28 August 2013.

[106] 2011 Prolongation Communication, point 9.

[107] Point 42 of the 2013 Banking Communication governs adequate burden-sharing "after losses are first absorbed by equity".

Commission, the ECB and the IMF, within the Framework of the Economic Adjustment Programme for Cyprus.[108]

(143) The State will be entitled to future proceeds from its 99% shareholding. The Recapitalisation Decree[109] and a commitment submitted by Cyprus provides that the CCB may repurchase part or whole of the State participation and the voting rights of the State in the CCB only if it pays first a remuneration equal to a cumulative and compounded annual 10% on the injected capital net of any dividends pay out. That option ensures that that in case of repurchase by the Cooperative group the State will get at least a 10% return, in line with footnote 1 to point 46 of the Recapitalisation Communication.

(144) Cyprus also submitted a commitment concerning the sale of the participation of the State (in part or in whole). Such a sale will be organised via an open, transparent, non-discriminatory and unconditional competitive tender and take place on market terms with the shares sold to the highest bid. The Commission observes that a valuation of a financial institution like the Cooperative group is difficult because of its specific features. The Commission therefore considers the commitment essential to not enter into bilateral sale processes but to hold an open sale procedure in order to determine the market value of the group.

(145) A pre-emptive right to the Cooperative Restoration Fund, the CCB Holding Company and the Cooperative Holding Companies will only be given if there are at least two bidders (not including the Cooperative Restoration Fund, the CCB Holding Company and the Cooperative Holding Companies) from financial institutions, private equity firms or asset management firms. Since this condition only gives the mentioned cooperative institutions the right to match the highest bid (pre-emptive right) and since the sale, as indicated above, must be organised as an open, transparent, non-discriminatory and unconditional competitive tender on market terms in any case, this pre-emptive right will not negatively affect the market price.

(146) In respect of the contribution to the restructuring costs through internal resources, the Commission notes positively the envisaged and partly already implemented cost-cutting measures that will result in a reduction of the operating expenses both through a reduction of personnel costs by means of a general 15% to 16% salary cut and the VRS as well as through other measures such as the CCI mergers and the closure of branches. As a consequence of all of those measures and the commitment[110] defining limits for the cost-income ratio of the Cooperative group will, that ratio will not exceed 42% by 2018 (compared to almost 60% now).

(147) In that context another commitment will also ensure that the total remuneration of any member of staff including board members and senior managers may not exceed 15 times the national average salary in Cyprus or 10 times the average salary of the employees in the group, whichever is higher, and that those

[108] See European Commission, Occasional Papers 161, The Economic Adjustment Programme for Cyprus, First Review Summer 2013, pp. 73 and 74 (Memorandum of Understanding on Specific Economic Policy Conditionality) and European Commission, Occasional Papers 169, The Economic Adjustment Programme for Cyprus, Second Review – Autumn 2013, pp. 26 and 27 as well as p. 68 (Memorandum of Understanding on Specific Economic Policy Conditionality).

[109] The *Recapitalisation of the Cooperative Central Bank / Central Body (CCB/CB), (Amendment)(No1) Decree of 2014.*

[110] See Commitments of Cyprus in the Annex to this decision, point 35.

restrictions apply until the end of the restructuring period.[111] The remuneration policy is therefore in line with point 18 of the 2013 Banking Communication.

(148) In line with point 23 of the Restructuring Communication, the Commission notes positively the commitment not to make acquisitions.

(149) Furthermore, the sale and winding down of the non-banking activities and the divestment of all non-core participations will generate proceeds, even if they are of a moderate level. Since the CCIs do not engage in international businesses and do not carry out sizable non-banking activities, there was no option for more divestments outside core Cypriot banking operations.

(150) Since seeking further downsizing of the Cypriot banking activities would endanger the Cypriot economy (see section 5.2.2.3), which entails that additional own contribution through additional downsizing of the Cypriot banking activities is not possible, the Commission can accept the proposed burden-sharing, even though it is very limited for an entity receiving a recapitalisation amounting to 13% of RWA.

5.2.2.3. Measures limiting the distortion of competition

(151) The Restructuring Communication requires that the restructuring plan proposes measures limiting distortions of competition and ensuring a competitive banking sector. Moreover, the measures should also address moral hazard issues and ensure that State aid is not used to fund anti-competitive behaviour.

(152) To assess measures limiting distortions such as a reduction of the market presence, the amount of State aid will be taken into account both in absolute terms and in relation to the bank's RWA.

(153) The Cooperative group, currently the second-largest Cypriot bank in terms of loans and deposits, will receive an aid amount of EUR 1.5 billion in the form of capital support amounting to 13% of its RWA.

(154) That significant amount of State aid must be adequately reflected in measures to mitigate distortions of competition in line with point 31 of the Restructuring Communication.

(155) The underlying assumption of the business plan is that the Cooperative group's gross loan book will increase at an annual rate of 2% to account for the capitalisation of the interest suspension of non-performing loans, thereby keeping new loan origination at the level of yearly loan repayments[112]. Repayments out of the existing loans would be used for new lending and the downsizing of the balance sheet will come mainly from provisioning.

(156) That flat trend in new loan originations in combination with the deleveraging effect of the increased provisions and the negative trend in deposits is estimated to result in a downsizing of the Cooperative group from total assets of EUR 17.1 billion in 2012 to almost EUR 15 billion in 2017 and 15.4 billion in 2018 which amounts to a downsizing of 10% to 12% (rounded figures).

(157) The Commission notes that it is a rather limited downsizing plan compared to the aid amount that account for 13% of RWA. However, the Cypriot authorities see a deeper deleveraging of the Cooperative group as too risky for the economy of that Member State since the whole Cypriot banking sector has already heavily

[111] See Commitments of Cyprus in the Annex to this decision, point 30.
[112] See notified restructuring plan, p. 96.

shrunk due to the crisis and the subsequent sale of foreign assets and high losses on the domestic loan book.[113]

(158) According to the Central Bank of Cyprus, the Cooperative group has systemic importance and is currently an essential domestic lender. On 31 December 2013, the loan portfolio of the Cooperative group amounted to EUR 12.7 billion, representing 28% of the total domestic banking system (excluding banking institutions not active locally). In other words, the Cooperative group is the second-largest domestic lender and particularly important for small and medium-sized local enterprises.

(159) This can be demonstrated by Table 7 showing the lending by the Cypriot banking system to residents:

Table 7 - Domestic lending shares 31.12. 2013

Lending only to Cyprus residents, Gross loan book - 31/12/2013	**Market shares/ market share ranges**
Bank of Cyprus	45-50%
Cooperative group	25-30%
Hellenic Bank	5-10%
Other Banks	4%
Subsidiaries of Greek Banks	12%
Total	**100%**

(160) The Cypriot economy is experiencing a deep recession and the lack of liquidity in the real economy is a major impediment for recovery. However, a large part of the banking sector in Cyprus cannot take over the necessary and required function of a lender to the domestic economy.

(161) The traditionally largest lender, BoC, which has taken over the Cypriot activities of Cyprus Popular Bank, still faces difficulties and its capacity to provide new funding to the real economy is limited in the short- and medium-term. Other banks, including the third-largest (Hellenic Bank), are too modest in terms of size to serve as a true substitute. As regards banks from Greece which have traditionally had a significant presence in the Cypriot banking sector, they are undergoing restructuring. Consequently, the Commission accepts the claim of the Governor of the Central Bank of Cyprus that the Cooperative group will be essential to provide new credit facilities to the real economy which will be a necessary condition for the recovery of the economy.

(162) Moreover, the Commission accepts the claim of the Central Bank of Cyprus that the anticipated but modest downsizing of the Cooperative group will not endanger the Programme requirement of a significant deleveraging of the

[113] The Commission has discussed this matter with the Cypriot authorities during the preparation phase of the restructuring plan, and the reasoning was submitted again in writing, together with the notification of the restructuring plan, by the Central Bank of Cyprus on 31 January 2014.

Cypriot banking sector since that deleveraging has already been very large as consequence of the divestment of foreign subsidiaries, the large impairments taken on domestic loans and the already implemented reduction of lending.

(163) The Commission accepts that a further downsizing of the Cooperative group would create serious risks regarding a shortage of lending and thereby harm to the domestic economy.

(164) In order to mitigate the distortions of competition resulting from the State aid granted to the Cooperative group, the Cypriot authorities have further submitted a number of commitments. They concern, first of all, structural measures such as the sale and winding down of non-banking activities, the divestiture of participations and the reduction of the branch network.[114]

(165) Secondly, as already discussed, the Cypriot authorities submitted several behavioural commitments relating, inter alia, to advertising (refraining from advertising the State support and from aggressive commercial strategies) and to acquisitions (not acquiring stakes in undertakings).

(166) Moreover, the Commission notes that the Cypriot authorities committed that the Cooperative group will not offer on deposits interest rates higher than the average of the banks active in Cyprus. That commitment ensures that the aid is not used to offer interest rates that are not in line with market conditions, in order to collect deposits at the expense of non-aided competitors.

(167) The Commission also considers that the commitments regarding the implementation of prudent loan underwriting process and risk management contribute to ensure that the aid will not be used to distort the lending market by making inappropriate lending but will only be used to grant viable lending.

(168) The Commission also notes that Cypriot authorities committed that the Cooperative group will not engage in foreign markets or in new in-house activities such as the creation of insurance products or structured products until the end of the restructuring period[115]. That commitment helps ensure that the aid is used to restore viability of the core Cypriot banking activities and not to expand in other financial sectors or geographies.

(169) The Commission regards the measures provided for in the restructuring plan as sufficient, under these specific circumstances, to mitigate the distortions stemming from the restructuring aid which can hence be found compatible.

(170) The compliance with the commitments in the Annex to this decision will be monitored by a monitoring trustee.

5.2.3. Conclusion on the compatibility of the restructuring aid

(171) The Commission finds that the restructuring aid in the form of a State recapitalisation of EUR 1.5 billion constitutes restructuring aid in favour of the Cooperative group. That aid, the associated restructuring plan and the commitments ensure the restoration of the viability of the Cooperative group, the limitation of the aid to the minimum necessary and the limitation of the competition distortions. That restructuring aid is therefore compatible with the internal market for reasons of financial stability on the basis of Article 107(3)(b) of the Treaty on the Functioning of European Union.

[114] See Commitments of Cyprus in the Annex to this decision, points 33, 42 and 43.
[115] See Commitments of Cyprus in the Annex to this decision, point 4.

6. CONCLUSIONS

The Commission concludes that the State recapitalisation of the CCB amounting to EUR 1.5 billion constitutes restructuring aid in favour of the group made up of the CCB and the CCIs. In view of the notified restructuring plan and the commitments undertaken by Cyprus regarding the restructuring and the repayment of the aid measures, the Commission concludes that the restructuring aid is compatible with the internal market pursuant to Article 107(3)(b) of the Treaty on the Functioning of European Union.

The Commission notes that Cyprus exceptionally accepts the adoption of this Decision in the English language

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: http://ec.europa.eu/competition/elojade/isef/index.cfm

Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Greffe
B-1049 Brussels
Fax No: +32-2-296 12 42

Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President

ANNEX

List of Commitments

The Republic of Cyprus ("The Republic") (Ministry of Finance) commits that the Cooperative Central Bank ("the CCB") and the Cooperative Credit institutions ("the CCIs") will implement the restructuring plan that was notified to the European Commission on 31 January 2014 and the associated list of commitments.

The Cooperative Central Bank ("the CCB") and the Cooperative Credit institutions ("the CCIs") commit to implement the restructuring plan that was notified to the European Commission on 31January 2014 and the measures described in the present document. These measures will be in place until the end of the restructuring period (31 December 2018) unless it is stated otherwise.

1. The payment of any interest or coupon on any tier 1 or tier 2 instruments, and the call, buyback or early redemption of any tier 1 or tier 2 capital instrument by the Cooperative Central Bank (″the CCB″) or Cooperative Credit Institutions (″CCIs″) is not permitted for the entire period during of which the Republic participates in the ownership structure of the CCB.

2. Each CCI distributes to the CCB in the form of dividend its annual total after tax profits or a commission fee determined by the Board of CCB to the extent this distribution does not affect the compliance of the CCI with the required, in a horizon of 2 years, supervisory minimum capital adequacy as that is defined by the Central Bank.

3. The CCB will not pay any dividends on shares for the fiscal years until end 2016. For the fiscal year 2017 and onwards, the CCB may distribute to the Republic and the other shareholders of the CCB such an amount of dividend based on their stake in the ownership structure of the CCB, from its accumulated reserves that does not affect the compliance of the CCIs and the CCB ("the group") with the required, in a horizon of 2 years, supervisory minimum capital adequacy as that is defined by the Central Bank

4. CCIs and the CCB will not engage in foreign markets, new in-house activities such as the manufacturing of insurance products or structured products until the end of the restructuring period. Structured products should be understood as any kind of fund, security, banking product or insurance policy that is market-linked (single security or single market index, basket of securities or/and indexes, single or basket of commodities, swaps and generally based on derivatives) and that offers a principal guarantee function, which offers protection of principal if held to maturity.

5. CCIs and the CCB will not acquire a stake in any undertaking, be it an asset or share transfer. That requirement does not cover: (i) acquisitions that take place in the ordinary course of the banking business in the management of existing claims towards ailing firms; and (ii) the acquisition of stakes in undertakings provided that the purchase price paid is less than 0,01 % of the last available balance sheet size of the institution at that moment and that the cumulative purchase prices paid for all such acquisitions from that moment until the end of the restructuring

period is less than 0,025 % of its last available balance sheet size at that moment; (iii) the acquisition of a business, after obtaining the Commission's approval, if it is, in exceptional circumstances, necessary to restore financial stability or to ensure effective competition; until the end of the restructuring period.

6. CCIs and the CCB will refrain from advertising referring to State support and from employing any aggressive commercial strategies which would not take place without the support of the Member State until the end of the restructuring period.

7. An independent Monitoring Trustee will be appointed and will ensure that the group complies with all the commitments (see commitments 46 to 65).

Exit Mechanism

8. CCIs will not repurchase any of their own shares for the entire period during of which the Republic participates in the ownership structure of the CCB.

Exit through buy back by the CCB (or any other part of the group)

9. The Republic grants to CCB from 2014 until 2028 the right to repurchase part or the whole participation and the voting rights of the Republic in the ownership structure of the CCB through the use of cumulative profits attributable to the Republic. The repurchase price is at least equal to a cumulative and compounded annual 10% on the injected capital net of any dividends pay out. No other part of the group has this repurchase right. Any sale to another buyer than the CCB will take place under the conditions described in paragraphs 10, 11 and 12 of the commitments ("Exit through the sale of the shares to a third party").

Exit through the sale of the shares to a third party

10. The Republic shall not sell its stake in the CCB before December 2018 at the earliest.

11. The sale of the participation of the Republic (in part or in whole) in the CCB must be organised via an open, transparent, non-discriminatory and unconditional competitive tender. The sale must take place on market terms and the assets and liabilities shall be sold to the highest bid. To the extent that there are at least 2 bidders (not including the Cooperative Restoration Fund, the CCB Holding Company and the CCIs Holding Company) from financial institutions, private equity firms or asset management firms, the Cooperative Restoration Fund and/or the CCB Holding Company and/or the CCIs Holding Company could exert its pre-emptive rights to match the best price offer and acquire the shares at the said price.

12. The Republic will inform the European Commission as soon as possible, of its intention to proceed with a sale of its participation in the CCB and will provide an independent fairness opinion including an appropriate valuation of the entity before starting the sale process.

13. The Republic commits that it will not sell its stake to any buyer that is funded, directly or indirectly, by the Group (consisting of the CCB and the CCIs).

Risk Monitoring

14. The CCB will review its organizational structure, in order to ensure that the Internal Audit, and the Risk Management departments are fully independent from commercial networks of the CCIs and report to the Board of Directors through the Board Audit and Risk Committee with notification to the General Manager. The Board Audit and Risk Committees will be assessing all issues that are raised by these respective departments. An adequate Internal Audit Charter and Risk Management Charter will be enacted, and specify the roles, responsibilities and necessary resources of these departments. These charters will comply with international standards and secure a full independence to the departments. A Credit Policy enacted by the CCB will provide guidance and compulsory instructions to the CCIs regarding the granting of loans, including the pricing of loans and the restructuring of loans.

15. The Credit Policy will define the thresholds above which the granting of loans must be approved by higher levels of management at both CCB and CCI. Similar thresholds will be defined regarding the restructuring of loans and the handling of claims and litigations. The Credit Policy will define a centralized decision-making process at the CCB level (group level), and provide clear safeguards to ensure a consistent implementation of its instructions within the group.

16. Within the Credit Policy, a specific section will be devoted to the rules governing relations with connected borrowers. Connected borrowers should include employees, shareholders, directors, managers, as well as their spouses, children, and any individuals to whom they are financially inter-connected (e.g. borrower and guarantor) and any legal entity directly or indirectly controlled by key-employees (i.e. employees involved in the decision making process of the Credit Policy), shareholders who own more than [5%], directors or managers or their spouses, children. By extension, any politically exposed individuals and any legal persons/entities as those defined in Annex a (attached) will be considered as a connected borrower. Political parties will also be treated as such in the Credit Policy. Particular focus will be on decisions regarding any restructuring and write downs of loans to current or former employees, directors, shareholders, managers and their relatives and financially inter-connected individuals as well as policies followed in the appropriateness, valuation, registration of liens and foreclosure of loan collateral.

17. The Credit Policy will make an obligation that the pricing of loans and mortgages comply with strict guidelines. These guidelines will include the obligation to respect strictly the group’s standard tables of interest rate bands (ranges) depending on the maturity of the loan, the credit risk assessment of the customer, the expected recoverability of pledged collateral (including the time frame to a potential liquidation), the overall relationship with the bank (e.g., level and stability of deposits, fee structure and other cross-sales activities) and the funding cost of the bank. It is therefore expected that, specific loan asset classes will be generated (e.g., commercial loan, mortgage, secured/unsecured, etc…) and their pricing framework be tabulated to an appropriate Credit Policy table to be approved by the Board Risk Committee at the level of the CCB and to be updated on a regular basis. Any exception will need to be duly authorized by the Board Risk Committee, or at lower level of authority when allowed by the Credit Policy. Tailor-made transactions such as syndicated loans or project finance will respect the same principles, albeit they may not fit in standardized credit policy

tables. Infringements to this pricing policy will be reported to the monitoring trustee.

18. The CCB's Risk Management Department will be responsible for the entire group for the assessment of credit risk and the valuation of collateral and the mapping of all connected group of borrowers that represent a single credit risk with a view to properly monitor credit risk concentration. When assessing the loan quality (with respect to significant exposures at group level as defined in the credit policy (or other policy documents i.e. the Credit Risk Policy), the CCB's Risk Management Department will act independently, providing its written opinion so as to ensure that criteria used in the assessment are applied consistently over time and among customers and in respect of the group's Credit Policy.

19. The CCB's Risk Management Department will monitor the exposure of the group to connected borrowers including the public sector entities and political parties. The new production of loans to connected borrowers (annual % of Y-1 stock) should be no higher than the new production of the group's total loan portfolio (annual % of Y-1 stock). This commitment should be complied with separately for each type of connected borrower (employees, directors, shareholders, managers, public entities, political party). The credit assessment of the connected borrowers, as well as the pricing conditions and possible restructuring offered to them, will not be more advantageous compared to conditions offered to similar but unconnected borrowers. This obligation does not apply to existing general schemes benefiting employees, offering them subsidized loans. The CCB will report every quarterly about the evolution of this exposure, the amount of the new production and the recent requests greater than 0.02% of RWA to the monitoring trustee. The roll-over of existing loans will be excluded from the above calculations.

20. Regarding loans to connected borrowers and non-connected borrowers, the CCB, on the basis of the best international practices, will set up strict individual and aggregated limits at the level of the group governing the maximum loan amount that can be granted to a single credit risk. These limits will take into account the maturity of the loan, and the quality of any collateral / security provided and will be set against key benchmarks including against capital.

21. The credit criteria applied to employees/managers/shareholders/directors will not be less strict than those applied to other, non-connected borrowers. In case that the total credit exposure to a single employee/manager/shareholder/ director exceeds an amount equal to a 5-years fixed salary for secured loans and an amount equal to a 6-months fixed salary for unsecured loans, the exposure will be reported promptly to the monitoring trustee who may intervene and postpone the granting of the loan according to the procedure described in paragraph 23 of the Commitments.

22. Granting loans to enable borrowers to purchase shares or hybrid instruments of the credit cooperatives and/or other banks will be prohibited, whoever are these borrowers. Granting loans collateralized by shares or hybrid instruments will be prohibited, whoever are these borrowers.

23. (a) All loan requests by connected borrowers as per paragraph 16 above greater than 0.01% of RWA or any loan which keeps the exposure to one group (defined as a group of connected borrowers that represent a single credit risk) higher than

0.05% of RWA will be reported to the monitoring trustee, which will be entitled, if the conditions do not appear to be set at arm's-length or if no sufficient information has been provided to the monitoring trustee, to postpone the granting of the credit line / the loan by 8 working days. In emergency cases, this period can be reduced to 3 working days provided sufficient information has been provided to the Monitoring Trustee.

(b) All loan requests by non-connected borrowers greater than 0.05% of RWA or any loan which keeps the exposure to one group (defined as a group of connected borrowers that represent a single credit risk) higher than 0.1% of RWA will be reported to the monitoring trustee, which will be entitled, if the conditions do not appear to be set at arm's-length or if no sufficient information has been provided to the monitoring trustee, to postpone the granting of the credit line / the loan by 8 working days. In emergency cases, this period can be reduced to 3 working days provided sufficient information has been provided to the Monitoring Trustee.

24. The group's Credit Policy will give clear instructions on the restructuring of loans. It will clearly define which loans are eligible, under which circumstances, and indicate the terms and conditions that can be proposed to eligible customers. The CCB' BoD will ensure that all restructurings aim at enhancing the future recoveries, thus safeguarding the interest of the group. In no case the restructuring policy will jeopardize the future profitability of the group. For this purpose, the CCB's Risk Management Department is responsible for developing and deploying adequate restructuring effectiveness reporting mechanisms, for performing in-depth analyses of internal and/or external best practices, reporting its findings at least on a quarterly basis to the Board Risk Committee, suggesting actionable improvements to the processes and policies involved and oversee and reporting on their implementation to the Board Risk Committee.

25. The restructuring of loans involving connected borrowers will comply with the same requirements as for unconnected borrowers. Furthermore, established frameworks and policies to deal with troubled assets will be assessed and improved, if necessary. However, it is expected that restructured loans of connected borrowers will be reported separately, at least per loan asset class and connected borrower type.

26. The CCB will enact a claim and litigation policy aiming at maximizing recovery and preventing any discrimination or preferential treatment in the management of litigations. They will ensure that all necessary actions are taken to maximize the recoveries for the bank and protect their financial position in the long term. Any breach in the implementation of this policy will be reported to the monitoring trustee.

27. The CCB will monitor the credit risk through a well-developed set of alerts and reports, which will enable the Risk Management Department to (i) identify early signals of loan impairment and default events, (ii) assess recoverability of the loan portfolio (including but not limited to alternative repayment sources such as co-debtors and guarantors as well as collateral pledged / available but not pledged), (iii) assess their overall exposure on an individual customer or on a portfolio basis (iii) propose corrective and improvement actions to the Board of Directors as necessary. This set of alerts and reports will be designed at the level of the CCB and implemented by each CCI. The monitoring trustee will be given access to this information.

28. The CCB and the CCIs will not engage in proprietary trading activities. Proprietary trading activities should be understood as means of purchasing or selling, or otherwise acquiring and disposing of, stocks, bonds, options, commodities, derivatives, or other financial instruments, by any entity of the group, for the trading book of any entity of the group, and does not include purchasing or selling, or otherwise acquiring and disposing of, stocks, bonds, options, commodities, derivatives, or other financial instruments on behalf of a customer, as part of market making activities, or otherwise in connection with or in facilitation of customer relationships, including hedging activities related to such a purchase, sale, acquisition, or disposal of assets.

29. The CCB will define an Investment Policy guideline that will apply to the CCB and the CCIs. This guideline should ensure inter alia that the CCB and the CCIs will not buy any bonds/loans whose rating is lower than investment grade by any of the three main rating agencies (Moody's Baa3, Standard & Poors BBB-, Fitch BBB-). This requirement will however not apply for any issues by the Cypriot Government.

Operational efficiency

30. Total remuneration of any member of staff including board members and senior managers may not exceed 15 times the national average salary in Cyprus or 10 times the average salary of the employees in the group, whichever is higher. Restrictions on remuneration must apply until the end of the restructuring period.

31. No severance payments in excess of what is required by law or contract should be made.

32. The maximum number of full-time equivalent employees of the group will not exceed 2580 by 31 December 2014, 2580 by 31 December 2015, 2580 by 31 December 2016, 2580 by 31 December 2017 and 2580 by 30 June 2018

33. The number of branches will be reduced from 417 (of which 340 full-time) as of 31 December 2012 to 258 (197 of which full-time) by 31 December 2015.

34. Total operating expenses shall not exceed EUR 160 million in accounting year 2014, EUR 156 million in accounting year 2016 and EUR 149 million in accounting year 2018.

35. The Cost/Income ratio of the group shall not exceed 42% in accounting year 2014, 43%in accounting year 2015, 44% in accounting year 2016, 42% in accounting year 2017 and 42% in accounting year 2018. If the Cost/Income ratio target is not met on two consecutive years, a new proposal for cost reduction including mergers of CCIs should be presented to the European Commission and implemented by the group upon approval by the European Commission.

36. The Cost/Income ratio of each individual CCI shall not exceed the thresholds defined in the table below in accounting year 2017. If the Cost/Income ratio is not met, the CCI will be considered non-viable and will be required to merge with another CCI.

CCI – Target Cost/Income Ratios in 2017 and 2018		
Total assets > EUR 1 billion	Total assets > EUR 500 million and < EUR 1 billion	Total assets < EUR 500 million
47.5%	50.0%	62.5%

Profitability drivers

37. The deposit policy of the group will not jeopardize its liquidity and/or its financial position and its net interest margin. The CCIs and the CCB will make sure that an adequate pricing of deposits strengthens their viability and their future profitability.

38. For each month, the average interest rate which is paid by the group on each new deposit category per month, as presented below, until end 2018, shall not be more than the respective interest rates of the preceding month paid by the Monetary Financial Institutions in Cyprus, as they are published every month by the Central bank of Cyprus.

    a. Deposits from households

       - Overnight

       - With agreed maturity

       - Redeemable at notice

    b. Deposits from non-financial corporations

       – Overnight

       – With agreed maturity

39. With the aim of recovering value from non-performing loans, five special units will be implemented. Each of these special units will report directly to the executive committee. Recovery and legal actions will be implemented systematically and in line with the provisions of the Directive of the Central Bank of Cyprus “The Arrears Management Directive of 2013” and in particular the “Code of Conduct of handling of borrowers”. These actions will be closely monitored by the management board. A regular report of the implementation of this directive will be transmitted to the monitoring trustee.

40. Unless an impaired loan was deemed eligible for restructuring as provided under commitment [18], the CCIs will systematically initiate the legal or administrative proceedings (aiming at seizing and selling the pledged collateral) of each and every loan that becomes non-performing (except for the loans eligible for restructuring as provided by the Credit Policy of the group).

41. To this aim, a special unit will be dedicated to engage in selling foreclosed properties. The accomplishments of the unit shall be reported to the executive committee on a quarterly basis.

42. All commercial non-banking activities are considered as non-core business and shall be entirely (100%) removed from the balance sheet CCB and CCI's. This removal shall be carried out in two ways:

    1. Non viable activities to be wound down or sold to a third party.

    2. Viable activities:

        a) to be transferred at fair value to non credit cooperative companies in return for equity participation in those non-credit cooperative companies that will be sold before end 2018; or

        b) to be sold at maximum price for cash to a third party buyer (including any non credit cooperative company)

    The executive committee of the CCB, based on a viability assessment of the activities on a case by case basis, which will start immediately and to be concluded by March 2014, at the latest, will compile a precise list of the commercial activities to be mandatorily removed through ways 1&2 explained above. A precise binding plan which will include milestones that will be reported at least semi annually to the monitoring trustee will be concluded by September 2014 and will include all steps for the removal of these activities before end 2016 (or before end 2018 if the activities are divested according to point 2 a) here above) .

43. All participations of the group that are considered as non-core business as reported in Annex b, shall be divested before end 2018. A precise binding divestment plan which will include milestones that will be reported at least semi annually to the monitoring trustee will be concluded by September 2014 and will include all divestment steps (valuation, identification of prospective buyers, reception of non binding offers etc.) for the divestment of these participations.

44. Existing lending facilities to the Demetra Investment Public Ltd. shall not be rolled-over and shall be terminated as soon as possible. The group (the CCB and the CCIs) shall not grant any new lending and any overdraft facilities to Demetra Investment Public Ltd until the end of the restructuring period.

45. No lending facilities/overdraft facilities shall be granted to any individual/company, to contribute, wholly or partially, to the financing, directly or indirectly, of the purchase of non-core participations that will be divested by 2018.

Monitoring Trustee

Appointment procedure

46. The monitoring trustee shall be independent of the group and work on behalf and under the instruction of the Commission, possess the necessary qualifications to carry out its mandate (for example as an investment bank or consultant or auditor)

and shall neither have nor become exposed to a conflict of interest. To this end, the monitoring trustee shall be a respected international auditing or consulting firm that will include the participation of overseas based partners and managers.

47. The monitoring trustee will be appointed until the end of the restructuring period i.e. until December 2018.

48. The monitoring trustee and his required subcontractors shall be remunerated reasonably by the group in a way that does not impede the independent and effective fulfillment of its mandate. However, the trustee shall aim at the fulfillment of its task so as to ensure reasonable comfort as regards proper implementation of the monitored commitments and obligation without losing sight of the overall cost policy of the bank. In case of conflict, the group or the Ministry of Finance shall address any such perceived issues to the European Commission. The monitoring trustee shall present an upfront working plan and an indicative cost calculation including the cost of subcontractors, together with his offer. The indicative cost projections shall be reviewed by the group, the monitoring trustee, the Commission and the Ministry of Finance every three months, if the bank deems necessary.

Proposal by the group

49. The Cypriot Government commits that no later than 31 December 2013, the group will propose to the Ministry of Finance a list of two or more international firms for submission to the Commission, which in the end will approve the name of the monitoring trustee. The group will send the detailed application of the international firms to the Ministry of Finance, including the outline of the work plan describing how the monitoring trustee would carry out its tasks, and indicate which of the applicants is the group's preferred choice, verifying that there is no conflict of interest for the proposed candidates.

Approval or rejection by the Commission

50. The Commission shall analyze the group’s proposal on the basis of its competence, its independence from the group and the absence of any potential conflict of interest.

51. The Commission shall have the discretion to approve or reject the proposed monitoring trustees subject to any modifications it deems necessary for the monitoring trustee to fulfil its obligations. If only one firm is approved, the group shall appoint the firm concerned as monitoring trustee, in accordance with the mandate approved by the Commission. If more than one firm is approved, the group shall be free to choose the monitoring trustee to be appointed from among the firms approved. The monitoring trustee shall be appointed at the latest within 30 calendar days of the Commission’s approval.

New proposal by the group

52. If all the proposed monitoring trustees are rejected, the Cypriot Government (Ministry of Finance) commits that the group will propose to the Ministry of Finance the names of at least two more firms within 60 calendar days of being informed of the rejection. The Ministry of Finance will then submit these names

to the Commission, in accordance with the requirements and the procedure set out in paragraphs 49-53.

Monitoring trustee nominated by the Commission

53. If all further proposed monitoring trustees are rejected by the Commission, the Commission shall nominate a monitoring trustee, whom the group shall appoint, or cause to be appointed, in accordance with the monitoring trustee mandate approved by the Commission provided that such monitoring trustee has no conflict of interest with the group.

Functions of the monitoring trustee

54. The monitoring trustee shall assume its specified duties in order to ensure that the group complies with the Commitments. The services of the Commission may, on their own initiative, give any orders or instructions to the monitoring trustee in order to ensure compliance with the Commitments. The group is not entitled to give instructions to the monitoring trustee.

Reporting

55. The monitoring trustee shall submit to the European Commission quarterly reports on the implementation of these Commitments, as well as ad-hoc reports, as needed.

56. Within 15 working days of the end of each quarter, the monitoring trustee shall submit a draft written report in English to the European Commission and the Cypriot Government (Ministry of Finance), giving each the opportunity to submit comments within 15 working days.

57. Within 5 working days of receipt of the comments, the monitoring trustee shall prepare a final report and submit it to the European Commission, taking into account, if possible and at his sole discretion, the comments submitted. The monitoring trustee will send a copy of the final report to the Cypriot Government (Ministry of Finance) and to the group. Under no circumstances will the monitoring trustee submit any version of the final report to the Cypriot Government (Ministry of Finance) and/or the group before submitting it to the European Commission.

58. The final report shall cover the monitoring trustee's fulfillment of its obligations under the mandate and the compliance of the group and the monitoring trustee with the Commitments.

59. Ad-hoc reports may be submitted to the European Commission and will be forwarded to the Cypriot Government (Ministry of Finance). If the European Commission deems necessary, the ad-hoc reports can also be submitted for comments to the group.

Duties and obligations of the monitoring trustee

60. The monitoring trustee shall:

c. propose in its first report to the European Commission a detailed work plan describing how it intends to monitor compliance with the Commitments;

d. propose to the group such measures as the monitoring trustee considers necessary to ensure the group's compliance with the Commitments and/or the Mandate;

e. propose necessary measures to the Commission in the event that the group does not comply with the monitoring trustee's proposals within the timeframe set by the monitoring trustee.

f. keep in close contact with the Commission including sharing of data and assessments.

Duties and obligations of the group

61. The Cypriot Government (Ministry of Finance) commits that the group will provide and cause its advisors to provide the monitoring trustee with all such cooperation, assistance and information as the monitoring trustee may reasonably require in performing its tasks.

62. The group will set up an internal process to channel to the monitoring trustee all necessary information and documentation in order to monitor the implementation of the Commitments. The group will give the monitoring trustee full and complete access to any of its books, records (including board minutes), documents, management or other personnel, facilities, sites and technical information necessary for fulfilling its duties. The group will make available to the monitoring trustee one or more offices in the bank's head office and will be available for meetings on request of the monitoring trustee.

Replacement, discharge and reappointment of the monitoring trustee

63. If the monitoring trustee ceases to perform its functions under the Commitments or for any other good cause, including the exposure of the monitoring trustee to a conflict of interest:

    g. The Commission may, after hearing the monitoring trustee, require the group to replace the monitoring trustee; or

    h. The group, with the prior approval of the Commission, may replace the monitoring trustee.

64. If the monitoring trustee is removed according to paragraph 63, the monitoring trustee may be required to continue its function until a new monitoring trustee is in place to whom the monitoring trustee has effected a full hand over of all relevant information. The new monitoring trustee shall be appointed in accordance with the procedure referred to in paragraphs 49-53.

65. Beside the removal according to paragraph 63, the monitoring trustee shall cease to act as monitoring trustee only after a final report is sent and the Commission has discharged it from its duties after all the Commitments, with which the monitoring trustee has been entrusted, have been implemented. However, the Commission may at any time require the reappointment of the monitoring trustee

if it subsequently appears that the relevant remedies might not have been fully and properly implemented.

Annex a: Borrowers connected to the Republic of Cyprus

1. Borrowers connected to the Republic of Cyprus shall include:

(a) Politically exposed persons defined as the President of the Republic of Cyprus, ministers and deputy or assistant ministers, as well as Members of the Parliament;

(b) The legal persons/entities included below; and

(c) Individuals, including the managers and the Board of Directors of the legal persons/entities included below, as well as senior civil servants and employees of the Central Bank of Cyprus (CBC), that have the capacity to exercise control, directly or indirectly, over these entities.

2.1 The Republic of Cyprus

The Presidency of the Republic, the Ministries and the district administration offices

2.2 Churches and other religious institutions and organisations

This category should include the Church of Cyprus, all Metropolis in Cyprus, all Churches and Monasteries in Cyprus; any organizations/entities/institutions they own or control, as well as any other religious institutions and organizations

2.3 Independent services/authorities

All services/authorities funded or operated by or on behalf of the government. This category should include also the Central Bank of Cyprus

2.4 Semi-Government Organisations (SGOs)

All businesses and organizations belonging to the Republic of Cyprus or controlled by it, either directly or indirectly, including non-profit organisations and publicly-owned companies and enterprises (State owned enterprises -SOEs).

2.5 Public pension / insurance funds

All social security institutions of public law entity status or similar arrangements provided by the government

2.6 Public sector companies / institutions

Any other public companies/institutions which provide vital social services and goods to members of the social body, of various legal forms under the control, supervision and guaranteed by the Republic of Cyprus.

2.7 Political Parties

All Cypriot political parties, whether or not they are represented in the current Cypriot Parliament, any legal entities (corporate) directly or indirectly controlled by them.

2.8 Local authorities

All municipalities and Communities and the Union of Cyprus Municipalities as well as any legal entities (corporate) directly or indirectly controlled by them.

Annex b

List of participations of the group that are considered non-core

Name of entity	Name of entity
ΠΑΓΚΥΠΡΙΑ ΣΥΝΕΡΓΑΤΙΚΗ ΣΥΝΟΜΟΣΠΟΝΔΙΑ ΛΤΔ	Cyprus Coop Confederation Ltd
ΝΕΑ ΣΕΒΕΓΕΠ	NEW SEVEGEP
ΣΕΔΙΣ	SEDIS
COMARINE LTD	COMARINE LTD
ΣΕΒΕΓΕΠ ΛΤΔ	SEVEGEP LTD
ΣΠΕΑΛ	SPEAL
ΈΝΩΣΗ ΧΑΡΟΥΠΙΩΝ ΛΑΡΝΑΚΑΣ	CAROB MARKETING LARNAKA
ΣΕΔΙΓΕΠ	SEDIGEP
ΣΟΔΑΠ	SODAP
ΈΝΩΣΗ ΧΑΡΟΥΠΙΩΝ ΛΕΜΕΣΟΥ	CAROB MARKETING LIMASSOL
ΣΠΕΛ	SPEL
ΣΕΔΙΧ ΑΜΜΟΧΩΣΤΟΥ	CAROB MARKETING FAMAGUSTA
ΑΓΡΟΤΕΧΝΙΚΑ ΛΤΔ	AGROTEXNIKA LTD
ΕΣΕΛ-ΣΠΟΛΠ	ESEL-SPOLP
ΣΥΝΕΡΓΚΑΖ	SYNERGAZ
Συνεργατικό Συσκευαστήριο	COOPERATIVE PACKING COMPANY
ΈΝΩΣΗ ΧΑΡΟΥΠΙΩΝ ΠΑΦΟΥ	CAROB MARKETING PAPHOS
ΣΕΔΕΣ	SEDES
ΝΕΟΣ ΣΟΓΕΑ	NEOS SOGEA
ΣΟΠΑΖ	SOPAZ
Συνεργατικός Οργανισμός Γενικών Υπηρεσιών Κύπρου (ΣΟΓΥΚ)	Cooperative Organisation of General Services Cyprus
ΣΥΝΕΡΓΑΤΙΚΗ ΟΜΟΣΠΟΝΔΙΑ ΧΑΡΟΥΠΙΩΝ	CAROB MARKETING FEDERATION
Society for Worldwide Interbank Financial Telecomunication (SWIFT)	Society for Worldwide Interbank Financial Telecomunication (SWIFT)
ΕΣΣΕ ΛΕΥΚΟΝΟΙΚΟ ΛΤΔ	LEVKONOIKO INVESTMENT GROUP OF COOPERATIVE COMPANIES
ATLANTIC INSURANCE LTD	ATLANTIC INSURANCE LTD
TSOKOS HOTELS LTD	TSOKOS HOTELS LTD
MARFIN CLR	MARFIN CLR
ASPIS HOLDINGS	ASPIS HOLDINGS
GOLDEN SUN LEISURE	GOLDEN SUN LEISURE
TOXOTIS INVESTMENTS PUBLIC	TOXOTIS INVESTMENTS PUBLIC
PETROLINA HOLDINGS	PETROLINA HOLDINGS
LOUIS	LOUIS
CCCT LTD	CCCT LTD
OPTIONS KASOULIDES	OPTIONS KASOULIDES
Αναπτυξιακή Εταιρεία Επαρχίας Λεμεσού	LIMASSOL DISTRICT DEVELOPMENT COMPANY
Αναπτυξιακή Εταιρεία Επαρχίας Λάρνακας	LARNAKA DISTRICT DEVELOPMENT COMPANY
Άλκης Χατζηκυριάκος	ALKIS HATZIKYRIAKOS
ΕΤΚΟ Λτδ	ETKO LTD
Τράπεζα Κύπρου	BANK OF CYPRUS
F.W. WOOLWORTH	F.W. WOOLWORTH
SFS GROUP	SFS GROUP
ORPHANIDES SUPERMARKET	ORPHANIDES SUPERMARKET
ΚΥΠΕΡΙΣ ΛΤΔ	KYPERIS LTD
ΒΑΣΙΛ. ΟΙΝ.	VASILIKOS WINERY
Primetel Plc	Primetel Plc
Primetel Plc Warrants	Primetel Plc Warrants
HELLENIC BANK PUBLIC LTD	HELLENIC BANK PUBLIC LTD
LIBRA GROUP PLC	LIBRA GROUP PLC
LAIKI CAPITAL PUBLIC CO LTD	LAIKI CAPITAL PUBLIC CO LTD
LIBERTY LIFE INSURANCE PUBLIC COM.LTD	LIBERTY LIFE INSURANCE PUBLIC COM.LTD
MALLOUPAS & PAPACOSTAS LTD	MALLOUPAS & PAPACOSTAS LTD
Helioupolis Estates Development Ltd	Helioupolis Estates Development Ltd
Green Dot	Green Dot
Newfields	Newfields
ΠΕΑΛ ΤΡΟΟΔΟΥΣ	PEAL TROODOUS