Subject: State aid SA.43367 (2015/N) – Cyprus
2015 Additional restructuring aid to the Cooperative Central Bank Ltd

Sir,

1. PROCEDURE

(1) In 2014 the European Commission approved a EUR 1.5 billion State recapitalisation of the Cooperative Central Bank Ltd ("CCB") as restructuring aid compatible with the internal market on the basis of Article 107(3)(b) of the Treaty on the Functioning of European Union (the "2014 decision").

(2) That recapitalisation was granted in the context of the Economic Adjustment Programme agreed in April 2013 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).

(3) Following the Commission's approval of the restructuring plan ("the 2014 restructuring plan") which included a new governance and ownership structure of the CCB and the Cooperative Credit Institutions ("CCIs"), Cyprus injected EUR 1.5 billion into the CCB in return for ordinary shares. As a consequence, the State

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2 The corresponding Memorandum of Understanding ("MoU"), setting out the underlying policy conditionality of the Programme, provided for a State-supported recapitalisation and restructuring of the Cooperative Credit Institutions and their central body, the CCB.
became the 99% shareholder of the CCB with the old owners, namely the CCIs, holding 1% via the CCB Holding Company.

(4) In the course of 2015 the ECB's Banking Supervision carried out an on-site inspection on the subject of risk management and risk control systems for credit risk. Also in 2015, the ECB concluded its 2014 Supervisory Review and Evaluation Process ("SREP") and, by decision of 25 November 2015, required for the CCB, as a minimum on a consolidated basis, a capital ratio of 12.25% Common Equity Tier 1 capital ("CET1") as defined in Regulation (EU) No 575/2013 of the European Parliament and of the Council.3

(5) On 27 November 2015, the ECB notified to the CCB that the Governing Council of the ECB had decided, pursuant to Articles 4(1)(d), 16(1)(b) and 16(2)(c) of Regulation (EU) No 1024/20134, to require the submission of a capital plan - including a proposed increase of own funds by 30 June 2016 - since, as explained in the decision, the ECB identified a provisioning shortfall amounting to EUR 470.7 million from the assessment of adequacy of specific loan loss provisions. As a result, the ECB considered that the CCB was likely to breach on a consolidated basis the required CET1 capital ratio as identified in an ECB decision establishing prudential requirements which was sent to the CCB on 25 November 2015.

(6) The capital plan submitted by Cyprus to the ECB on 4 December 2015 proposed, apart from retained earnings, a capital injection of EUR 175 million.

(7) Subsequently, and following subsequent meetings, conference calls and electronic mail exchanges between the Cypriot authorities, the CCB and the Commission, Cyprus on 9 December 2015 notified an additional recapitalisation measure as restructuring aid. Accordingly, EUR 175 million will be injected into the CCB by the recently established Recapitalisation Fund5 in return for ordinary shares in the CCB. With the notification Cyprus also submitted a new restructuring plan ("the 2015 restructuring plan").

(8) In the present decision, the group made of the parent company CCB and their subsidiaries, the CCIs, is referred to as the "Cooperative Group" or "the group".

(9) By letter submitted with the notification of 9 November 2015 Cyprus agreed to waive its rights deriving from Article 342 TFEU in conjunction with Article 3 of Regulation 1/19586 and to have the present decision adopted and notified in English.

2. DESCRIPTION

2.1. The beneficiary

(10) The Cooperative Group is one of Cyprus' largest banks7. It has mostly local residents as clients. Originally the cooperatives were comprised of a number of independent retail banks, the CCIs that together owned their central body and

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5 The Recapitalisation Fund will be established in Cyprus funded from the special levy imposed on credit institutions; for further details see recital (28).
6 Council Regulation No 1 determining the languages to be used by the European Economic Community, OJ 17, 6.10.1958, p. 385.
7 See also 2014 Decision, recital 6.
banker, the CCB. The CCIs themselves were owned by their members who were, in most cases, also their customers. Since the CCB as their central body guaranteed the liabilities and commitments of the affiliated CCIs - while the CCIs guaranteed the liabilities of the CCB – the CCIs did not have to comply individually with the capital requirements for banks but had to do so only as a ‘group’, on a consolidated basis with the CCIs.

(11) When the economy of Cyprus went into a crisis in 2012, unemployment rates increased and real estate demand and prices came under pressure. As a consequence, the level of non-performing loans ("NPLs") increased and the cooperatives needed EUR 1.5 billion capital which Cyprus injected into the CCB in return for ordinary shares, thereby becoming a 99% shareholder of the CCB and diluting the shareholding of the old owners, the CCIs to 1%. The CCB became the 99% in each CCI, diluting thereby the members.

(12) That new ownership structure of the group was the result of the restructuring plan which the Commission had accepted in the context of its approval of the 2014 State recapitalisation. The 2014 restructuring plan and the respective commitments given by Cyprus aimed at a major overhaul of the cooperatives' governance and commercial practices, towards more centralisation and more consistent policies among the CCIs. Apart from the change of the CCB's and CCIs' ownership, it included the reduction of the number of CCIs from over 90 to 18 through mergers as well as measures to improve governance and operational capacity, in particular with respect to arrears and risk management. Furthermore, Cyprus committed the new group to implement measures enhancing its operational efficiency such as a Voluntary Redundancy Scheme and the streamlining of the branch network and to wind-down or sell the non-banking activities. A key part of the restructuring plan was the development and/or strengthening of headquarters corporate functions in the CCB, like risk and NPL management. Such functions were until then non-existent or deeply underdeveloped.

(13) Following the Commission's approval of the 2014 restructuring plan, the Cooperative Group implemented a large part of the above described measures and underwent a major restructuring, mostly relating to the interplay between the CCB and the CCIs on operational and control matters as well as to the responsibilities of the CCB’s Board, its Executive Management and various divisions. Reporting lines between the CCB and the CCIs were defined, aiming to streamline and delineate the responsibilities for new business development, financial reporting and goal setting. They included a revised Risk Management Framework in line with European and international best practices incorporating Basel Committee and the European Banking Authority ("EBA") technical documents.

(14) As a result the group's governance structures and control functions improved, and progress was made as to operational efficiency, for instance, by reducing the number of the CCIs’ branches (from 417 in December 2012 to less than 260 currently). Deposits have stabilised and even increased following short periods of outflows during the first half of 2014.

(15) With regard to handling of overdue loans, in line with the 2014 restructuring plan, a NPL Management Division was established at the CCB level in May 2014. Since November 2014, that Division has assumed full responsibility for the arrears and the NPLs of the Cooperative group. Moreover, with a view to
increasing its administrative capacity, the NPL Management Division has
developed and is currently implementing an action plan based on
recommendations provided by the IMF in the context of its Technical Assistance
Report in the area of arrears management, issued in March 2015. An external
consultant to the NPL Management Division has also been hired by the CCB, in
order to provide their expertise on international best practices in the area of
arrears and Non-NPLs Management.9

(16) In 2014 the ECB and the national supervisory authorities (Joint Supervisory
Teams, "JSTs") of the participating countries under the Single Supervisory
Mechanism ("SSM") undertook a comprehensive assessment which consisted of
the asset quality review ("AQR") and a forward-looking stress test of significant
banks of the participating countries. As one of the three largest banks established
in Cyprus, the parent company of the Cooperative Group, the CCB, was included
in that comprehensive assessment. A capital shortfall, however, was not identified
for the CCB in the context of that exercise in 2014. The CET1 ratio in December
2014 amounted to 13.56%.

(17) The Cooperative Group is, however, still facing a large volume of overdue loans.
Whereas in November 2013 the level of loans that were more than 90 days past
due ("90+dpd") accounted for 42% of the Cooperative's Group's total gross loans' value,10
that ratio increased to 53% in September 2015. Those loans were
generally denoted as NPLs.11

(18) With the implementation of updated technical standards developed by the EBA
and amending the Commission Implementing Regulation (EU) No 680/2014 with
regard to supervisory reporting of institutions, non-performing exposures
("NPEs") have become the current reporting standard.12 13

(19) In the following, in particular the financial projections and assumptions, where
both categories, 90+dpd and NPEs, are used, it will be marked accordingly. This

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8 Notified restructuring plan, p. 23.
9 Notified restructuring plan, p. 23.
10 See 2014 Decision, recital 32.
11 Based on the then just updated regulatory definition in Cyprus in the Directive on the Definitions of
Non-Performing and Restructured Credit Facilities of 2013; that definition, however, had been strictly
speaking already wider and included 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 from which the observation period has not elapsed; on the basis of that exact regulatory
definition the NPL ratio of the Group was 44% instead of 42% on the basis of 90+dpd loans.
12 Principally, NPEs are 90+dpd exposures – loans, debt securities and off-balance sheet exposures -
and/or those as to which the debtor is unlikely to pay its credit obligations in full without realisation of
collateral, regardless of the existence of any past due amount or of the number of days past due. For
further details, see Commission Implementing Regulations (EU) 2015/227 of 9 January 2015
amending Implementing Regulation (EU) No 680/2014 laying down implementing technical standards
with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the
laying down implementing technical standards with regard to supervisory reporting of institutions as
regards instructions, templates and definitions, OJ L 205, 31.7.2015, p. 249.
13 See also notified restructuring plan, page 4, where it is stated by Cyprus that "According to
the definition of EBA, the following advances are considered as non-performing: 1) Important advances
that present past due balances more than 90 days, or 2) advances for which the clients cannot fully
repay their obligations without the sale of collateral, or 3) client advances for which the Bank took
legal actions against them, or advances of bankrupt clients, or advances for which the Bank has
recognized a provision for impairment or write off, or 4) advances that have been restructured twice in
a period of 2 years, or 5) Advances that have been restructured and during the monitoring period (2
years) present arrears for a period for more than 30 days."
Decision will refer to NPLs as a general description for loans that are not performing.

(20) While the level of 90+dpd loans accounted for 53% of the Cooperative's Group's total gross loans' value ("90+dpd ratio") in September 2015, the group had an NPE ratio of 60% in same month with a projected NPE ratio of 62% by the end of 2015.

(21) The financial projections of the 2014 restructuring plan already estimated a significant increase in non-performing loans from 2015\textsuperscript{14}. Since those projections were based on the old definition, the actual figure corresponding to the same definition - 53% in September 2015 – is now even lower than forecasted at that time.

(22) However, the effect of the credit losses in the loan portfolio on the capital of the Cooperative Group is more severe now due to the insufficient provisioning as analysed by the ECB Banking Supervision in its decision notified to the CCB on 27 November 2015.

(23) The latter identified a provisioning shortfall of EUR 470.7 million.\textsuperscript{15} As a result, the ECB considered that the CCB is likely to breach on a consolidated basis the CET1 capital ratio as identified by the ECB Decision establishing prudential requirements – the SREP Decision - which was sent to the CCB on 25 November 2015. Accordingly, the ECB identified an overall capital ratio equal to 12.25% CET1 which the CCB should satisfy, as a minimum, on a consolidated basis at all times.

(24) As of 30 June 2015 the CCB had a CET1 ratio of 13.05%.\textsuperscript{16} However, the required additional provisioning made the CET1 ratio likely to fall below the required minimum, and additional capital will be needed. De facto, when the CCB booked the specific provision shortfall in the Q3 results, it resulted in a significant reduction of the CET1 ratio to 12.01% and will have a negative impact on the annual profits of CCB.\textsuperscript{17}

(25) As a consequence, the ECB considered it proportionate to exercise the supervisory power pursuant to Article 16(2)(c) of Council Regulation (EU) No 1024/2013 and to require from the CCB the submission of a capital plan with the necessary measures to restore compliance by 30 June 2016 with the supervisory requirements set in the SREP Decision of 25 November 2015.

(26) That capital plan, which was submitted by the CCB to the ECB on 4 December 2015, includes the injection of EUR 175 million fresh capital and retained earnings as measures to restore compliance with the supervisory requirement regarding the CET1 ratio.

2.2. Aid measure

(27) Neither the CCB nor the CCIs are listed companies. They are not able to otherwise raise capital on the market. That inability has been confirmed by the CCB's letter regarding the request for additional State aid to the Ministry of Finance of 9 December 2015. According to that letter the group had not taken

\textsuperscript{14} See 2014 Decision, recitals 21 and 62.
\textsuperscript{15} See recital (5).
\textsuperscript{16} In October 2015, the ECB approved the inclusion of interim profits as of 30 June 2015 in COREP return for September 2015. Based on that approval the pro-forma June 2015, CET1 ratio is 13.48%.
\textsuperscript{17} See CCB's letter regarding the request for additional State aid to the Ministry of Finance of 9 December 2015.
steps to identify potential private investors or to prepare its listing, given that until September 2015 it did not appear that it would have any additional capital needs. In that letter, the CCB further explains that it will not be able to raise the required capital amount to cover the shortfall from private investors or with a public offer within the timeframe allowed by the ECB. Therefore taking into account the existing shareholding structure of the group, the letter concludes that there is no other option available than its recapitalisation with an amount of EUR 175 million from the Recapitalisation Fund, before the end of 2015.

The Recapitalisation Fund will be funded from the special levy imposed on credit institutions by virtue of the “Imposition of the Credit Institution’s Special Tax Law of 2011 to 2015” (‘the Special Levy Law’). To establish the Recapitalisation Fund, Cyprus had to amend a number of existing laws including the Special Levy Law under which banks are required to pay a levy of 0.15% on their customer deposits. The amendment provides for part of the levy to go into the Recapitalisation Fund. The Government will provide a loan to the Recapitalisation Fund to enable it to provide its capital injection to the CCB.

As a consequence of the capital injection, the Recapitalisation Fund will become a co-owner of the CCB with a shareholding ranging, on the basis of the provisional valuation\(^{18}\) carried out by an independent expert hired by the CCB and commissioned by the Ministry of Finance (‘provisional valuation’), indicatively from 21.21% to 33.33%. According to the same valuation, it will dilute the previous shareholders: the State's shareholding will decrease to a level between 65.90%-77.81% and the previous CCB minority shareholders, the CCB Holding Company, to 0.67%-0.79%. Moreover, the previous minority shareholders of the CCIs (the individual members of the CCIs, through the Cooperative Holding Companies) will hold – in exchange for their shareholding in the individual CCIs – a 0.10%-0.19% shareholding in the CCB. In parallel with the recapitalisation of the CCB, those minority shareholders in the CCIs will exchange their shares in the CCIs for shares in the CCB, so that the CCB holds 100% of each CCI. The final allocation of the shares between the CCB shareholders will be decided on the basis of an ex-post definitive valuation to be carried out by an independent expert after the conclusion of the recapitalisation of the CCB by the Recapitalisation Fund.

2.3. The 2015 restructuring plan and commitments

2.3.1. The commitments

Many of the measures in the 2014 restructuring plan have already been implemented or, where not, continue to apply. In addition, in the 2015 restructuring plan, the Cypriot authorities have brought forward several new commitments, which aim \textit{inter alia} at enhancing the viability and profitability of the entity through further operational and organisational efficiencies and at restoring the group's market access as described in detail below. The text of the commitments is set out in the Annex to the present Decision. The following sections provide a summary.

2.3.1.1. Commitment to achieve the operational integration of the 19 legal entities

\(^{18}\) Provisional valuation dated 8 December 2015, annexed to the notification.
Transfer of the work contracts of all CCI staff to the CCB

At present, each CCI has its own Human Resources function, collective agreements and employee terms and conditions. As a result, the group is less flexible in transferring staff resources, whilst employee transfers between CCIs and between CCIs and the CCB can only take place with the prior consent of the employees and of their employer (the CCIs). The group is committed to address that cause of difficulties, via: a) the transfer of the existing employment contracts between CCI employees and CCIs to the CCB and b) the recruitments of any new employees in the future only at the CCB level.

Governance structure

The CCIs are separate legal entities with their own Board of Directors (BoD). At present that BoD is partly made of independent members and is not fully controlled by the CCB. To increase central control and oversight, the composition of the CCIs' BoD will be changed to a three-member Board and be exclusively comprised of CCB members. At the same time, the CCB will change the mandate of the CCIs' BoD and abolish several of their existing responsibilities, which will be assumed onwards by the CCB.

In an effort to retain the affiliation to the local communities, the group intends to establish five regional and one professional Advisory Councils, with their members being people connected to the local market dynamics. The group has committed that those Advisory Councils will only play an advisory role and will not intervene in the business decisions of the CCIs or of the CCB.

Transfer of all physical assets of the CCIs to the CCB

As a means to further the operational integration of the CCIs and the CCB, all physical assets of the CCIs (such as properties, branches, ATMs, etc.) will be transferred to a Special Purpose Vehicle (SPV) which will be fully owned and controlled by the CCB.

Centralisation / Merger of CCIs operational functions

To streamline the operations of the CCB and of the CCIs, the 2015 restructuring plan entails further centralisation mainly with regard to control and support functions such as the internal audit, risk management, credit control, compliance, legal, information technology, human resources, finance and accounting, etc. Those functions will exclusively be conducted from now onwards at the CCB level.

2.3.1.2. Commitment to improve operational efficiency

The group has set up a new and more ambitious restructuring target for the maximum number of branches and by the end of June 2017 it will further reduce its branch network to 200.

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19 Currently comprising of 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).

20 According to the 2015 restructuring plan (p. 10) the establishment of an SPV serves the purpose of avoiding the creation of a tax liability involved in the transfer of assets between separate legal entities, such as the CCB and the CCIs.
The remuneration of group's employees and managers will continue to be restricted until the end of the restructuring period to 15 times the annual average salary in Cyprus or 10 times the average salary of the employees of the group, whichever is higher.

The commitment regarding the maximum number of full-time equivalent employees ('FTE') has been adjusted upwards from 2,580 in the framework of the 2014 decision to 2,700 (at end 2017 as well as at end 2018). That adjustment is due to the absorption of the Cooperative IT Society 'SEM'\(^{21}\) by the group and the incorporation of its 120 employees into the group, which was not envisaged at the time of the 2014 restructuring plan.

With the aim to reinforce critical functions such as IT, NPL management and risk management, the group has committed to redeploy staff from other functions whereby it currently maintains spare capacity (such as in the front line functions of the CCB and the CCIs). That redeployment of staff will be conducted according to the plan provided in Annex (c) to the list of commitments attached to this Decision.

Furthermore, with regard to NPL management – a function which has been extensively centralised thanks to the implementation of the measures included in the 2014 restructuring plan\(^{22}\) – the group has committed to further enhance its administrative capacity, via the centralisation of its 18 call centres into one. According to the 2015 restructuring plan, that centralisation is expected to improve the performance of the group in early arrears management.\(^{23}\)

As for the commitments related to the 2014 decision, the group commits to comply with targets for total costs and group cost/income ratio. The levels have been slightly adjusted upwards due to the changes in the restructuring plan (need to reinforce several headquarter functions, lower income due to higher provisioning level). In addition, as a consequence of the operational integration of the 19 legal entities and the consequent consolidation of accounts and expenses, at group level, the 2015 restructuring plan no longer includes individual targets for the cost/income ratio of the CCIs.

2.3.1.3. Commitment for the restoration of market access and divestment of the stake of the State (including the stake of the Recapitalisation Fund)

The CCB is exploring options for the eventual restoration of its market access including through the issuance of new share capital, if deemed necessary, which will be sold to a strategic investor and/or through an initial public offering (“IPO”). That engagement translates into the following concrete commitments:

a) The CCB will obtain all the necessary approvals by end December 2016, to be able to implement and complete a listing by end June 2017, as confirmed by the Monitoring Trustee. More specifically the CCB will start taking all the necessary steps to prepare for a potential listing of its shares to the main market of the Cyprus Stock Exchange (“CSE”) or to the alternative market of the CSE, if the conditions for the listing in the main market cannot be met.

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\(^{21}\) Formerly a subsidiary of the CCB.

\(^{22}\) See recital (15).

\(^{23}\) See notified restructuring plan, p. 23.
b) The CCB will list at least 25% of the total shares (i.e. 25% total shares post-listing in case the listing is made through the issuance of new shares) by September 2018 at the latest.

c) Following that initial listing, CCB will proceed to list, following that procedure and prioritisation: i) of another 25% of the total shares within nine months and ii) of a next tranche within 18 months. Following the listing of the latter tranche, the residual combined shareholding of the Republic and the Recapitalisation Fund in the CCB should not exceed 25%.

d) In case the group presents a capital shortfall compared to Pillar 2 requirements at end December 2016, or at any time during the period until September 2018 then, with a view of remedying the identified shortfall with private means, the CCB will initiate the listing process earlier.

e) As an alternative to a listing the corresponding shareholding can be sold to International Financial Institutions, other large cooperative or commercial banks, insurance companies, investment or pension funds, as well as any other large and renowned institutional investor in the financial services industry with private offering. The buyers cannot be connected to the State and are required to have enough resources to support the group in case it would need capital in the future. Cyprus has also committed to not sell its stake (or the stake of the Recapitalisation Fund) to any buyer that is funded, directly or indirectly, by the CCB.

2.3.1.4. Contingent additional commitment

(43) Cyprus (as shareholder of the CCB) and the CCB undertook a rendezvous clause in case the 2015 restructuring plan fails to be implemented. That engagement translates in the following concrete commitments:

a) If by end-June 2017, the group has not achieved in full and cumulatively the measures relating to branch reduction, the preparation for its listing, the operational integration of the 19 legal entities, as well as the cap on the number of FTE at end 2016,

or

b) If by end-March 2018, the group has not achieved in full and cumulatively the measures relating to the cap on the number of FTE at end 2017, the actual listing or sale of the first 25% shareholding and additional 25% if applicable, the cap on total costs for 2017 and the cost/income ratio in 2017

Then

a) The group shall proceed in the full legal merger of the existing 19 standalone legal entities (consisting of the CCB and the CCIs) into a single entity. That legal merger shall be completed within five months from the trigger of this commitment (i.e. from either end June 2017 or end September 2018).

Or alternatively
b) Cyprus will notify by end-April 2018 at the latest, as an amendment to the 2015 restructuring plan for formal Commission approval, an alternative proposal setting out measures to achieve the same results as a legal merger – including further restructuring and restoration of access to market measures (provided that the latter has not been yet achieved in that point in time). Once approved by the Commission, that proposal shall be implemented in full completed within five months from the trigger of this commitment (i.e. from either end June 2017 or end September 2018).

2.3.1.5. Valuation commitment

(44) An ex-post definitive valuation of the CCB and/or the CCIs will take place following the recapitalisation of the CCB by the Recapitalisation Fund. That valuation shall be: i) completed by end- of March 2016 at the latest; ii) carried out from the independent expert that was hired by the CCB and commissioned by the Management Unit of the Cypriot Ministry of Finance to carry out the provisional valuation and iii) fully compliant with the requirements of Article 36 of Directive 2014/59/EU.24

(45) The amount of capital to be injected in the CCB by the Recapitalisation Fund shall not be taken into account for the purpose of the ex-post definitive valuation.

(46) The existing 1% CCI minority shareholders25 shall exchange their shares in the CCIs for CCB ordinary shares at the price determined by the ex-post definitive valuation of the CCB and/or the CCIs. That exchange shall be completed by end- of April 2016 at the latest.

(47) The Recapitalisation Fund shall be remunerated for its recapitalisation of the CCB in the form of CCB ordinary shares at the price determined by the ex-post definitive valuation of the CCB and/or the CCIs. The allocation of CCB shares to the Recapitalisation Fund shall be completed by end-of April 2016 at the latest.

(48) In the event that the ex-post definitive valuation carried out of the CCB and/or the CCIs is higher than the provisional valuation26, Cyprus shall notify the ensuing re-allocation of shares between the existing 1% CCI minority shareholders, the Recapitalisation Fund and the other shareholders of the CCB (including Cyprus) as an amendment to the restructuring plan, for a formal Commission approval.

2.3.1.6. Other commitments

(49) The group shall also maintain behavioural commitments consisting of a ban on advertising State support, an acquisition ban and a deposit price leadership ban27.

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25 Consisting of 18 Cooperative Holding Companies, which were formed at the time of the 2014 public recapitalisation, in order to group the rights of the then existing shareholders/CCIs members into each CCI.

26 The provisional valuation understood as the mid-point of the valuation range which has been notified on 9 December 2015.

27 See Commitments of Cyprus in the Annex to the 2014 decision, points 5, 6 and 38.
In the 2015 restructuring plan, the group has also reiterated its commitment to proceed with the divestment of its non-core activities and of its so called 'commercial activities'.

The CCB and the CCIs will continue to pay particular attention to the monitoring of risk and NPL management. Therefore, the centralised risk management and NPL management structures that were established under the 2014 restructuring plan will be maintained and all the related commitments will continue to apply.

2.3.1.7. Duration of the commitments, monitoring

Unless otherwise specified, the commitments will apply throughout the restructuring period (i.e. until 31 December 2018).

The appointed Monitoring Trustee will continue to monitor the compliance of the group with the implementation of the 2015 restructuring plan and of the list of commitments included in the annex to this decision.

2.3.2. Financial projections (base case scenario)

The restructuring plan is based on the following key assumptions set out in Table 1:

Table 1: Assumptions for base case scenario

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP growth (%)</td>
<td>1.4</td>
<td>2.0</td>
<td>2.2</td>
</tr>
<tr>
<td>Fees and Commissions income and expenses decrease (%)</td>
<td>18.0</td>
<td>3.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Client Deposit volume growth (%)</td>
<td>1.5</td>
<td>2.0</td>
<td>2.2</td>
</tr>
<tr>
<td>[...]*</td>
<td>[...]</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td>[...]</td>
<td>[...]</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

28 Commercial activities concerns non-banking activities of the group mainly relating to the trading (import and distribution) of farming-related products.

29 See Commitments of Cyprus in the Annex to the 2014 decision, points 42-45.

30 See Commitments of Cyprus in the Annex to the 2014 decision, points 14-29 and 39-41.

31 See notified restructuring plan, p. 37.

* Confidential information; the omissions are shown as [...]
The projected P&L are presented in Table 2.

Table 2 – Projected P&L of the consolidated CCB\textsuperscript{32} – base case

<table>
<thead>
<tr>
<th>(EUR '000)</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Interest Income</strong></td>
<td>411.739</td>
<td>378.976</td>
<td>323.688</td>
<td>[...]</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td><strong>Total income</strong></td>
<td>468.022</td>
<td>419.293</td>
<td>361.774</td>
<td>[...]</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td><strong>Operating expenses</strong></td>
<td>(189.892)</td>
<td>(156.814)</td>
<td>(160.420)</td>
<td>[...]</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td><strong>Profit / Loss from Operations</strong></td>
<td>278.130</td>
<td>262.478</td>
<td>201.354</td>
<td>159.713</td>
<td>167.866</td>
<td>163.347</td>
</tr>
<tr>
<td><strong>Provisions</strong></td>
<td>(1.867.736)</td>
<td>(166.050)</td>
<td>(384.121)</td>
<td>[...]</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td><strong>Profit / Loss on disposal of AFS</strong></td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>[...]</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td><strong>Profits / Losses on disposal of property</strong></td>
<td>(78.870)</td>
<td>(32.266)</td>
<td>(4.750)</td>
<td>[...]</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td><strong>Voluntary Retirement Costs</strong></td>
<td>(282)</td>
<td>(23.484)</td>
<td>(140)</td>
<td>[...]</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td><strong>Taxation</strong></td>
<td>(24.521)</td>
<td>(3.757)</td>
<td>(14.223)</td>
<td>[...]</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td><strong>Profit for the year</strong></td>
<td>(1.693.279)</td>
<td>36.920</td>
<td>(201.880)</td>
<td>67.198</td>
<td>109.847</td>
<td>121.563</td>
</tr>
</tbody>
</table>

(56) The CCB expects to end year 2015 with approximately EUR 200 million losses due to the one-off provision adjustment based on the SSM estimates. It expects to return to profitability in 2016 with about EUR 67 million and with about EUR 122 million at the end of the restructuring period in 2018.

(57) The CCB is currently taking significant measures to improve its arrears management framework, building on recommendations from the SSM, IMF and external consultants. [...] 

(58) Cost-to-income will increase from 41% in Q3/2015 to 49% in 2018, which is due to a stable cost base combined with a reduction in income coming mainly from the increased interest suspended following the increased provisioning coverage.

(59) The CET1 ratio of the CCB, which stands at 12.01% at the end of Q3/2015 will increase to 14.17% at the end of 2015.

(60) The return on equity of the CCB will be 5.3% in 2016, and 8.1% and 8.5% in 2017 and 2018 respectively.

(61) The projected consolidated balance sheet is presented in Table 3.

\textsuperscript{32} See notified restructuring plan, p. 39.
### Table 3: Projected balance sheet of CCB – base case – main assets and liabilities

<table>
<thead>
<tr>
<th>(EUR ’000)</th>
<th>2013</th>
<th>2014</th>
<th>Q3 2015</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Main assets components</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans to clients (gross)</td>
<td>13,385,351</td>
<td>13,107,793</td>
<td>12,903,595</td>
<td>12,883,408</td>
<td>[...]</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td>Provisions</td>
<td>(2,585,615)</td>
<td>(2,968,358)</td>
<td>(3,417,514)</td>
<td>(3,494,642)</td>
<td>[...]</td>
<td>[...]</td>
<td>[...]</td>
</tr>
<tr>
<td>AFS (Commercial Business and other Investments)</td>
<td>100,163</td>
<td>130,784</td>
<td>132,767</td>
<td>135,459</td>
<td>119,040</td>
<td>94,178</td>
<td>39,241</td>
</tr>
<tr>
<td>AFS (Bonds)</td>
<td>2,517,476</td>
<td>2,409,781</td>
<td>934,214</td>
<td>870,442</td>
<td>1,563,751</td>
<td>2,195,160</td>
<td>2,894,947</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>15,209,143</td>
<td>13,927,480</td>
<td>14,070,882</td>
<td>14,299,119</td>
<td>14,558,012</td>
<td>14,905,837</td>
<td>15,277,005</td>
</tr>
</tbody>
</table>

| **Main liabilities components** | | | | | | | |
| Client Deposits | 13,506,534 | 12,424,334 | 12,771,013 | 12,791,556 | [...] | [...] | [...] |
| **Total Equity** | 1,177,809 | 1,231,134 | 1,036,114 | 1,243,807 | 1,307,803 | 1,395,891 | 1,475,686 |
| **Total Equity and Liabilities** | 15,209,143 | 13,927,480 | 14,070,882 | 14,299,119 | 14,558,013 | 14,905,837 | 15,277,004 |

The Balance Sheet of CCB will increase marginally in the next three years primarily due to the moderate increase of client deposits, which will fund an increase in the bond portfolio of the group.

2.3.3. **Stress case scenario**

As regards key business parameters, the restructuring plan in adverse scenario is based on the assumptions set out in Table 4:

### Table 4: Assumptions for adverse case

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP growth (%)</td>
<td>0.0</td>
<td>0.5</td>
<td>2.2</td>
</tr>
<tr>
<td>Increase of deposit interest rate (%)</td>
<td>0.25</td>
<td>0.25</td>
<td>0.25</td>
</tr>
</tbody>
</table>

The CCB Group is expected to be loss-making in 2016 with a loss of EUR 161 million (compared to the projected profit under the base case scenario of...
approximately EUR 67 million) due to the additional provisions. However it is expected under the adverse scenario to return to profitability in 2017 and 2018 with profits of EUR 57 million and EUR 69 million in each year respectively.

(65) Compared to the base case, the cost-to-income ratio would increase with its peak in Q2 2016 at 62% and decrease to 58% at the end of 2018, mainly due to the reduction of the net interest margin.

(66) Return on equity, by the end of 2018, would pick up to approximately 6%.

(67) The CET1 ratio of the CCB would face significant stress in 2016 in the adverse scenario but is then expected to recover due to the projected profitability of the CCB in years 2017 and 2018. CCB estimates that the ratio would drop to 12.96% as at the end of 2016 but then increase to 15.05% in 2018.

3. ASSESSMENT OF THE AID

3.1. Existence of State Aid

(68) According to Article 107(1) TFEU, 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.

(69) The qualification of a measure as State aid therefore depends on the fulfilment of all of the following criteria: (i) the measure must be imputable to the State and financed by a Member State through State resources; (ii) it must grant an advantage favouring 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.

Imputability and State Resources

(70) The Recapitalisation Fund has been established by the Republic of Cyprus by virtue of the "The Establishment and Operation of the Independent Recapitalisation Fund Law of 2015" (the Recapitalisation Fund Law'). Moreover, its initial capital was covered by the State. The State will eventually recover that capital through the special levy imposed on financial institutions by virtue of the Special Levy Law35. The management and the use of the Recapitalisation Fund's resources are decided in accordance with the Recapitalisation Fund law, for the recapitalisation of financial institutions, until the end of 2015. In the present case, the use of the Recapitalisation Fund resources for the recapitalisation of CCB has been decided by virtue of the Recapitalization of the Cooperative Central Bank Ltd/Central Body of the Cooperative Credit Institutions(CCB/CB), Amending Decree of 2015 enacted on 17 December 2015. The Commission therefore considers that the measure is financed through State resources and is imputable to the State.

Selective advantage

(71) The recapitalisation strengthens the capital of the Cooperative Group allowing it to comply, on a consolidated basis, with the regulatory capital requirement.

35 See recital (28).
Without the EUR 175 million capital injection, the capital of the Cooperative Group would fall below regulatory requirements.

(72) Under the current circumstances private investors would not have provided the Cooperative Group with such capital resources. Furthermore, the CCB is not a listed company in an EU regulated market and, to become one, would need time to prepare compliance with a number of relevant EU Directives. That assessment has been confirmed by the CCB's letter to the Ministry of Finance of 9 December 2015 stating furthermore that "the bank will not be able to raise additional capital from private investors or with a public offer within the timeframe allowed by the SSM [30 June 2016] to cover the potential capital shortfalls". The letter therefore concludes that "there is no other option available than the recapitalisation of Bank with an amount of €175 million from the Recapitalisation Fund before the end of the current year."

(73) In addition, the State is the majority shareholder in the CCB not as the consequence of an investment made as an investor but as a consequence of a State aid granted as recently as in the first trimester of 2014. The State is therefore 99% shareholder in the CCB resulting from an intervention as public authority to preserve financial stability. The bank is still in the process of implementing the restructuring plan and will be deeply loss making in 2015. The expected profitability for the following years is rather low compared to private investors' requirements. Hence the State's behaviour is not comparable to that of a private investor being the 99% shareholder in a bank and recapitalising that bank.

(74) The Commission therefore concludes that the capital injection by the Recapitalisation Fund grants an advantage to the CCB and, thereby, the Cooperative Group. The measure is to the sole benefit of the Cooperative Group and is, therefore, selective.

Distortion of competition and effect on trade

(75) 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 distorts competition.

(76) Therefore the recapitalisation in favour of the Cooperative Group constitutes State aid within the meaning of Article 107(1) TFEU. That view is not contested by Cyprus.

3.2. Compatibility of the aid

3.2.1. Application of Article 107(3)(b) TFEU

(77) 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\textsuperscript{36} as well as in the 2013 Banking Communication\textsuperscript{37}.

(78) The Commission's approval of the Cypriot guarantee scheme for banks which meanwhile has been prolonged several times confirms that stabilising the banking sector is necessary to remedy the ongoing disturbance in the Cypriot economy\textsuperscript{38}. 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.

(79) Given the relevance of the Cooperative Group for the Cypriot banking sector and in particular for the collection of deposits and 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.

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

3.2.2. Compatibility of the aid: applicable communications

(81) 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.

(82) The measure also 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.


\textsuperscript{37} OJ C 216, 30.7.2013, p. 1.

3.2.3. Restoration of long-term viability

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

(84) 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.

(85) 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.

Risk and NPL management

(86) As indicated in the 2014 decision, one of the main sources of the Cooperative Group's difficulties was the poor loan underwriting process and the underdeveloped risk management. The Cooperative Group has overhauled its governance structure, giving CCB a clear leading role with regard to shaping and monitoring the implementation of the group's risk management, credit, restructuring and pricing policies. The increased centralisation of the group and the reinforcement of the central risk management function, supported by a more developed and integrated IT system are key elements. Those structures as described in recital (51) will remain intact under the 2015 restructuring plan.

(87) Regarding the handling of its NPLs, which remains as one of the main sources of concern for the viability of the Cooperative Group, as described in recital (15) the CCB has taken over from the CCI the handling of those loans, via the establishment of its NPL Management Division. The Cooperative Group has already devoted considerable resources to build and operate the NPL Management Division. The Commission notes positively that that the resources of that Division will be further reinforced through the redeployment of staff from other functions whereby the group currently maintains spare capacity.\(^{39}\) In addition, with the aim to further improve the administrative capacity of the NPL Management Division especially in the area of early arrears, the CCB and the CCI have committed to centralise the existing 18 call centres into one.\(^{40}\) The Commission further positively notes that the Cooperative Group has sought external assistance in order to align that critical function with international best practises.\(^{41}\)

(88) It should be emphasized however, that, until now, the amount recovered from the NPLs is very low. The ability of the Cooperative Group to recover money from its very large stock of NPLs depends upon on the use to the maximum possible extent of the new legal framework\(^{42}\) that was put in place by Cyprus as part of the MoU conditionality, e.g. to facilitate the seizing and pledging of collateral. In that context, the Commission pays particular attention to the commitment Cyprus has made that the Cooperative Group shall use to the maximum possible extent that

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\(^{39}\) See Commitments of Cyprus in the Annex to this decision, point 48.

\(^{40}\) See Commitments of Cyprus in the Annex to this decision, point 50.

\(^{41}\) See recital (17).

\(^{42}\) See for instance Immovable Property (Transfer and Mortgage) (Amending) Law of 2014.
new legal framework in order to recover value from its NPLs. The correct implementation of that commitment is indispensable for the restoration of viability.

Operational efficiency

(89) The Commission notes positively that additional significant rationalising measures are included in the 2015 restructuring plan, which should increase the Cooperative Group's viability and profitability.

(90) The cost-cuttings stem from a further rationalisation in the already downsized branch network of the CCIIs, as well as from a further centralisation and the rationalisation of functions that were until now duplicated at level of the CCIIs and the CCB: functions such as IT, internal audit and human resources will in future be only conducted at the level of the CCB.

(91) Furthermore, Cyprus reiterated its commitment regarding defined thresholds of operating expenses that are not to be exceeded by the Cooperative Group during the restructuring period and a defined cost-income ratio limit of 50% that the group should also not exceed.

(92) The Commission also observes that Cyprus retains in the 2015 restructuring plan its commitment that the Cooperative Group should not exceed a defined maximum regarding FTE employees. 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, IT and the management of NPLs, will receive the necessary resources, and that Cyprus has undertaken commitments that facilitate mobility across the group. Annex (c) to the list of commitments attached to this Decision illustrates the depth of the internal reallocation of staff within the group.

(93) Pre-provision profits present a negative trend for the period 2015-2018 (from 201 million in 2015 to EUR 163 million in 2018), mainly due to the lower interest income which derives a decrease in customer loans (repayments) and, to a limited extent, from a slight increase of operating expenses in 2016 (from EUR 160 million in 2015 to EUR 167 million in 2016) which mainly reflects the cost of the absorption of SEM as well as the high professional fees that the group pays out for the ongoing projects to improve infrastructures and efficiency.

(94) The Commission notes positively that Cyprus undertook commitments that require the Cooperative Group to undertake additional operational integration and efficiency measures, should the measures at hand prove insufficient to restore its viability and profitability. In particularly, according to the undertaken commitments, in such a case, unless the Cooperative Group proceeds in a legal merger of the CCB with the CCIIs, Cyprus will have to notify those additional measures as an amendment to the 2015 restructuring plan for formal Commission approval.

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43 See Commitments of Cyprus in the Annex to this decision, point 56.
44 See Commitments of Cyprus in the Annex to this decision, point 49.
45 See Commitments of Cyprus in the Annex to this decision, point 48.
46 See recital (41); see Commitments of Cyprus in the Annex to this decision, points 52 and 53.
47 See Commitments of Cyprus in the Annex to this decision, point 47.
48 See Commitments of Cyprus in the Annex to this decision, point 48.
49 See Commitments of Cyprus in the Annex to this decision, points 6 and 7.
50 See recital (41); see Commitments of Cyprus in the Annex to this decision, points 26 and 27.
(95) 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 at the end of the restructuring plan (8.5% in 2018) appears, if sustained in the long term, to be appropriate, in view of the low risk profile which the Cooperative Group will try to achieve by turning itself into a prudently managed domestic retail bank.51

(96) Point 13 of the Restructuring Communication requires that the bank be 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.52 Due to the recapitalisation the consolidated group will show a CET1 ratio of above the required 12.25% in the base case as well as (even though stressed at 2016) in the adverse case.53

Restoration of market access

(97) The group needs again State aid because it was unable to raise capital from the market to cover the capital shortfall identified by the ECB. Such repeated granting of State aid and such structural reliance on State aid to cover capital needs is an aggravating factor in the State aid assessment; if those issues were not solved, the Commission could not conclude that the notified restructuring plan allows the restoration the long-term viability of the group. Viability is achieved only when a firm is able to compete on the market without State aid.

(98) In that context, the Commission notes positively the commitment54 to prepare for listing and to list a first part of the shares of the group by end September 2018 at the latest or in the alternative, to sell a first part of the shares to private investors. It increases the likelihood that, if a new capital need would unexpectedly arise, the group could finance it by raising capital from private investors and would not need State aid. The correct implementation of that commitment is therefore key to the restoration of long term viability.

Conclusion

(99) 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. The Commission notes positively the commitment to continue with a mandate of a monitoring trustee to monitor the correct implementation of the plan and of the associated commitments.

3.2.4. Own contribution (burden-sharing)

(100) 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.

(101) A recapitalisation amount of EUR 175 million is considered by the ECB Banking Supervision as "the minimum amount which, coupled with other management actions reducing the level of unprofitable assets, will promote the viability and

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51 See recitals (60) and (66).
52 See point 11 of the Restructuring Communication.
53 See recitals (59) and (67).
54 See Commitments of Cyprus in the Annex to this Decision, points 18-20.
sustainability of the Bank." According to the ECB, organic profit generation and retention would not be rapid enough to bring the bank in compliance with the capital requirements.

(102) In order to ensure that restructuring aid is kept to the minimum necessary, points 35 to 39 of the 2013 Banking Communication require there to have been capital raising measures by the bank. To prevent moral hazard and ensure that restructuring aid is kept to the minimum necessary, points 40 to 46 of the 2013 Banking Communication require adequate burden-sharing by existing investor. As described above, the group is unable to raise capital on the market from private shareholders so that there is no other option available than a recapitalisation provided by the Recapitalisation Fund. Moreover, there is no outstanding subordinated debt, junior debt or other hybrid/Tier 2 instruments issued by the group so that the options for burden-sharing by historical shareholders and subordinated debt holders are limited to a dilution of existing shareholders.

(103) The Commission notes positively that the number of shares to be attributed to the Recapitalisation Fund in exchange for the EUR 175 million recapitalisation, will not be based on a price per shares determined by the accounting value of the equity of the group, which was around EUR 1 billion at the end of Q3 2015 pre-recapitalisation (see Table 3). It will be calculated based on an estimated fair/market value of the group, calculated by an independent expert. According to the provisional valuation of the expert, the value of the group pre-recapitalisation has been estimated as being within a range with a midpoint of EUR 500 million. That evaluation complies with the requirement of the 2011 Prolongation Communication.

(104) The final allocation of the shares between the different shareholders will be decided on the basis of an ex-post definitive valuation to be carried out after the recapitalisation.

(105) Consequently, following its capital injection in the CCB, the Recapitalisation Fund will hold, based on a provisional valuation a shareholding within the range of 21-33% in the CCB while the State's shareholding will be reduced from 99% to an estimated shareholding and corresponding voting rights within the range of 66%-78% in the CCB. The 1% shareholders of the CCB, the CCB Holding Company, and the 1% shareholders of the CCIs, the old members, who will exchange their shares in the CCIs for shares in the CCB, will hold a combined share with the range of 0.77%-0.98% in the CCB. They will therefore be further diluted by the new recapitalisation and represents only a negligible shareholding. Hence the requirements of the 2011 Prolongation Communication and of the 2013 Banking Communication are complied with.

(106) The Cypriot authorities have committed to notify the final valuation for approval if it is higher than the mid-point of the range of provisional valuations. This is a useful safeguard which ensures that the actual burden-sharing is not smaller than the one calculated based on the provisional valuation.

(107) The CCB will not pay out any dividends on shares for the fiscal years until end 2016.  

55 Letter of the ECB Banking Supervision to the Commission of 11 December 2015. 
56 See recital (27).  
57 See Commitments of Cyprus in the Annex to this decision, point 14. 
20
Finally, the Commission notes positively further cost-cutting measures that will result in a reduction of the operating expenses, for instance, by means of a further closure of branches\(^59\). The total remuneration of any member of staff including board members and senior managers may, as before, 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 restrictions apply until the end of the restructuring period.\(^60\) The remuneration policy is therefore in line with point 38 of the 2013 Banking Communication.

The Commission observes that the new lending envisaged by the group is low compared to its large stock of deposits, resulting in the expected further decline of the net loan-to-deposit ratio during the restructuring period, despite the fact that currently it is already well below 100%. Seeking quicker downsizing of the loan book would endanger the financing of the Cypriot economy.\(^61\) Therefore, additional own contribution through even quicker downsizing of the loan book is not appropriate.

In conclusion, the Commission can accept, also in view of the limited aid amount, the proposed burden-sharing.

### 3.2.5. Measures limiting the distortion of competition

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.

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 risk weighted assets ("RWA").

The Cooperative Group, one of the largest Cypriot banks will receive an aid amount of EUR 175 million in the form of capital support amounting to roughly 2% of its RWA. That proportionate amount of State aid, even if limited, should be adequately reflected in measures to mitigate distortions of competition in line with point 31 of the Restructuring Communication.

Following a downsizing of the loan book from 2013 to Q3 2015, the new business plan envisages a further reduction of the loan book. As already concluded, a quicker deleveraging of the Cooperative Group, which could only be achieved by further reducing the already low envisaged new lending, would risk endangering the financing of the Cypriot economy.

The Cypriot economy has still not fully recovered from the past recession. Other banks also still face difficulties and have only limited capacity to provide new funding to the real economy. Therefore, and in view of the rather limited amount of State aid, the Commission does not require a downsizing of the Cooperative Group.

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, structural measures such as the

\(^58\) See Commitments of Cyprus in the Annex to this decision, point 1.
\(^59\) See Commitments of Cyprus in the Annex to this decision, point 49.
\(^60\) See Commitments of Cyprus in the Annex to this decision, point 45.
\(^61\) See recitals (114) and (115).
further reduction of the branch network\textsuperscript{62} as well as a number of behavioural commitments.

(117) Thus, the authorities continue to commit the Cooperative Group to refrain from advertising the State support and from aggressive commercial strategies, to not acquire stakes in undertakings) and to respect certain price ceilings on deposits. Thus, 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.

(118) Similarly, Cyprus continues to be committed to restrictions regarding new product or geographic markets. Thus, 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\textsuperscript{63}. That commitment helps ensure that the aid is not used to expand in other financial sectors or geographies.

(119) 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.

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

3.2.6. Conclusion on the compatibility of the restructuring aid

(121) The Commission finds that the restructuring aid in the form of a State recapitalisation of EUR 175 million 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) TFEU.

4. Compliance of the resolution of the bank with the provisions of Directive 2014/59/EU on bank recovery and resolution

(122) Although Cyprus has not yet transposed Directive 2014/59 into national law and the respective provisions on bail in, the Commission needs to assess whether the measure violates indissolubly linked provisions of the Directive 2014/59.

(123) That obligation is in line with the jurisprudence of the Union Courts, which have consistently held\textsuperscript{64} "that those aspects of aid which contravene specific provisions TFEU other than [Articles 107 and 108 TFEU] may be so indissolubly linked to the object of the aid that it is impossible to evaluate them separately to that their effect on the compatibility or incompatibility of the aid viewed as a whole must

\textsuperscript{62} See Commitments of Cyprus in the Annex to this decision, points 49.

\textsuperscript{63} See Commitments of Cyprus in the Annex to this decision, point 2.

therefore of necessity be determined in the light of the procedure prescribed in [Article108]".65

(124) To ascertain whether a violation of a provision of Union law is indissolubly linked to the object of the aid, a relation of necessity has to be established. It means that the State aid measure has to be connected with a national measure in a way that necessarily breaches a specific provision of Union law which is relevant for the compatibility analysis under paragraphs 2 and 3 of Article 107 TFEU.

(125) In this decision, according to the information provided by Cyprus, the Commission has identified the use of at least the following provisions of Directive 2014/59.

(126) The Commission notes that the group requires extraordinary public financial support which comes within the scope of Article 32(4)(d) of Directive 2014/59. Such support is not of precautionary nature as it aims at covering a capital shortfall which stems from additional loan loss provisioning.

(127) The provisions of the measure are in line with Article 34(1)(a) of Directive 2014/59. Taking into account that the CCB has no subordinated debt, and its equity consists of ordinary shares, 99% of which is owned by Cyprus and roughly 1% by the previous shareholders (to which an additional consolidated shareholding of less than 1% through the old members’ 1% shareholding in the CCIs). Those existing shareholders will be diluted as a consequence of the additional capital injected by the Recapitalisation Fund.

(128) Furthermore, according to Cyprus the provisional valuation submitted with the notification complies with Article 36(2) of Directive 2014/59 on the possibility to perform a provisional valuation for the purposes of resolution. 66 The Cypriot authorities committed that the final valuation will also comply with Article 36 of Directive 2014/59.

(129) Commission finally notes that the Recapitalisation Fund has been established in Cyprus to fulfil the Member State's obligations under Article 100(1) of Directive 2014/59. Therefore, the funding of the recapitalisation measure appears to be in compliance with Article 100 of Directive 2014/59 on the requirement to establish and use resolution financing arrangements.

(130) Therefore, the Commission concludes that the restructuring aid measure does not seem to violate the intrinsically linked provisions of Directive 2014/59 in the context of the State aid rules.

(131) This is without prejudice to the prerogative of the Commission to initiate infringement procedures against a Member State for breach of Union law, including breach of the provisions of Directive 2014/59.

65 Case 74/76 Ianelli v Meroni EU:C:1977:51 paragraph 14.
66 See recital (29).
5. CONCLUSION

The Commission concludes that the State recapitalisation of the CCB amounting to EUR 175 million constitutes State 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, 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 electronically to the following address:

European Commission,
Directorate-General Competition
State Aid Greffe
B-1049 Brussels
Stateaidgreffe@ec.europa.eu

Yours faithfully,
For the Commission

Margrethe VESTAGER
Member of the Commission

CERTIFIED COPY
For the Secretary-General,

Jordi AVET PUIGARNAU
Director of the Registry
EUROPEAN COMMISSION
ANNEX

List of Commitments

The Republic of Cyprus (“The Republic”) 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 (“the Commission”) on 9 December 2015 (“the restructuring plan”) and the associated list of commitments. The present list of Commitments replaces in entirety the commitments of the restructuring plan submitted to the Commission on 31 January 2014 and approved by Commission decision of 24 February 2014 under case SA.35334 (2014/N)

The Cooperative Central Bank (“the CCB”) and the Cooperative Credit institutions (“the CCIs”) commit to implement the restructuring plan and the measures described in the present document.

The Commitments shall apply throughout the restructuring period (31 December 2018) unless the individual Commitment states otherwise.

1. Standard Commitments

1. The CCB will not pay out any dividends on shares for the fiscal years until end 2016.

2. 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.

3. 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.

4. 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.

5. The CCB shall modify the mandate of the appointed Monitoring Trustee so as that his duty will be adjusted to monitoring the Commitments listed in this document.
2. Operational integration of the 19 legal entities (CCB and CCIs)

2.1. Transfer of the work contracts of all CCI staff to the CCB

6. The CCB and the CCIs commit to transfer the existing employment contracts of all CCIs staff (including those of the CCIs managers) with the CCIs to the CCB. Following this transfer, CCIs employees will have none employment contractual relationship with the CCIs, while the CCB shall have the power to transfer those employees between CCIs and between CCIs and CCB, without the prior consent of the employee and the CCIs. The implementation of this commitment should start immediately and be completed by end-September 2016 at the latest.

7. Any new employment contracts to cover for the staff needs of the group shall exclusively be undertaken by the CCB.

2.2. Governance Structure

8. The CCIs Board of Directors (BoD) shall exclusively be comprised of CCB managers. To this end, CCB shall change the composition of the existing CCIs BoD by the termination of the appointment of all existing non-executive members and by the reduction in the number of members to three (3) members only. The implementation of this commitment should start immediately and be completed by end-February 2016 at the latest.

9. The CCB shall change the mandate of the CCIs BoD, in order to transfer control to the central organisation (CCB). Going forward, several of the existing CCIs BoD responsibilities shall be abolished and the CCI Audit and Risk Committees shall no longer exist as the respective functions will be centralised. The implementation of this commitment should start immediately and be completed by end-February 2016 at the latest.

10. In an effort to retain the affiliation to local communities, the group intends to establish at the CCIs level, Advisory Councils at a maximum number of six (6). If such establishment takes place, those Advisory Councils shall only have a purely advisory role and shall have no power to intervene in the business decisions of the CCIs or of the CCB.

2.3. Transfer of all physical assets of the CCIs to the CCB

11. All physical assets of the CCIs such as properties branches, ATMs, etc. shall be transferred to a Special Purpose Vehicle (SPV). CCB will own (by 100%) and manage this SPV. The implementation of this Commitment should start immediately and be completed by end-June 2016 at the latest.

2.4. Centralisation/Merger of CCIs operational functions

12. With the aim to avoid duplication of costs and functions, the following operational functions of the CCIs should be merged and transferred to the CCB according to below timeline:

<table>
<thead>
<tr>
<th>Function</th>
<th>Deadline for completion of merger</th>
</tr>
</thead>
<tbody>
<tr>
<td>IT</td>
<td>End-January 2016</td>
</tr>
<tr>
<td>Internal audit</td>
<td>End-December 2015</td>
</tr>
<tr>
<td>Risk management</td>
<td>End-May 2016</td>
</tr>
<tr>
<td>Credit control</td>
<td>End-May 2016</td>
</tr>
</tbody>
</table>
Compliance End-March 2016
Organisation & methods End-June 2016
Human resources End-May 2016
Legal Documentation and Mortgages Dept. End-June 2016
Tenders End-December 2016
Own property related operations End-June 2016
Finance and accounting End-December 2016

13. The CCB shall implement fourteen (14) ongoing projects which were included in the action plan for addressing the deficiencies identified with respect to Financial Control and Reporting in the context of the Memorandum of Understanding (MoU) for the Economic Adjustment Program for Cyprus, within the deadlines set out in this action plan, except for the deadlines adjustments mentioned in page 12 of the restructuring plan regarding the implementation of the MIS action plan.

3. Valuation

14. (a) An ex-post definitive valuation of the CCB and/or the CCIs will take place following the recapitalisation of the CCB by the Recapitalisation Fund. This valuation shall be: i) completed by end-of March 2016 at the latest; ii) carried out from the independent expert that was hired by the CCB and commissioned by the Management Unit of the Ministry of Finance to carry out the provisional valuation; iii) fully compliant with the requirements of Article 36 of the Directive 2014/59/EU on Bank Recovery and Resolution.

(b) The amount of capital injected in the CCB by the Recapitalisation Fund shall not be taken into account for the purpose of the ex-post definitive valuation.

15. The existing 1% CCI minority shareholders shall exchange their shares in the CCIs with CCB ordinary shares at the price determined by the ex-post definitive valuation of the CCB and/or the CCIs. This exchange shall be completed by end-of April 2016 at the latest.

16. The Recapitalisation Fund shall be remunerated for its recapitalisation of CCB in the form of CCB ordinary shares at the price determined by the ex-post definitive valuation of the CCB and/or the CCIs. The allocation of CCB shares to the Recapitalisation Fund shall be completed by end-of April 2016 at the latest.

17. In the event that the ex-post definitive valuation carried out for the CCB and/or the CCIs is higher than the provisional valuation (the provisional valuation understood as the mid-point of the valuation range which has been notified on 9 December 2015), the Republic shall notify the ensuing re-allocation of shares between the existing 1% CCI minority shareholders, the Recapitalisation Fund and the other shareholders of the CCB (including the Republic) as an amendment to the restructuring plan, for a formal Commission approval.

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1 Recapitalisation Fund: the Fund that has been established by the Republic, through the Law “the Establishment and Operation of the Independent Recapitalisation Fund Law of 2015”.
4. Restoration of market access and divestment of the stake of the Republic (including the stake of the Recapitalisation Fund)

18. The Republic commits that the CCB will obtain all the necessary approvals by end December 2016, to be able to implement and complete a listing by end June 2017, as confirmed by the Monitoring Trustee. More specifically the CCB will start taking all the necessary steps to prepare for a potential listing of its shares to the main market of the Cyprus Stock Exchange (“CSE”) or to the alternative market of the CSE if the conditions for the listing in the main market cannot be met. Such steps require Management to be prepared to meet shareholder and market expectations from day one as a listed company. Group structure, status of restructuring process, financial information, corporate governance, financial reporting procedures and risk and compliance issues are some examples of the areas that the CCB will examine in preparation for an initial public offering (IPO) and listing.

19. The Republic commits that the CCB will list at least 25% of the total shares (i.e. 25% total shares post-listing in case the listing is made through the issuance of new shares) by September 2018 at the latest.

20. At the time of the IPO, if the IPO takes the form of the issuance of new shares by the CCB (and not the sale of existing shares), the existing shareholders of the CCB other than the State and the Recapitalisation Fund may be granted a right to buy a percentage of the new shares. Such percentage shall not exceed the shareholding of those shareholders in the CCB. The purchase price of the new shares under that right will be determined based on a valuation of the CCB carried out at the time of the IPO.

21. Besides the possibility to grant a right to the existing shareholders, the Republic may decide that a given percentage of the shares issued/sold has in any event to be allocated to the public/retail investors. That percentage may not exceed 25% of the shares issued/sold in the IPO. In the allocation of the shares to the public/retail investors, existing shareholders or customers of the group³ will not enjoy a more favourable allocation.

22. Following this initial listing, the Republic commits that the CCB will proceed in the listing following the above procedure and prioritisation: i) of another 25% of the total within 9 months i.e. by June 2019 at the latest and ii) of a next tranche within 18 months i.e. by June 2020. Following the listing of the latter tranche, the residual combined shareholding of the Republic and the Recapitalisation Fund should not exceed 25%.

23. However, in case the group presents a capital shortfall compared to Pillar 2 requirements at end December 2016, or at any time during the period until September 2018 then the Republic commits that with a view of remedying the identified shortfall with private means the CCB will initiate the listing process earlier. In such a case and taking into account the above prioritisation the listing of the total shares should be according to the following procedure: (i) an initial listing for 25% of the total shares or at the amount required to remedy the shortfall (whichever is higher) shall be implemented immediately and in any

³ Consisting of the CCB and the CCIs.
event rapidly enough to raise the additional capital within the timeframe allowed by the regulator. Following this initial listing, the Republic commits that the CCB will proceed in the listing: i) of another 25% of the total within 9 months i.e. from the date of the initial listing and ii) of a next tranche within 18 months from the date of the initial listing. Following the listing of the latter tranche, the residual combined shareholding of the Republic and the Recapitalisation Fund should not exceed 25%.

24. As an alternative to a listing the corresponding shareholding can be sold to International Financial Institutions, other large cooperative or commercial banks, insurance companies, investment or pension funds, as well as any other large and renowned institutional investor in the financial services industry with private offering. The buyers cannot be connected to the State and are required to have enough resources to support the group in case it would need capital in the future. The Republic commits that it will not sell its stake to any buyer that is funded, directly or indirectly, by the CCB. It is clarified that the Republic undertakes to fulfil this Commitment also on behalf of the Recapitalisation Fund.

25. When selling their CCB's shares, the Republic and the Recapitalisation Fund will take due consideration on the minimisation of the taxpayer's losses and intend to achieve a sale price equal or higher than the valuation price.

5. Contingent additional Commitment

26. If
   a. by end-June 2017, the group has not achieved in full measures prescribed under Commitments 49 (branch reduction target) , 18 (preparation for listing), 6 to 13 (operational integration of the 19 legal entities) as well as the measures prescribed under Commitments 47(cap on the number of FTE at end 2016),
   or
   b. by end-March 2018, the group has not achieved the measures prescribed under Commitments 47 (cap on the number of FTE at end 2017) , 19 to 24 (actual listing or sale of the first 25% shareholding and additional 25% if applicable), 52 (cap on total costs for 2017) 53 (cost/income ratio in 2017),

27. then the Republic additionally to the Commitments included in the present document, undertakes the following Commitments
   a) The group shall proceed in the full legal merger of the existing 19 standalone legal entities (consisting of the CCB and the CCI) into a single entity. This legal merger shall be completed within five months from the trigger of this Contingent additional Commitment (i.e. from either end June 2017 or end September 2018).
   b) Alternatively to a) the Republic may opt, instead of the group proceeding in a legal merger, to notify by end-April 2018 at the latest, as an amendment to the restructuring plan for formal Commission approval, an alternative proposal setting out measures to achieve the same results as a legal merger – including further restructuring and restoration of access to market measures (provided that the latter has not been yet achieved in that point in time). Once approved by the Commission, this proposal shall be implemented in full and be
completed within five months from the trigger of this Contingent additional Commitment (i.e. from either end June 2017 or end September 2018).

6. Risk Monitoring

28. The CCB shall ensure that the Internal Audit and the Risk Management departments are fully independent from commercial networks of the CCIs and report to the CCB's BoD through the Board Audit and Risk Committee with notification to the General Manager. The Board Audit and Risk Committees shall be assessing all issues that are raised by these respective departments followed by an appropriate action plan to address identified problems. Decision not to act on findings by the internal audit function shall be well substantiated and, upon request, reported to the Monitoring Trustee. An adequate Internal Audit Charter and Risk Management Charter shall specify the roles, responsibilities and necessary resources of these departments. These charters shall comply with international standards and secure a full independence to the departments.

29. A Credit Policy enacted by the CCB shall provide guidance and compulsory instructions to the CCIs regarding the granting of loans, including the pricing of loans and the restructuring of loans.

30. The Credit Policy shall 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 shall adhere to 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.

31. Within the Credit Policy, a specific section shall be devoted to the rules governing relations with connected borrowers. Connected borrowers shall 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) shall 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.

32. The Credit Policy shall require that the pricing of loans and mortgages comply with strict guidelines. Those guidelines shall 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. Specific loan asset classes are generated (e.g., commercial loan, mortgage, secured/unsecured, etc...) and their pricing framework is approved by the Board Risk Committee of the CCB and revised on a regular basis. Any exception must 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 shall respect the same principles, albeit they may not fit in standardized credit policy tables. Infringements of that pricing policy shall be reported to the Monitoring Trustee.

33. The CCB’s Risk Management Department shall be responsible for the entire group for the assessment of credit risk, 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 shall 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 CCB’s Credit Policy.

34. The CCB’s Risk Management Department shall 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 benefitting employees, offering them subsidized loans. The CCB shall report every quarter 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 shall be excluded from the above calculations.

35. Regarding loans to connected borrowers and non-connected borrowers, the CCB, on the basis of the best international practices, shall 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 quality of any collateral / security provided and shall be set against key benchmarks including against capital.

36. The credit criteria applied to employees/managers/shareholders/directors shall 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 38 of the Commitments.

37. Granting loans\(^4\) to enable borrowers to purchase shares or hybrid instruments of the CCB and the CCIs and/or other banks shall be prohibited, whoever are these borrowers. Granting loans collateralized by shares or hybrid instruments shall be prohibited, whoever are these borrowers.

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\(^4\) For the purpose of that Commitment, the term "loans" shall be interpreted largo sensu, as any kind of financing, e.g. credit facility, guarantee, etc.
38. (a) All loan requests by connected borrowers as per paragraph 31 above greater than 0.01% of RWA of the group 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 of the group will be reported to the Monitoring Trustee, who 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 shall be reported to the Monitoring Trustee, who 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.

39. The group’s Credit Policy shall give clear instructions on the restructuring of loans. It shall clearly define which loans are eligible, under which circumstances, and indicate the terms and conditions that can be proposed to eligible customers. The CCB’s BoD shall ensure that all restructurings aim at enhancing the future recoveries, thus safeguarding the interest of the group. In no case the restructuring policy shall 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.

40. The restructuring of loans involving connected borrowers shall comply with the same requirements as for non-connected 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 shall be reported separately, at least per loan asset class and connected borrower type.

41. The CCB shall enact a claim and litigation policy aiming at maximizing recovery and preventing any discrimination or preferential treatment in the management of litigations. The CCB shall ensure that all necessary actions are taken to maximize the recoveries for the group and protect its financial position in the long term. Any breach in the implementation of this policy shall be reported to the Monitoring Trustee.

42. The CCB shall monitor the credit risk (on a portfolio basis) 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. The Monitoring Trustee shall be given access to this information.
43. The CCB and the CCIs shall 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.

44. The CCB shall define an Investment Policy guideline that will apply to the CCB. 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 & Poor's BBB-, Fitch BBB-). This requirement shall however not apply for any issues by the Cypriot Government.

7. Operational efficiency

45. Total remuneration of any member of staff including board members and senior managers shall 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.

46. No severance payments in excess of what is required by law or contract should be made.5

47. The maximum number of full-time equivalent employees of the group, including the employees of the Cooperative IT Society 'SEM' who have been incorporated in the CCB staff, will not exceed 2770 by 31 December 2015, 2720 by 31 December 2016, 2700 by 31 December 2017 and 2700 by 30 June 2018.

48. The CCB shall redeploy staff towards key functions (such as IT, NPL management and risk management functions) and reduce it in functions where currently it has spare capacity (such as in the front line functions of the CCB and the CCIs). This redeployment of staff shall follow the plan provided in Annex c (attached). A margin of (10%) in variations for the number of staff between departments/divisions set out in Annex c shall not constitute a breach of the Commitment. The progress in the implementation of this Commitment shall be reported at least semi-annually to the Monitoring Trustee starting from June 2016.

49. The number of branches shall be reduced from 258 as of 31 December 2015 to 200 by 30 June 2017 at the latest.

50. The CCB's NPL Management Division shall further enhance its administrative capacity via a centralisation of its eighteen (18) call centres into one (1). This action shall be completed by end-June 2016 at the latest.

51. The effectiveness of the activities undertaken by the NPL Management Division will be closely monitored by the Monitoring Trustee.

52. Total operating expenses shall not exceed EUR 165 million in each one of the accounting years 2017 and 20186.

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5 This provision does not apply to voluntary retirement schemes (VRS), which however have to be implemented at the lowest cost possible necessary to achieving the targeted workforce reduction.

6 In case of unexpected higher contributions to the DGS, the difference to the anticipated contributions will not be taken into account for this calculation.
53. The Cost/Income ratio of the group shall not exceed 50% in each one of the accounting years 2017 and 2018.7

8. Profitability drivers

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

55. 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 current month paid by the Monetary Financial Institutions in Cyprus, as they are extrapolated by the CCB based on data for the sector's average rates 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

56. 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” and the “Immovable Property (Transfer and Mortgage) (Amending) Law of 2014” (‘foreclosure law’). These actions shall be closely monitored by the management board. A regular report of the implementation of this directive shall be transmitted to the Monitoring Trustee.

Unless an impaired loan was deemed eligible for restructuring as provided under commitment 33, the CCB and the CCIs shall systematically initiate the legal or administrative proceedings (aiming at seizing and selling the pledged collateral) of each and every loan that becomes non-performing. The group shall use to the maximum possible extent the powers provided under the 'foreclosure law' to seize and sell the pledged collateral.

57. To this aim, a special unit in the CCB has been established and is dedicated to engage in selling foreclosed properties. The accomplishments of the unit shall be reported to the executive committee on a quarterly basis.

58. 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:

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7 In case of unexpected higher contributions to the DGS, the difference to the anticipated contributions will not be taken into account for this calculation.
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, has compiled a precise list of the commercial activities to be mandatorily removed through ways 1&2 explained above. The CCB has concluded a precise binding plan which includes milestones which will continue to be reported at least semi annually to the Monitoring Trustee and includes 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).

59. All participations of the group that are considered as non-core business as reported in Annex b, shall be divested before end 2018. The CCB has concluded a precise binding divestment plan which includes milestones which will continue to be reported at least semi annually to the Monitoring Trustee and includes all divestment steps (valuation, identification of prospective buyers, reception of non binding offers etc.) for the divestment of these participations.

60. 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.

61. 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.

9. Monitoring Trustee

9.1. Reporting

62. The Monitoring Trustee shall submit to the Commission quarterly reports on the implementation of these Commitments, as well as ad-hoc reports, as needed.

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

64. Within 5 working days of receipt of the comments, the Monitoring Trustee shall prepare a final report and submit it to the 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 Commission.

65. 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.
66. Ad-hoc reports may be submitted to the Commission and will be forwarded to the Cypriot Government (Ministry of Finance). If the Commission deems necessary, the ad-hoc reports can also be submitted for comments to the group.

9.2. Duties and obligations of the group

67. 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.

68. 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.

9.3. Replacement, discharge and reappointment of the monitoring trustee

69. 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:
   c. The Commission may, after hearing the Monitoring Trustee, require the group to replace the Monitoring Trustee; or
   d. The group, with the prior approval of the Commission, may replace the Monitoring Trustee.

70. If the Monitoring Trustee is removed according to paragraph 69, 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.

71. Beside the removal according to paragraph 69, 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.

10. Legal framework for the recapitalisation of the CCB by the Recapitalisation Fund

72. The Republic commits to prepare and adopt by 18 December at the latest all necessary legal acts and/or amendments to the existing legal framework to enable the recapitalisation of the CCB by the Recapitalisation Fund.
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

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**Annex c**

Redeployment of staff

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