

Banking Sector Dynamics

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At a glance

As a result of the sustained efforts towards its restructuring over the last couple of years, the Cypriot banking sector appears to be on a path to recovery. The recapitalisation of all the systemic banks, along with the full abolition of capital controls on 6 April 2015, helped improve economic sentiment and confidence in the sector.

The latest Greek financial crisis that almost led to the collapse of the Greek banking sector brought back unpleasant memories of the March 2013 events in Cyprus. Collapse was, however, averted and some stabilisation has since been recorded, with the Greek bank branches operating in Cyprus showing good resilience.

The very high levels of non-performing loans (NPLs) remain the main challenge of the sector, with disappointingly little progress achieved since the end of 2014. After months of delay in their approval by the legislature, enhanced tools enabling the restructuring of loans are now in place, including, inter alia, the adoption of the foreclosure and insolvency framework. Most recently, the Parliament has passed a bill governing the sale of loans, a prerequisite for the release of the last bailout tranche to Cyprus.

Since July 2015, bank deposits have been increasing by more than 0.3% per month. Since the beginning of the year, total deposits increased marginally by 0.2%. The deposit outflows after March 2013 had resulted in a 26.9% decrease in total bank deposits in the period leading to September 2015. Meanwhile, the deleveraging in the sector continues, as total loans decreased by 5.5% during the same period.

Building on efforts to strengthen the financial sector, supervision and regulation is of crucial importance for the recovery of the Cypriot banking system. Overall, the key developments in the sector have been:

- ▶ enhanced regulation and supervision
- ▶ restructuring and recapitalisation of financial institutions
- ▶ increasing financial transparency
- ▶ deleveraging

The Cypriot banking sector comprises domestic banks, Coops and international banks with subsidiaries or branches based in Cyprus. As of September 2015, there are 6 local authorised Banks, the Cooperative Central Bank (CCB), 18 Cooperative Credit Institutions, 6 subsidiaries of foreign credit institutions, 25 branches of foreign credit institutions and 2 Representative Offices.

As of June 2015, the assets of the 2 largest domestic banks (Bank of Cyprus (BOC) and Hellenic Bank (HB)) and the Coops, were €47.1b (or 62.9% of total banking assets). Since September 2013, the Central Bank of Cyprus is the sole regulatory body, overseeing all the banks incorporated in Cyprus, including the Coops. As of November 2014, BOC, CCB, HB and the Russian Commercial Bank (RCB), are directly supervised by the European Central Bank (ECB).

The financial system is now stable and, absent all domestic restrictions as from April 2015, international debt markets have opened up a second time for Cyprus (IMF, September 2015)

Capital adequacy

Banks in Cyprus currently maintain healthy capital adequacy ratios. As of the end of the first nine months of the year, BOC, the Coops, HB, Eurobank Cyprus and Alpha Bank Cyprus (ABCY) were all well capitalised, as per their Common Equity Tier 1 (CET1) ratios. The BOC CET1 ratio stood at 15.6%, as at 3Q2015. On the basis of the ECB's Supervisory Review and Evaluation Process (SREP) and onsite inspections, it was disclosed that the ECB would like to see greater levels of provisioning against certain portfolios of assets of the bank. According to the CEO of BOC, the bank disagrees with the ECB's proposed adjustment but, even if such an adjustment would be considered, the bank's capital would still be sufficient for the risk it manages and there is no need for further capital raising. Taking into consideration the adjustments requested by the ECB (est. at €600m), the Bank's CET1 ratio would decline to 13.2%.

At the same time, the Cooperative Central Bank raised its non-performing loans coverage ratio to 50%, which had a significant negative impact on its CET1 ratio, which declined from 13.5% (30/06/2015) to 12.0% (30/09/2015) over a period of three months. According to the Coops' CEO, the bank's main shareholder (i.e. the Cypriot Government) intends to further boost the capital buffer so as to more than cover the supervisory requirements set by the ECB's SREP. On 24 November 2015, the Council of Ministers approved five bills for the establishment of a legislative framework for the Coops recapitalisation that were put forward to the Committee on Financial and Budgetary Affairs for discussion.

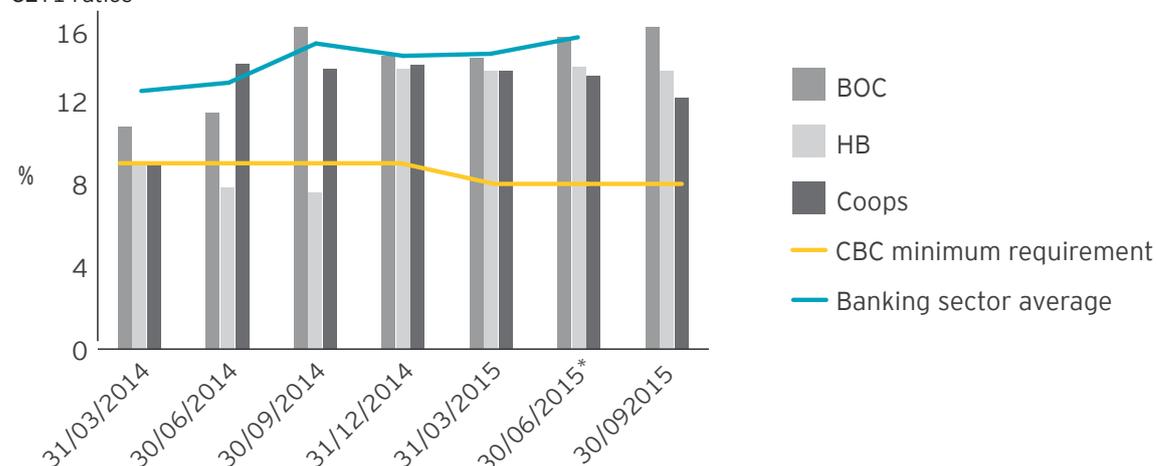
On 12 October 2015, the European Bank for Reconstruction and Development (EBRD) closed a €20m investment in HB that resulted in the issue of 10,666,666 new shares to EBRD (at an issue price of €1.875). EBRD now holds 5.38% of the Bank's share capital. The additional capital raised through this issue, strengthened the CET1 ratio of the Bank to 13.8% at the end of the third quarter of the year, up by 20 basis points compared to the 1H2015 figures (13.6%). According to the bank's CEO even if the bank had to adopt the ECB's pre-draft comments and recommendations, the bank has the capital potential to absorb such requirements and be in compliance with both its Pillar I and revised draft Pillar II add-on capital requirements.

As at 30 September 2015, the CET1 ratio of Eurobank Cyprus and Alpha Bank Cyprus stood at 24.2% and 18.6% respectively, well above the minimum CET1 of 8% as set by the Central Bank of Cyprus.

Capital raising

BOC completed a €1b share capital increase in September 2014, while HB followed with a share capital increase of €204m a few months later (January 2015). The Cooperative Central Bank and the Cooperative Credit Institutions were recapitalised with a capital injection of a total €1.5b of programme funds allocated to the banking sector.

CET1 ratios



*For BOC CET1 ratio includes independently verified profits for 1H2015.

Source: BOC, CBC, Coops, HB

Major shareholders of HB and BOC

HB		BOC	
Shareholder	%	Shareholder	%
Wargaming Public Company Ltd	24.8	Cyprus Popular Bank Public Company Ltd	9.6
CPB FBO Third Point Hellenic Recovery Fund	25.3	Lamesa Holding S.A. (Renova Group affiliate)	6.2
Demetra Investments Ltd	10.0	TD Asset Management	5.2
EBRD	5.4	EBRD	5.0

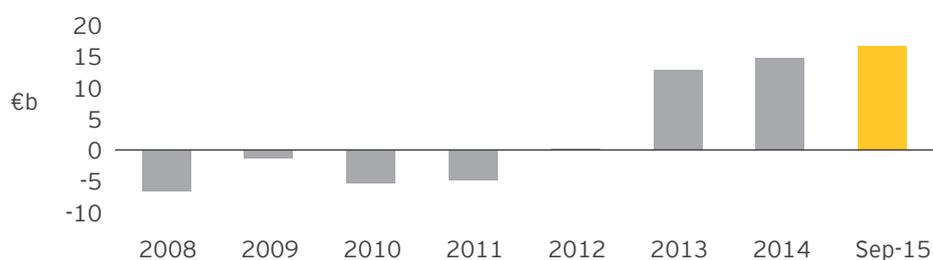
Source: BOC, HB

Funding needs of the Cypriot banks

The funding needs (total loans minus total deposits) of Cypriot banks increased considerably since 2012, from €2b in September 2012 to €14.6b in August 2015. Following the bail-in programme of 2013, total deposits decreased substantially (-€17.4b or -26.9% since March 2013). At the same time, the total

loans of the banking system contracted from €70.4b in March 2013, to €61.2b in September 2015 (-€9.2b or -13.1% since March 2013). Since the beginning of the year the monthly difference of the total loans over deposits is on a downward trend except from June 2015, which recorded a monthly increase equal to 3%.

Funding needs



Source: CBC

Selected Indicators

	2010	2011	2012	2013	2014	Jun-15
Liquidity						
Cash and trading assets (% of total assets)						
CY	6.9	6.6	6.0	5.1	11.4	14.5
Euro area	14.4	16.7	16.9	14.6	n/a	n/a
EU average	19.5	22.3	20.2	20.0	n/a	n/a
Probability						
Operating profits ¹ (% of total assets)						
CY	1.3	1.4	1.2	1.3	2.1	2.5
Euro area	0.8	0.8	0.7	0.8	n/a	n/a
EU average	0.9	0.8	0.7	0.8	n/a	n/a
Impairment (% of total assets)						
CY	(0.5)	(4.9)	(4.6)	(3.9)	(1.9)	(1.7)
Euro area	(0.5)	(0.7)	(0.6)	(0.5)	n/a	n/a
EU average	(0.4)	(0.6)	(0.5)	(0.4)	n/a	n/a
Efficiency						
Cost to income ratio (%)						
CY	49.9	49.5	55.6	53.4	40.4	35.3
Euro area	62.9	63.9	66.1	65.6	n/a	n/a
EU average	62.5	63.5	66.1	65.5	n/a	n/a

¹ Profit before provisions and impairments. Year end results unless otherwise stated

Source: CBC, EC

Net interest income

The net interest income to total assets ratio, a key profitability ratio, decreased considerably in March 2013 (-12.1% compared to the first quarter of 2011, following a sharp decline of both total net interest income (-42.7%) and total banking assets (-34.8%). As at June 2015, the ratio increased by 42.7% compared to March 2013, following a 9% increase in net interest income and 23.6% fall in total banking assets.



Source: CBC

Emergency Liquidity Assistance (ELA)

Following the upgrade of the BOC covered bonds credit rating to Baa3 from B1 by Moody's Investor Service, the bank became eligible for Eurosystem credit operations. Therefore, the bonds have been placed as collateral for accessing funding from the ECB. Thereafter, BOC raised a total of €550m of ECB funding for the repayment of ELA. Through this repayment and the customer deposit inflows during the third quarter of 2015, BOC was able to repay a total of €1.4b of ELA funding, reducing ELA exposure to €4.5b by October 2015. ELA decreased by €6.9b (-60.5%) from its peak levels of €11.4b in April 2013. The ELA held by the Cypriot banking system as a whole decreased to €4.4b by October 2015, down by 42.7% or €3.3b since October 2014.

Key banking sector indicators

BOC reported an after tax cumulative profit of €58.2m for the nine-month period ended 30 September 2015. Profit was severely impacted by increased provisions for impairment

of customer loans (€592.7m), while it was boosted by gains on derecognition and changes in expected cash flows on acquired loans (€263.4m). As of 3Q2015, HB posted a profit of €6.2m, bringing the cumulative profit of the nine-month period to €6.7m. The profit for the period has been negatively affected from the impairment losses and provisions to cover credit risk (€59.1m). In the same period the Coops registered losses of €228m, as a result of the increased provisions for impairment of loans and advances. Coops cumulative provisions increased to €3,417.5m compared to €2,968.5m at the end of 2014. The increase in provisions is partly a result of the adoption of special provisions with regard to the value of immovable properties, as set by the European Stability Mechanism. Alpha Bank Cyprus also recorded losses of €6.8m for the nine-month period to September 2015, compared to losses of €44.1m in the same period of 2014.

The bank had reported quarterly profits for the second (€4.7m) and third (€8.3m) quarters of the year. Eurobank Cyprus reported profits of €28.4m, after tax for the same period.

Based on the year end results of 2014, the National Bank of Greece reported after tax profits of €6.5m, while Piraeus Bank (Cyprus) Ltd registered losses of €30.8m, up by €3m compared to those of the previous year. The provisioning costs of Piraeus Bank increased further compared to the previous year (YE2014: €43.7m, YE2013: €35m).

Local authorised institutions operating in Cyprus

	Nine month results (or latest available)			
(€m)	BOC ¹	Coops	HB	RCB Bank Ltd ²
Total assets	24,197	14,079	7,544	8,030
Net loans	17,930	9,473	3,145	7,026
Deposits	13,608	12,740	6,296	7,290
Accumulated provisions	4,933	3,418	1,239	19
Profit/loss after tax	58	(228)	6.2	34
NPEs	14,225	7,682	2,683	45
Key performance ratios (%)	BOC	Coops	HB	RCB Bank Ltd
NPEs (% of gross loans)	62.2	59.6	61.2	0.6
Net loans/deposits	131.8	74.4	50.0	96.4
CET1 ³	15.6	12.0	13.8	20.9
Cost/Income	38.0	41.2	64.8	n/a
Coverage ratio of NPEs	34.7	44.5	46.2	n/a
Cost of risk (annualised)	2.1	3.8	1.8	n/a
Net interest margin	3.9	2.5	2.0	n/a

¹Ignoring classification as disposal group held for sale. ²YE2014 results. All the figures for RCB were converted from USD to EUR based on the EUR/USD rate as at 31/12/2014 (1 USD=0.8237 EUR). ³For RCB Bank Ltd calculated as total qualifying tier 1 capital over risk-weighted assets.

Source: BOC, CCB, HB, RCB Bank Ltd

Foreign authorised institutions and branches of foreign credit institutions

(€m)	Nine month results (or latest available)			
	ABCY	Eurobank Cyprus Ltd	National Bank of Greece (Cyprus) Ltd ¹	Piraeus Bank (Cyprus) Ltd ¹
Total assets	2,502	n/a	1,742	1,330
Net loans	2,096	n/a	834	709
Deposits	1,761	2,900	789	1,235
Accumulated provisions	742	n/a	164	137
Profit/loss after tax	(6.8)	28.4	6.5	(30.8)
NPEs ²	1,704	128	562	418
Key performance ratios (%)	ABCY	Eurobank Cyprus Ltd	National Bank of Greece (Cyprus) Ltd	Piraeus Bank (Cyprus) Ltd
NPEs ²	60.0	6.7	56.3	50.8
Net loans/deposits ³	119.0	33.0	105.7	57.4
CET1	18.6	24.2	17.9	12.4
Cost/Income	56.3	28.0	42.9	n/a
Coverage ratio of NPEs	43.6	n/a	29.2	n/a
Cost of risk (annualised)	n/a	n/a	1.2	n/a
Net interest margin	n/a	n/a	2.4	n/a

¹Net loans, accumulated provisions, NPEs and coverage ratio of NPEs are as at 30 June 2015. All other figures for National Bank of Greece are based on the YE2014 results. NPEs and accumulated provisions for Piraeus Bank (Cyprus) Ltd are as at 30 June 2015. ²NPLs for Alpha Bank Cyprus and Piraeus Bank (Cyprus) Ltd. ³For Eurobank Cyprus excludes the loans that are secured with the freezing of deposits.

Source: ABCY, Eurobank Cyprus Ltd, National Bank of Greece (Cyprus) Ltd, Piraeus Bank (Cyprus) Ltd

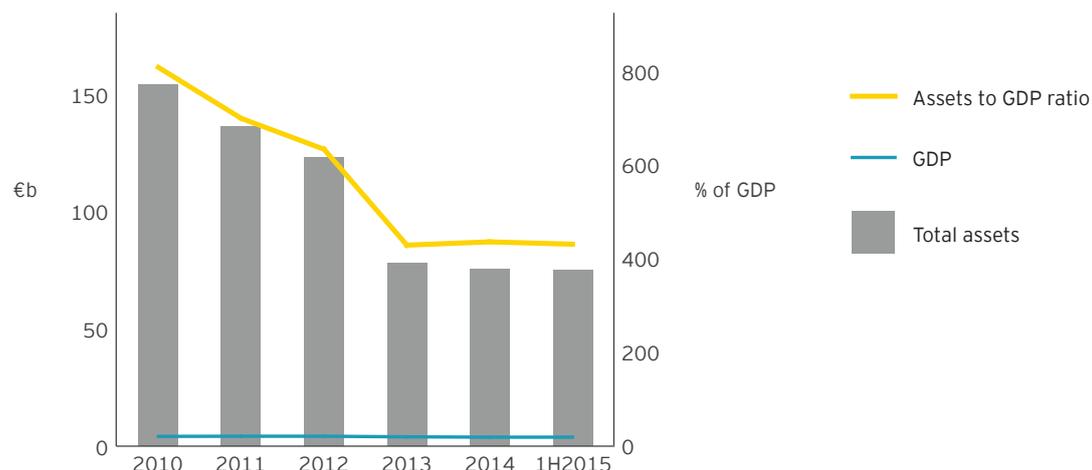
The deleveraging continues

Despite the overall progress achieved, more work will be needed in order to further improve the balance sheets of the Banks. The Cypriot banking sector remains large, especially when seen in relation to the country's GDP. However, the bank assets to GDP ratio continues decreasing from its peak of 808% in 2010, 633% in 2012 and 430% in the first half of 2015. The decrease in the total assets of the banking sector from 2012 to 2013 by €45.3b (or 205% of GDP) partly came about from the sale of the Greek branches of BOC and Cyprus Popular Bank (CPB), and partly from the resolution of CPB that took place in April 2013. The ratio, however, remains higher than the EU-28 and euro area averages. Based on the latest data available, at the end of 2014, the assets to GDP ratio for the EU-28 and euro area average stood at 314% and 278% respectively, while the Cyprus average for that period stood at 435%. The total

assets to GDP ratio remained relatively stable over the period December 2014 to June 2015 (the 5.2% decrease is mainly attributed to the decrease in the total assets of the banking system (-1% since December 2014, or €0.72b in real terms). The decrease in total assets for the period resulted from decreased loans and receivables (-€1.3b) as well as from a decrease in held-to-maturity investments (-€1.3b), and in available for sale financial instruments and other assets (-€0.2b each), while the cash and cash equivalents increased by €2.3b. According to the Memorandum of Understanding on Specific Economic Conditionality (MoU) signed with the Troika in March 2013, the size of the Cypriot domestic banking sector (as a ratio to GDP), excluding branches and subsidiaries of foreign banks in Cyprus, will reach the EU average of around 3 times of the country's GDP by 2018.

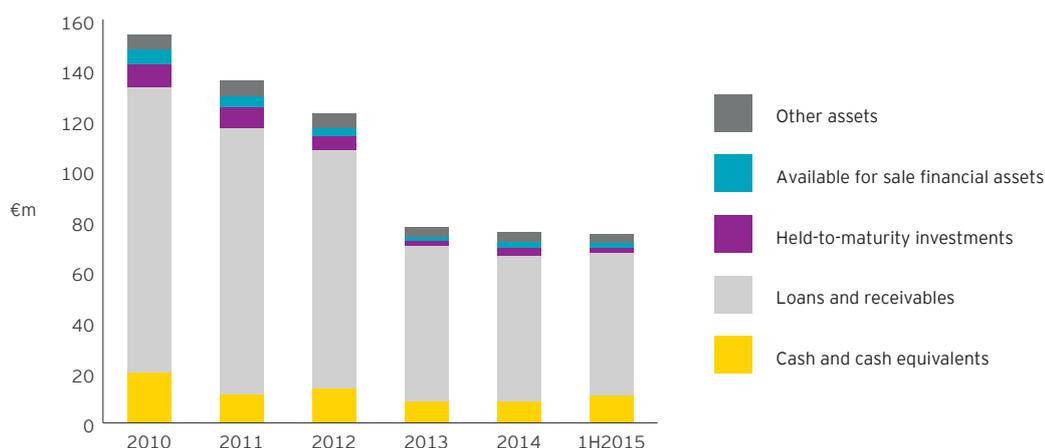
²The GDP for the period Jan-June 2015 calculated as the sum of the GDP for the first and second quarter of 2015, multiplied by 2.

Total assets³



Source: CBC, Eurostat

Asset growth



Source: CBC

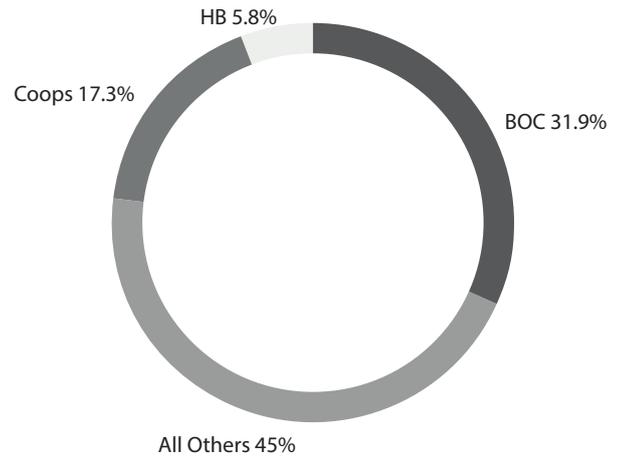
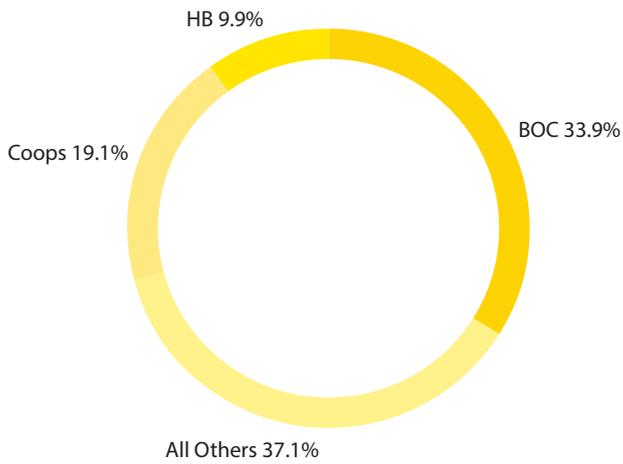
Total assets

BOC, Coops and HB continue to hold more than 50% of the total assets of the Cypriot banking system. The total assets of the banking sector on 30 June 2015 stood at €74.9b. BOC's share was 33.9% or €25.4b. Out of BOC's total assets, 71.5% (or €18.1b) were net loans and advances granted to customers. Coops held 19.1% (or €14.3b) of the total assets of the banking system and 69.2% (or €9.9b) of these were customer loans and advances. For the same period,

HB held 9.95% (or €7.4b) of the total assets of the banking system, with 42.3% of those being net loans and advances. Importantly, total net loans decreased significantly compared to the 1H2014 results. BOC's deleveraging was mainly a result of the disposal of non-core assets and increased provisions for impairment of customer loans, while for HB and the Coops, the result came from increased provisions and impairments.

³Aggregate data for all local and foreign banks operating in Cyprus, including the Coops.

Assets in the banking system* (as at 30/06/2015)



Total assets (% of total assets of the consolidated banking system)

Total loans (% of total loans of the consolidated banking system)

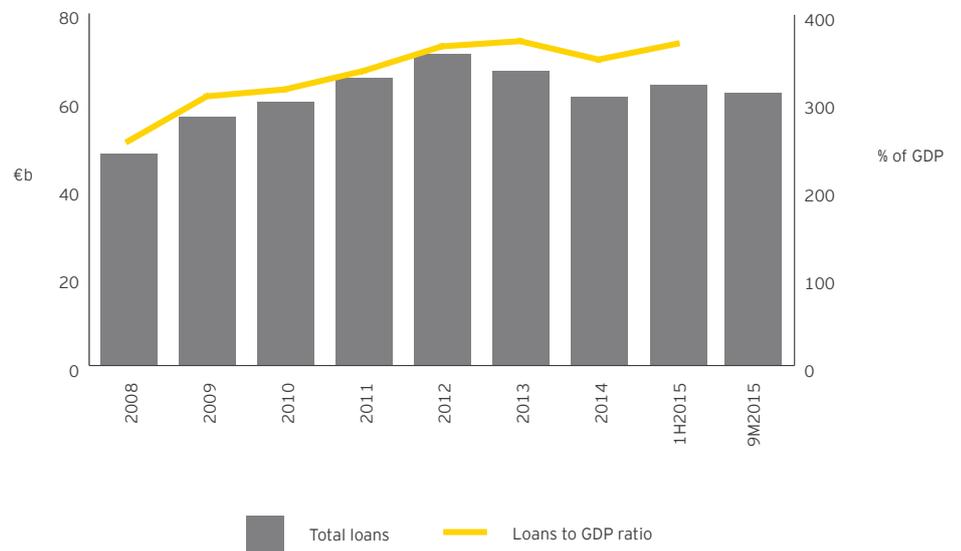
Source: CBC, BOC, HB

*Total banking figures as at 30/09/2015 were not available on 30/11/2015.

Total loans and loans to GDP ratio

Loans to GDP ratio

The most recent data (September 2015) suggest that the Cypriot banking system continues to deleverage, as total loans were €61.2b, down by €3.5b since the beginning of the year, and by €9.2b since March 2013. The total loans to GDP ratio stood at 349% at the end of 2014, and at 367% at the end of the first half of 2015. The ratio growth is attributed to heightened loans at the end of the first half of the year compared to the 2014 average.

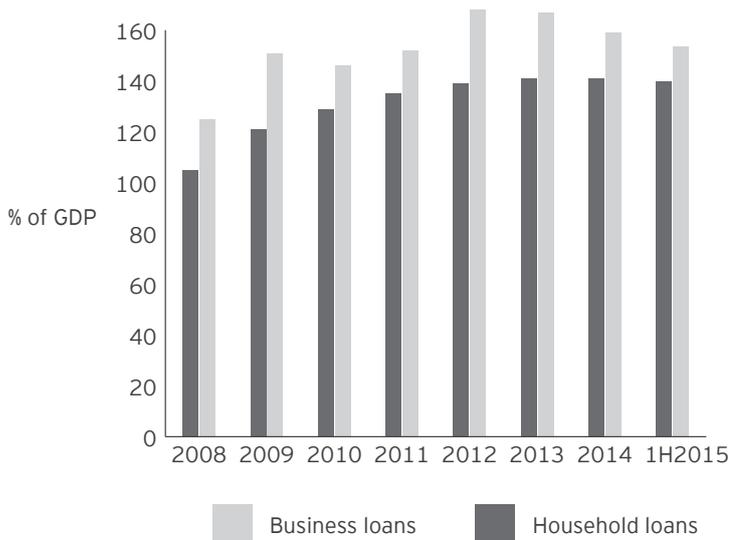


Source: Eurostat, CBC, CyStat

Household and business loans

Since the beginning of the year, total lending in Cyprus declined by 5.5% (or -€3.5b), as a result of the decreased demand from households (-6.3% or -€1.6b) and to a lesser extent, due to weaker business demand (-0.8% or -€0.2b). A considerable decrease in loans from other financial intermediaries (-13.2% or -€1.5b) contributed significantly to the reduction in the total demand for loans. The stricter regulatory environment of the financial institutions and subdued private consumption contributed to the decline. Lending to households contracted at an accelerating pace and the business loans to GDP ratio recorded a considerable decline from YE2014, falling from 158.7% to 153.7% for 1H2015. In the same period, the household loans to GDP ratio recorded a slight decrease from 141.1% to 140%.

Loans to households and businesses

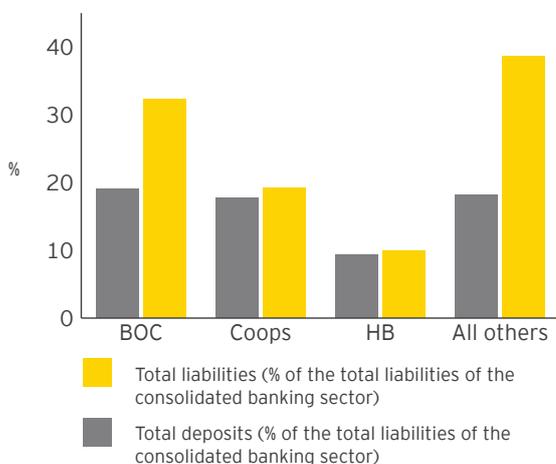


Source: CBC, Eurostat

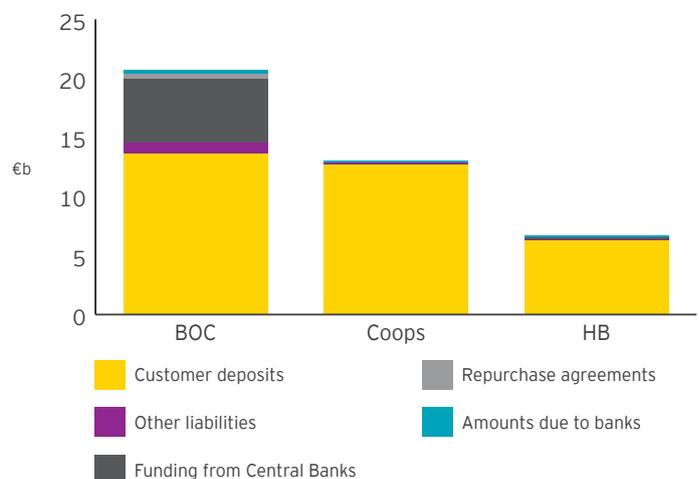
Total deposits and liabilities

At the end of 1H2015, BOC accounted for 32.3% (€21.9b) of the total liabilities of the sector, with its total deposits accounting for 19.3% (€13b) of the sector's total liabilities and 59.6% of the bank's total liabilities. At the same time, the Coops and HB accounted for 19.2% (€13b) and 9.9% (€6.7b) of the total sector liabilities respectively. A great part of their total liabilities were customer deposits, counting for 98% (€12.7b) of the Coops liabilities and 93.1% (€6.2b) of the total liabilities of HB. As at 30 September 2015, the same trend continued, and a significant part of the banks' portfolios comprised of customer deposits. Specifically, 65.9% (or €13.6b) of BOC's total liabilities were customer deposits and 26.2% (or €5.4b) was the ELA funding. Customer deposits for the HB and Coops were 97.8% (or €12.7b) and 93.1% (or €6.3b) of their total liabilities for the same period respectively.

Total liabilities* (as at 30/06/2015)



Liabilities by bank (as at 30/09/2015)



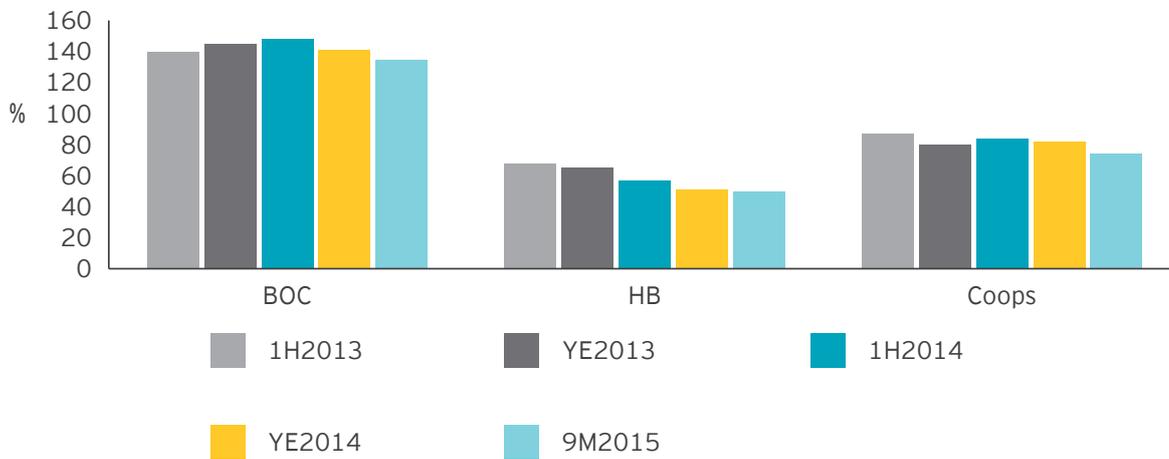
Source: BOC, HB, CCB, CBC

*Total banking figures as at 30/09/2015 were not available on 30/11/2015.

Since March 2013, the total amount of deposits in the Cypriot banking system decreased by 27.3%. On a monthly basis, the first positive deposit inflow was recorded in April 2014 (0.4%). Since June 2014, the annual decline in deposits was less than 8%. As of September 2015, the total amount of deposits in the Cypriot banking system was €46.6b, up by €0.26b compared to August 2015, up by 1.4% YoY. The monthly increase is attributed to the increase in deposits by domestic residents (€0.4b) and other euro area residents (€0.1b), while deposits by residents of the rest of the world decreased by €0.15b. As at September 2015, HB recorded a Net Loan-to-Deposit ratio (LTD) of 50%. Both net lending to

customers and deposits granted to customers decreased by 2.4% and 0.8% compared to YE2014, with the Net Loan-to-Deposit (LTD) ratio falling by 1.6%. For the same period, the LTD ratio of BOC stood at 132.1% compared to 138% at YE2014. The decrease is a result of a moderate deleveraging of its loan portfolio (-1%) and an increase in the amount of deposits (3.3%). A similar pattern was observed for the LTD ratio of the Coops. A 6.5% decrease in the Coops loan portfolio accompanied with a 2.8% increase in deposits, slightly reduced the ratio from 81.7% (YE2014), to 72.8% (30 September 2015).

Net Loan-to-Deposit ratio (LTD)



Source: BOC, HB, CBC

Deposit and lending rates

Deposit interest rates in September 2015 were 1.52% and 1.57% for households and businesses respectively. This represents a drop of 107 basis points (bps) for the household deposits and 96 bps for business deposits from one year before. The lending rates for consumer credit fell by 121 bps from September 2014 to reach 4.38% in September 2015, while the lending rates for businesses for amounts up to €1.0m fell by 95 bps over the same period, reaching 4.51%. This keeps the deposit-lending rate spreads at relatively high levels—the Cypriot business lending rates remain the highest in the euro area without adjusting for country specific credit risk.

Significant progress has been achieved in laying the ground for accelerating NPL resolution, including setting up and making operational the new legal framework for private debt restructuring, and having banks put in place large-scale internal workout units and policies in line with the Arrears Management Framework and the Code of Conduct (IMF, September 2015)

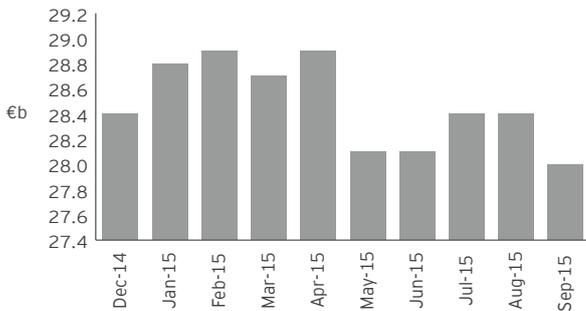
Non-performing loans

Following the introduction of the new NPLs definition by the European Central Bank in December 2014, the so-called non-performing exposures (NPEs), reached 47.5% (€28.4b) of the total credit facilities granted by banks. The NPE ratio in the core Cypriot banking system (September 2015: 47.3% of total credit facilities granted or €28b) declined slightly since the end of 2014 (December 2014: 47.5% of the total credit facilities or €28.4b).

Out of those, NPEs related to credit facilities granted to corporations were €14.4b (or 51.5% of the total), while €12.7b (or 45.7% of the total) were granted to private individuals. The remaining 2.9% (or €0.8b) are NPEs related to credit facilities granted to other financial corporations (€0.7b) and the general government (€0.06b)

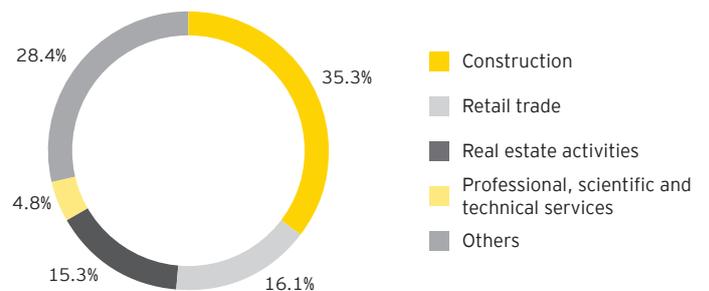
A large proportion of the NPEs can be attributed to the property development and construction sectors. As at June 2015, NPEs related to facilities provided to the construction sector represented 25.3% of the total loans given to corporations, or €5.1b (18.1% of the total NPEs).

NPEs in the Cypriot banking system



Source: CBC

NPEs in non-financial corporations* (as at 30/06/2015)



*Latest available data as at 30/11/2015.

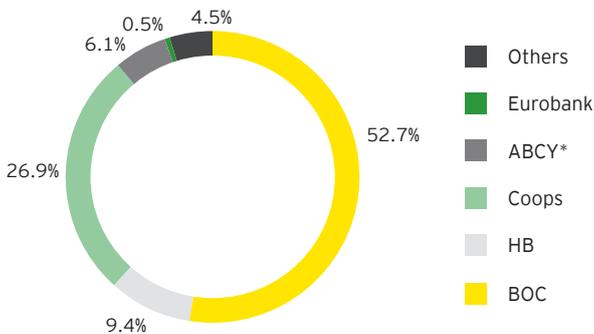
NPEs by bank

A breakdown of the NPEs by bank as of the end of June 2015 shows that BOC accounts for 52.7% of the total NPEs of the Cypriot banking system (€14.8b), down by €0.2b compared to their end 2014 values (€15b). In contrast, the loan portfolios of the Coops and HB deteriorated, as the total NPEs of both increased compared to the period ended 31 December 2014. The total NPEs of the Coops increased by €0.24b for the period to reach €7.6b in June 2015, while the NPEs of HB increased by €0.1b to reach €2.6b in June 2015. The loan portfolio of Eurobank Cyprus, slightly worsened for the period, as the NPEs of the bank increased by €0.01b, while the NPLs of ABCY decreased by €0.3b for the period.

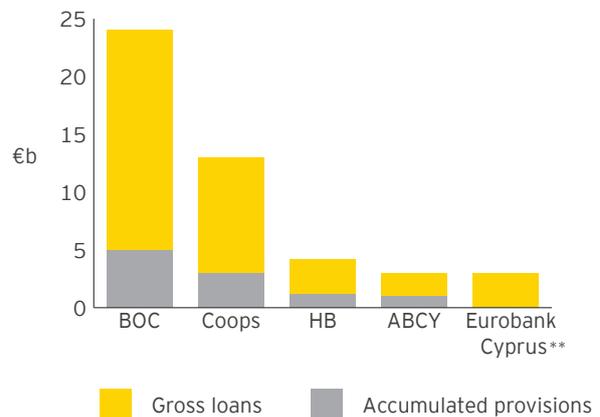
As at 30 September 2015, the accumulated provisions for BOC totalled €4.9b, those of Coops amounted to €3.4b, of HB €1.2b, and those of ABCY amounted to €0.7b respectively. As at 30 June 2015, the accumulated provisions for Eurobank Cyprus were €0.08b.

For BOC, HB, the Coops and ABCY, accumulated provisions represented more than one fifth of their loan portfolio (21.4%, 28.3%, 26.5% and 26.2% respectively), while those of Eurobank account for a relatively smaller part of their portfolio (3.8%).

NPEs in the Cypriot banking system (as at 30/09/2015)



Accumulated provisions as a fraction of total gross loans (as at 30/09/2015)



Source: BOC, HB, CCB, ABCY, Eurobank Cyprus

*Non-performing loans for ABCY

**As at 30/06/2015 for Eurobank Cyprus

Developments

Lifting of capital control measures

The capital controls imposed after the events of April 2013, were fully abolished on 6 April 2015. The full abolition of capital controls was born out of the positive outcome of the comprehensive assessment of the banking sector by the ECB and the stabilisation of deposit outflows. The lifting of capital controls was achieved much earlier than originally anticipated and was received smoothly, with no out of the ordinary outflows.

ECB thematic reviews

As a part of its supervisory role, the ECB is conducting the Supervisory Review and Evaluation Process (SREP) and onsite inspections on the four banks under its supervision (BOC, HB, CCB and RCB). The outcome of this analysis and any necessary

corrective actions are presented to the credit institution, giving to the institution the opportunity to comment in writing to the ECB on the facts, objections and legal grounds relevant to the ECB's supervisory decision. The main objective of SREP is to ensure that institutions have adequate arrangements, strategies, processes and mechanisms as well as capital and liquidity to ensure sound management and coverage of their risks, to which they are or might be exposed, including those revealed by stress testing and risks the institutions may pose to the financial system.

Loan arrears resolution targets

The CBC has established targets regarding the resolution of loan arrears, aimed at incentivising banks to increase the volume and improve the quality of restructurings for

loans presenting arrears over 90 days but also to take proactive action for the loans presenting arrears over 30 days to prevent them from becoming non-performing. The targets comprise four indicators that need to be applied to the whole loan portfolio and to sub-portfolios (residential mortgage loans to households, other loans to households, loans to non-financial corporations with total balances of up to €1m and loans to non-financial corporations with total balances of over €1m). The Banks should submit a quarterly report to the CBC, presenting their actual performance. In case of failure to achieve any of the targets, they need to provide justification for the failure and propose corrective measures.

Banking system loan arrears resolution targets

	2015		
	June	Sep	Dec
Proposed sustainable solutions rate¹			
Target	n/a	9.42	11.51
Actual	6.14	n/a	n/a
Concluded sustainable solutions rate²			
Target	n/a	7.45	10.12
Actual	4.69	n/a	n/a
Terms-being-met rate³			
Target	n/a	66.49	70.73
Actual	65.80	n/a	n/a
Aggregate early-arrears cure rate⁴			
Target	n/a	27.82	40.00
Actual	28.14	n/a	n/a

¹The percentage of balances of sustainable solutions proposed during the quarter in relation to the borrowers with loans exhibiting arrears of over 90 days at the beginning of the quarter. ²The percentage of the balances of sustainable solutions concluded during the quarter in relation to the borrowers with loans exhibiting arrears of over 90 days at the beginning of the quarter. ³The percentage of the balances of solutions concluded from 1/1/2014 up to the end of the previous quarter which exhibited arrears of less than 8 days at the end of the reporting quarter. ⁴The percentage of the amount of loans that presented early arrears (i.e. 31-90 days in arrears) at the beginning of the reporting quarter which were cured during the quarter (i.e. presenting no arrears at the end of the reporting quarter) by (i) being restructured with a sustainable repayment schedule and (ii) other effective means.

Legislation facilitating the sale of loans

In order to facilitate the sale of loans, the Council of Ministers approved a proposal for a law, in line with CBC directives.

The law is scheduled for adoption by the House of Representatives in 2015. According to the relevant legislation, this would allow third parties to acquire loans in Cyprus with minimal regulatory burden, while at the same time small borrowers will be protected under the Code of Conduct.

Eligible buyers, according to the draft legislation are:

- Cyprus-registered companies, having obtained licence from the CBC under the law regulating the sale of loans
- Cyprus credit institutions
- Cyprus-registered subsidiaries of EU-based institutions

Eligible buyers should have minimum capital reserves equal to €1m.

Under the updated MoU, the bill should have been voted into law by the end of September 2015. Opposition parties have proposed changes to the legislation that would allow borrowers and their family members to bid for the purchase of their own loans. The law enabling the sale of loans passed by the House of Parliament on 12 October 2015.

Proposal enabling the securitisation of assets

As it is prescribed in the updated MoU (September 2015), the House of Representatives should adopt legislation to remove existing impediments to the securitisation of assets. The legal proposal, in line with international best practices and EU law, expected to soon be adopted by the Council of Ministers, with a view to be adopted by the House of Representatives by end December 2015.

The legislation includes the removal of the requirement to obtain prior consent of borrowers and any changes to the tax system deemed necessary.

Loans in Swiss Francs

In October 2015, the Cyprus Parliament's Financial and Budgetary Affairs Committee, gave the Central Bank of Cyprus a strict deadline to formulate options that will mitigate the debt burden of borrowers who received mortgages in Swiss francs. According to the CBC, conversion of these mortgage loans to Euros at the prevailing exchange rates, would cost Cypriot banks €250m in losses. Meanwhile, the Moody's investor service has issued a report warning that any such action would create a moral hazard, making the restructuring of NPLs more challenging and significantly impacting the capital adequacy of the banks.

Latest credit agency ratings

MOODY'S				
	Long-term deposit ratings	Short-term deposit ratings	Standalone BFSR*	Date
RCB Bank Ltd	Caa2, stable outlook	NP**, no outlook	E, (BCA*** of caa2)	26/03/2014
BOC	Caa3, stable outlook	NP****	BCA of caa3 (stable outlook)	28/05/2015
HB	Caa2, stable outlook	NP, stable outlook	BCA of caa3 (stable outlook)	19/06/2015
FITCH				
	Long-term issuer default rating	Short-term issuer default rating	Viability rating	Date
BOC	CCC	C	ccc	28/04/2015
HB	B-	B	b-	12/06/2015

*Bank financial strength, **Not Prime, ***Baseline credit assessment

****As at 17 November 2014

Source: BOC, HB, Moody's Investor Service Ltd, Fitch

Insolvency framework

On 18 April 2015, the insolvency framework was passed by the House of Representatives. The framework comprises five laws and is expected to help the process of restructuring and normalisation of the very high levels of NPEs in the banking sector. Several banks have already started sending the first letters of notification to clients, in the first step in the process.

The insolvency system in Cyprus following the 2015 reforms

Procedures/Debtors	Companies	Individuals
Liquidation of the estate	Winding-up	Bankruptcy
Debt restructuring	Examinership	Personal Repayment Plan (PRP)
	Provides an opportunity of viable companies' reorganisation by allowing them to form a restructuring plan during a period where the company is protected from enforcement actions, while management continues to run the business, under the supervision of the examiner.	Provides an opportunity for debt restructuring to debtors who have a stable source of income. It allows them, where possible, to keep some of their assets, including their primary residence.
Debt relief		Debt Relief Order (DRO)
		It offers relief to debtors with virtually no income, no assets, by offering a discharge of unsecured debts up to €25,000 following extensive financial disclosure by the debtor and court approval.

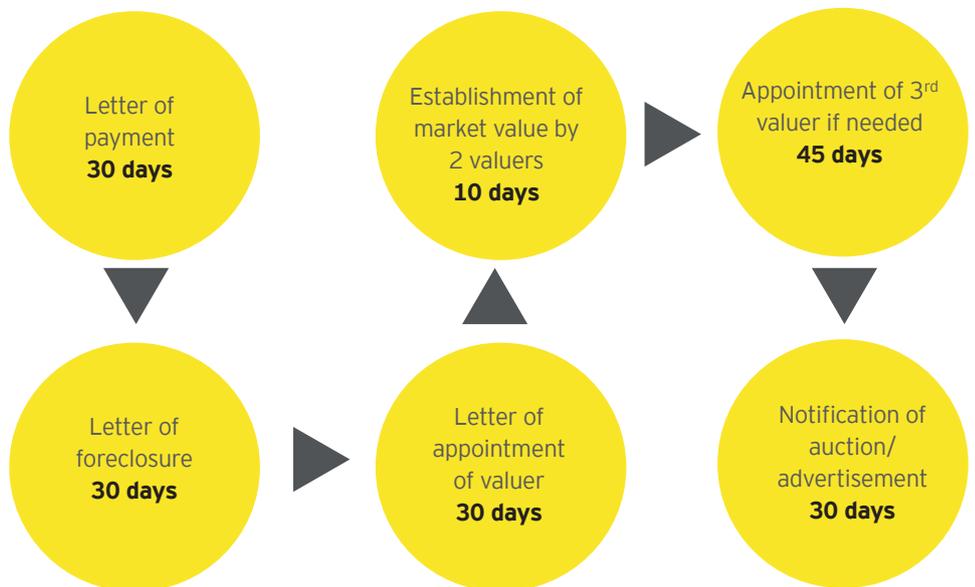
Source: International Monetary Fund (IMF)

Foreclosures legislation

In mid-May, the foreclosures legislation was adopted by the House of Representatives. The legislation aims at accelerating existing foreclosure processes. It will provide, inter alia, incentives for both debtors and creditors to agree on debt restructuring, reducing strategic defaults. In order to help

consensual negotiations between banks and borrowers, the institution of Financial Ombudsman began operations in November 2014. In February 2015, the Financial Ombudsman began examining client complaints for financial products and services.

Foreclosure procedure



Source: IMF

As part of the updated MoU (September 2015), necessary adjustments to the insolvency and foreclosure frameworks, including legislative changes, will be adopted by the Council of Ministers by end January 2016. Those will include incentives

for non-viable debtors to promptly pursue debt restructuring and, at the same time, ensure that the relief in legacy guarantees does not jeopardise the economic function of guarantees, taking into account the payment capacity of the guarantor.

Abbreviations

ABCY-Alpha Bank Cyprus
BCA-Baseline Credit Assessment
BFSR-Bank Financial Strength Rating
BOC-Bank of Cyprus
CBC-Central Bank of Cyprus
CCB-Cooperative Central Bank
CET1-Common Equity Tier 1
Coops-CCB and Cooperative Credit Institutions
CPB-Cyprus Popular Bank
CySEC-Cyprus Securities and Exchange Commission
EBA-European Banking Authority
EBRD-European Bank of Reconstruction and Development
ECB-European Central Bank
EIB-European Investment Bank
ELA-Emergency Liquidity Assistance
ESM-European Stability Mechanism
GDP-Growth Domestic Product
HB-Hellenic Bank
LTD-Loan-to-Deposit Ratio
Mid-caps-Medium-capitalisation enterprises
MoF-Ministry of Finance
MoU-Memorandum of Understanding on Specific Economic Policy
Conditionality
NPEs-Non-performing exposures
NP-Not Prime
NPL-Non-performing loan
QoQ-Quarter on Quarter
RCB-Russian Commercial Bank
RD-Restricted Default
SMEs-Small and Medium Size Enterprises
SSM-Single Supervisory Mechanism
SREP-Supervisory Review and Evaluation Process
TROIKA-EC, ECB, IMF
YE-Year end
YoY-Year on Year

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Definitions

NPL

A loan is considered as non-performing when it shows arrears of more than 90 days or if has been restructured and at the time of restructuring presented arrears for a period of more than 60 days, regardless of tangible or other collateral.

NPE

According to the EBA standards, a loan is considered a non-performing exposure if: (i) the debtor is assessed as unlikely to pay its credit obligations in full without the realisation of the collateral, regardless of the existence of any past due amount or of the number of days past due, for example in case of a write off, a legal action against the borrower, or bankruptcy, or (ii) the exposures are impaired i.e. in cases where there is a specific provision, or (iii) there are material exposures which are more than 90 days past due, or (iv) there are performing forborne exposures re-structured within a 2 year probation period, or (v) there are performing forborne exposures under probation (2 years) that present more than 30 days past due after the restructuring date.

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