

PUBLIC

**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

STRATEGY FOR CYPRUS

As approved by the Board of Directors at its meeting on 6 May 2015

PUBLIC

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EXECUTIVE SUMMARY

Cyprus is committed to and applying the principles of multiparty democracy, pluralism and market economics in accordance with the conditions specified in Article 1 of the Agreement Establishing the Bank.

Cyprus was hit by a deep crisis in 2012, revealing major flaws in the structure of the markets and market institutions, particularly in the banking sector. The economy has contracted sharply in the past two years due to the crisis and the subsequent introduction of necessary austerity measures but positive signs emerged in 2014. The international community is supporting Cyprus with a €10 billion economic adjustment programme ('EAP') managed by the European Commission, the European Central Bank and the IMF. Although the coalition of political parties represented in the government lost a formal majority in the parliament in March 2014, there is sufficient support for the government, headed by the President elected in 2013 for the term of five years, to continue the implementation of their overall reform programme, in particular the measures agreed under the EAP.

Efforts towards the re-unification of the island continue, having received a boost after the leaders of the Greek Cypriot and Turkish Cypriot communities agreed on 11 February 2014 on the text of a Joint Declaration for resuming fully-fledged negotiations on the comprehensive political solution. So far, however, there has been no progress in narrowing the gap in the positions of the two sides, and the *de facto* division of the island continues.

Although Cyprus is an EU member since May 2004, key structural problems were not sufficiently addressed either in the pre-accession period or in the years immediately following accession. The strong economic growth in 2004-08 was based on an unsustainable expansion of credit, combined with inadequate standards of governance and supervision in the banking sector. The privatisation and modernisation of public utilities and infrastructure have lagged behind other countries, while problems in the business environment such as difficulties in registering properties, enforcing contracts and implementing bankruptcy have held up the recovery.

Since the EAP was put in place, however, major strides have been made in implementing structural reforms. The main banks have made progress in their restructuring programmes and in attracting much-needed fresh capital. In the social sphere, the government is implementing a number of critical reforms, balancing the need to reduce expenditure to more sustainable levels with social protection criteria. Plans are being prepared for privatisation of a number of key state-owned enterprises, including the telecom company and, over time, the energy sector, and for the offering of concession in the ports sector.

The key remaining structural challenges in Cyprus include:

- *Restoring the soundness of the Cypriot banking sector and rebuilding depositors' and market confidence.* This will require a thorough restructuring of financial institutions, the strengthening of supervision and the attraction of fresh capital into the banking system.
- *Completing the privatisation programme.* It is important to make visible progress in the coming year in the privatisation of the telecoms company and port concessions, and to make preparations for privatisation in the energy sector.
- *Enhancing the business environment.* Business development has been held back by problems with enforcing contracts, and previous laws on insolvency and foreclosure

were totally inadequate for the problem at hand. The passing and implementation of new laws in these areas are urgently needed.

The overarching strategic focus of the Bank in Cyprus is to support transition with institution and market enhancement and deep economic restructuring. This ~~is~~ in turn should help the country to overcome the deep economic and financial crisis, in line with the objectives of the EAP. Consistent with the Cypriot Government's request, that the Bank's engagement be temporary and that the Bank does not engage in new operations in Cyprus following 2020, the proposed strategy assumes significant early operations to support financial sector restructuring, privatisation, and corporate restructuring.

The Bank will be active on the whole territory of the island with both finance and business advisory for private sector restructuring and the expansion of markets. Should an opportunity arise, the Bank will also support bi-communal projects.

The Bank's operations will be focused within three principal themes as follows:

- Theme 1: support for financial sector restructuring, to increase resilience, restore confidence, and improve corporate governance;
- Theme 2: support for privatisation, integrates all activities through which the Bank could support the implementation of the Government's privatisation programme, as well as expanded use of private concessions and public private partnerships, to increase competition and standards of operational efficiency;
- Theme 3: support for corporate restructuring, incorporates assistance with corporate restructuring and financing in order to enhance competitiveness and diversification of the local economy across the island, including finance and advice for SMEs as well as improving access to electricity and enhancing resource efficiency. The Bank's selective and focused corporate restructuring efforts will be closely linked with financial sector restructuring as there is currently hardly any risk-taking capacity among Cypriot financial institutions following the crisis.

The Bank will work in the context of and complementing the EAP. Potential policy advisory and capacity building assistance will be therefore limited, and focused on narrow areas of financial sector restructuring, including private sector debt restructuring and NPL management as well as on privatisation and private concession related issues, more sustainable and efficient use of energy and water resources, and access to finance and advice for SMEs, and will be coordinated through the EU Support Group for Cyprus ('SGCY'), as well as through cooperation of the EBRD resident office with representatives of the international parties involved in the EAP and the EU resident experts in Cyprus. The Bank's SME operations through Cypriot commercial banks will seek complementarity with EIB Group facilities.

The Bank's activities in the northern part of Cyprus will be coordinated with the EU and other donors by sharing of information to ensure complementarity and avoid overlaps, and is expected to include donor co-financing of technical assistance for SME finance and advice, and potential co-financing of bi-communal projects.

Consistent with the decision of the Board of Governors that Bank will not engage in new operations in Cyprus after the end of 2020.

1 OVERVIEW OF THE BANK'S ACTIVITIES

1.1 The Bank's current portfolio

Private Sector ratio: 100per cent, as of 31 March 2015

Sector	Portfolio				
	Number of projects	Portfolio	per cent of Portfolio	Operating Assets	per cent of Operating Assets
Financial Institutions	1	108	100per cent	108	100per cent
Depository Credit (banks)	1	108	100per cent	108	100per cent
TOTAL	1	108	100per cent	108	100per cent

Source: EBRD Business Performance Navigator

1.2 Implementation of the previous strategic directions

Since the approval of Cyprus as a country of operations in May 2014, the Bank has been operating in Cyprus on the basis of a Country Assessment developed in early 2014. The Bank has made one investment as of the end of March 2015. As part of a €1 billion capital increase by the Bank of Cyprus, the country's largest financial institution, the EBRD made an equity investment of €107.5 million into newly issued ordinary voting shares in September 2014, resulting in an EBRD stake in Bank of Cyprus of 5.021 per cent. With this investment, the EBRD supports the stabilisation of operations and the implementation of the on-going restructuring plan of Bank of Cyprus. As the largest bank in the country, the performance of Bank of Cyprus is highly correlated with economic activity in the country. The stabilisation and successful restructuring of the bank is critical for the full recovery of the country's economy and the rest of the financial sector. As an active shareholder the EBRD will work towards improvements in corporate governance. This successful capital increase has been a positive signal to the markets, providing investors with confidence that financial sector restructuring in Cyprus will make further progress alongside other reforms under the EAP.

2 OPERATIONAL ENVIRONMENT

2.1 Political context

The current pro-reform President, Nicos Anastasiades, supported by the largest centre-right party, Democratic Rally (DISY), was elected in 2013 for the term of five years. The outcome of the elections to the European Parliament at the end of May 2014 reaffirmed status quo in the balance of political forces. No anti-Memorandum, nationalist-populist or far right political parties have managed to obtain any seats in the European Parliament from Cyprus. Although the coalition of political parties represented in Anastasiades' government have lost formal majority in the parliament in the aftermath of the withdrawal from the government of the centre-right DIKO in March 2014, there is sufficient support there to continuing the implementation of the measures agreed under the EAP. The existing presidential system is able to counter risks of political destabilisation as a result of possible changes in the balance of political forces in the parliament. Another stabilising factor is the existence of a relatively stable and competent civil service resilient to politically motivated changes in the top echelons of government.

Efforts towards the re-unification of the island continue, having received a boost after the leaders of the Greek Cypriot and Turkish Cypriot communities agreed on 11 February 2014 on the text of a Joint Declaration for resuming fully-fledged negotiations on the comprehensive political solution. The settlement should be based on a bi-communal, bi-zonal federation with political equality as set out in the relevant United Nations Security Council resolutions and the High Level Agreements. So far, however, there has been no progress in narrowing the gap in the positions of the two sides on a wide range of issues. The *de facto* division of the island continues. Elevated political sensitivities on both sides are accompanied by controversy regarding property rights/titles, which dates back from the armed conflict.

2.2 Macroeconomic context¹

The Cypriot economy has contracted sharply in the past two years, but positive signs emerged in 2014. The severe recession is largely a result of a deep crisis in the banking sector and the introduction of necessary austerity measures. The international community is supporting Cyprus with a €10 billion economic adjustment programme: €9 billion from the European Stability Mechanism and €1 billion from the International Monetary Fund (IMF). The programme is managed by the European Commission, the European Central Bank and the IMF. Out of the €10 billion program envelope, €1 billion has been incorporated as a buffer for covering unforeseen fiscal needs and €1 billion has been incorporated as a buffer for covering unforeseen recapitalisation needs of the banking sector. So far neither of the buffers was used.

Real GDP fell by 2.4 per cent in 2012 and 5.4 per cent in 2013. In the first nine months of 2014, quarterly growth rates (seasonally adjusted), while still negative, have improved relative to previous quarters and the Q3 2014 year-on-year change in GDP of 2 per cent was the best outcome since the crisis began. The economy has also experienced a significant external balance adjustment. A sharp import reduction (of 14 per cent in 2013), combined with a resilient performance in the tourism and business services sectors, have contributed to a drop in the current account deficit, to the point where the current account deficit in 2013 was below 2 per cent of GDP.

Fiscal targets under the EAP have been met with considerable margins. The general government deficit² was reduced from 6.4 per cent of GDP in 2012 to 4.9 per cent of GDP in 2013. Measures addressing the wage bill including, inter alia, restrictive employment policies, wage and pension cuts (a progressive rate cut in addition to a flat rate cut of 3 per cent) in the public sector, abolition of allowances and a comprehensive pension reform have helped to contain spending while revenues have been boosted by increases in the rates of corporate income tax (from 10 to 12.5 per cent) and value-added tax (standard rate from 17 to 19 per cent, and reduced rate from 8 to 9 per cent) as well as higher excise taxes and a doubling of the withholding tax rate on interest income. Public finance management has been strengthened through the enactment of a Fiscal Responsibilities and Budget Systems Law and the establishment of an independent fiscal council. Nevertheless, general government debt marginally exceeded 100 per cent of GDP in 2013 (up from less than 50 per cent in 2008) and is likely to reach around 103 per cent in 2015, according to Ministry of Finance projections.

¹ Cyprus joined the Euro Area on 1 January 2008.

² This is based on the IMF calculations (see IMF Report No. 14/313, October 2014). According to the Eurostat, net borrowing under the EDF came down from 6.4 per cent of GDP in 2012 to 5.4 per cent in 2013 (see the table on Selected Economic Indicators).

The short-term economic outlook remains very challenging. Despite the resilience of the economy, the year 2014 was another one of recession, with GDP estimated to have dropped by more than 2 per cent for the year as a whole. The financial sector remains a significant drag on economic recovery, notwithstanding the major reforms to the system that are under way. Year-on-year credit growth to private sector has been negative since March 2013, while non-performing loans amount to about half of total loans. Further fiscal adjustment may be needed to ensure long-term fiscal sustainability. Under a baseline scenario, some modest growth may return to the economy in 2015, with a more significant pick-up in 2016 and beyond, building on the positive results already achieved in the past year for exports, particularly tourism and business services.

The outlook is subject to significant risks. Exports have not yet shown a robust recovery and the tourism sector and FDI could be adversely affected by regional instability and yet another Eurozone downturn. The necessary internal restructuring and reform agenda is subject to implementation risks. In the financial sector, major challenges remain to ensure an orderly private sector deleveraging process and a reduction in the current exceptionally high levels of NPLs.

The economy in northern Cyprus is significantly less developed than the rest of the island. According to one recent study,³ GDP per capita in northern Cyprus was 58 per cent that of the southern part in 2012, or 70 per cent adjusting for purchasing power standards. Since then, the economy appears to have grown by between 2.5 and 3 per cent in 2013 and 2014. Inflation has been relatively high by regional standards and was running at around 10 per cent year-on-year in 2014. The main sectors include (higher) education, tourism, construction and real estate, and agriculture, but there is also a large public sector that relies heavily on subsidies from Turkey.

Different analyses of the economy in northern Cyprus point to a number of weaknesses and risks, and the need for a new growth model. The economy has a large and inefficient public sector which relies to some extent on subsidies from Turkey which amount to more than 12 per cent. The agriculture sector is vulnerable to weather conditions, while private sector development and exports are hampered by weak business environment conditions and limited integration into the global economy.

2.3 Structural reform context

Although Cyprus is an EU member since May 2004, key structural problems were not sufficiently addressed either in the pre-accession period or in the years immediately following accession. The strong economic growth in 2004-08 was based on an unsustainable expansion of credit, combined with inadequate standards of governance and supervision in the banking sector. The privatisation and modernisation of public utilities and infrastructure has lagged behind other countries, while problems in the business environment such as difficulties in registering properties, enforcing contracts and implementing bankruptcy have held up the recovery.

In the northern part, structural reforms have lagged behind for many years. Total budget expenditure is close to 50 per cent of GDP, much of it financed by aid from Turkey, employment in the public sector is at elevated levels and the quality of public services is generally poor.

³ F.Mullen, A.Apostolides and M.Besim (2014), *The Cyprus Peace Dividend: A Productivity and Sectoral Approach*, Prio Cyprus Centre Report 1/2014.

Since the EAP was put in place, major strides have been made in implementing structural reforms. The main banks have made progress in their restructuring programmes and in attracting much-needed fresh capital. In the social sphere, the government is implementing a number of critical reforms, balancing the need to reduce expenditure to more sustainable levels with social protection criteria. Plans are being prepared for privatisation of a number of key state-owned enterprises, including the telecom company and, over time, the energy sector, and for the offering of concession in the ports sector.

The key remaining structural challenges in Cyprus include:

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- *Enhancing the business environment.* Business development has been held back by problems with enforcing contracts, and previous laws on insolvency and foreclosure were totally inadequate for the problem at hand. The passing and implementation of new laws in these areas are urgently needed.

2.4 Access to finance

Private sources of capital

Access to finance is currently difficult to obtain for most clients, as the banking sector is undergoing a major restructuring and deleveraging. Most lending from the banking sector has dried up and non-performing loans are above 50 per cent. As a result, the financial sector remains a significant drag on economic recovery, notwithstanding the major reforms to the system that are under way. Year-on-year monthly credit growth to private sector has been negative since March 2013.

In mid-2013, the largest bank, the Bank of Cyprus (BoC), which had been declared insolvent, was recapitalised through a bail-in of uninsured depositors. The second largest bank, Laiki, was divided into a “good” and “bad” part, with the good part merged into BoC. Another major bank, Hellenic bank, was recapitalised in October 2013 with private capital, while the cooperative credit sector underwent a significant consolidation and recapitalisation in early 2014. In mid-2014, the BoC announced that it had attracted €1 billion in fresh capital from private markets. In addition to restructuring, restoring the soundness of the banking sector also requires better supervision. In line with that, the authorities are enhancing supervisory standards in the banking sector as required for entry into the Single Supervisory Mechanism. Furthermore, the results of the ECB’s asset quality review and stress test exercise, published in November 2014, showed that the capital buffers of the four systemically important Cypriot banks (Bank of Cyprus, Hellenic Bank, Co-operative Central Bank and RCB Bank), including the recapitalisations that were announced or took place in 2014, were sufficient to cover capital needs. Under an adverse scenario stress test, only Hellenic Bank had a small deficit, but this bank has already put in place plans for a share capital increase to more than cover this deficit.

Capital controls are being relaxed based on a road map-based approach. As part of the authorities' initial response to the crisis in spring 2013, a range of capital controls was introduced in order to stem the potential outflow of capital from the country's financial institutions. These included tight restrictions on cash withdrawals along with similar limitations on cashless payments and transfers. By mid-2014, all domestic restrictions had been abolished while external restrictions were significantly relaxed. The Government is committed to further relaxing and eventually abolishing the remaining external capital restrictions, based on a careful monitoring of the situation.

Cyprus has re-entered international capital markets. In June 2014, 15 months after Cyprus was hit by a banking crisis and entered the EAP, the country issued a five-year, €750m bond. Investor interest was significant and the issuance was heavily oversubscribed, with a yield of just 4.85 per cent. The ratings agency, Standard & Poor's, has upgraded Cyprus's credit rating to B.

Although Cyprus is a member of the European Union and should theoretically enjoy all the market facilities within the EU, the access of Cypriot banks and end borrowers to the European markets has been severely curtailed by the sovereign rating downgrades of Cyprus as well as the state of the banking sector.

The capital markets are subject to a fragmented supervisory framework and there is a lack of trust between market participants. There is no well-functioning money market and few banks have credit lines with each other. The government debt and note market remains small. The ESM and IMF are providing technical assistance on bond market development.

Some reforms are in process as part of the EAP. Additionally there has been progress on EU compliant Alternative Investment Funds regulations.

It is not realistic to assume that the EU and other international markets will be easily accessible to Cyprus in the short to medium term, particularly if the NPL issue remains unresolved. EBRD and Donor engagement should focus initially on rebuilding confidence, including through supporting the NPL resolution process and developing a clearer framework for secured money market transactions.

The stock exchange has 130 listed companies, but it is characterised by relatively low levels of activity. Although there is a detailed privatization agenda of the small number of larger corporations including the stock exchange itself, this is only an interim step in improving access to finance for the real economy. While the EBRD could support the larger privatizations as well as NPL resolution, Cyprus might also benefit from a strategy of further developing a second tier market listing SME and Alternative Investment vehicles, as well as other forms of finance to the productive sectors of the economy, including through encouraging foreign investment.

EU and multilateral development banks

The financial package mobilised in the framework of the Economic Adjustment Programme covers up to €10 billion. The *European Stability Mechanisms (ESM)* will provide up to €9 billion, and the International Monetary Fund (IMF) is expected to contribute around €1 billion. As noted, €2 billion of this package is used as buffers for unforeseen developments. In addition to the EAP, the *EU Support Group for Cyprus (SGCY)* was established in March 2013 with a view to mobilise EU funds and technical expertise for helping to restore

financial, economic and social stability and to alleviate the social consequences of the economic crisis.

In June 2014, the European Commission has adopted a "Partnership Agreement" with Cyprus setting down the strategy for the optimal use of European Structural and Investment Funds in tackling the crisis and encouraging growth for the benefit of the country and its people. The agreement paves the way for investing EUR 735.6 million in total Cohesion Policy funding over 2014-2020 (in current prices, including European Territorial Cooperation funding) and EUR 132.2 million for rural development to be channelled into the country's real economy. To promote the fisheries and maritime sector, Cyprus will receive EUR 40 million from the European Maritime and Fisheries Fund (EMFF). The EU investments will support the Cypriot economy in emerging from the crisis and encourage economic activity. They will help tackle unemployment and boost competitiveness and economic growth through support to entrepreneurship, innovation, training and education. They will also fight social exclusion and help develop an environmentally-friendly and resource-efficient economy.

In addition, the European Council Regulation (EC) No 389/2006 (the "Aid Regulation") is the basis for the EU assistance to the Turkish Cypriot community. Between 2006 and the end of 2013, EUR 337 million was programmed for operations under the Aid Regulation. Under EU assistance to the Turkish Cypriot Community, the EU has been providing financing, among others, for private sector development through grants to and some advisory services for SMEs.

The EIB Group has a portfolio of approximately EUR 1.5 billion in Cyprus with the majority of operations undertaken in the public sector and/or with sovereign guarantees. Three programmes were recently approved or are under consideration: (1) a trade facilitation programme of EUR 150 million, of which EUR 50 million has been signed with the Bank of Cyprus; (2) a loan of EUR 100 million to the Cyprus Entrepreneurship Fund (CYPEF) to be managed by EIF. This programme envisages co-financing with the banks and an element of risk sharing; and (3) a programme of up to EUR 250 million of credit lines to commercial banks for SME lending, with sovereign guarantee.

UNDP launched in 2009 the Economic Interdependence Project, implemented in partnership between the Cyprus Chamber of Commerce and Industry and the Turkish Cypriot Chamber of Commerce and aiming at fostering and nurturing economic interdependence between the two communities in Cyprus through a variety of interventions. These include research, e.g. establishing the first island-wide Business Directory, supporting joint business partnerships and raising public awareness of the benefits of economic cooperation.

The IFC, in accordance with its mandate as part of the World Bank Group, invests in developing countries. The same applies for the German Kreditanstalt für Wiederaufbau (KfW). Both institutions are considering engaging in activities in Cyprus.

2.5 Business environment and legal context

Business environment

Cyprus has an open and liberalised economy, with a relatively enabling environment for doing business. The country ranks 64th (out of 189 countries) on the World Bank's 2015 ease of doing business score. Cyprus scores poorly on getting electricity, registering property and enforcing contracts. In addition, although the rank on resolving insolvency is relatively good

(51st), laws on insolvency and foreclosure and their implementation proved inadequate in dealing with the legacy of bankruptcies and non-performing loans (NPLs) brought about by the crisis. As of end-March 2014, the level of NPLs had reached 52 per cent of total loans, an extraordinarily high total by international standards, and it remained around 50 per cent by end-2014. In September 2014, the parliament passed a law on foreclosure that aims to reduce substantially the time needed to foreclose on business loans and mortgages but, as noted, this law has been subsequently suspended until the end of January. In the latest WEF's Global Competitiveness Report Cyprus is ranked 58th out of 144 countries without major changes since the ranking from a year ago. As expected, Cyprus is graded worst in the areas of macroeconomic and financial environment. In the northern part, a study by the Turkish Cypriot Chamber of Commerce (KTTO), using WEF methodology, identified a range of competitiveness problems, associated mainly with obstacles to doing business, poor-quality infrastructure and limited access to global markets.

Legal context

Until independence in 1960, the legal system of Cyprus was based on the English legal system but it is now a mixture of both English common law and civil law. As a member of the EU, Cyprus had to transpose EU directives into national law and is subject to the *acquis communautaire* and supervision by the relevant EU authorities.

The Cypriot constitution prescribes a strict separation of powers between the legislative, administrative and judicial branches. The judiciary enjoys high public confidence and is generally regarded as independent. The rule of law is generally adhered to and the legal system is seen as sophisticated, robust and clear. In the 2014 Index of Economic Freedom, Cyprus ranked as 46th in the world. This is a continuation of the decline that began in 2012 when it was ranking in the top twenty in the world. The economic crises of 2013, has highlighted a number of deficiencies and weaknesses in the economic system as well as the legal system, some of which have been outlined in greater detail in the body of the Legal Annex.

Whilst the judiciary is seen as independent and impartial, reform is required and is being undertaken primarily to deal with the slow pace of judicial proceedings. Despite the relatively high level of sophistication of the capital markets related laws, poor standards in corporate governance and supervision in the banking sector have been identified and need to be addressed. The legal regime applicable to insolvency, whilst workable is nevertheless outdated. It remains largely the same as when Cyprus acquired independence. Similarly with the legal framework for the taking of security, reform is required to modernize and to allow for the general registration of any type of pledge over any type of moveable asset or right in a centralized electronic registry. In the area of public procurement, some reform is needed to upgrade the law to the standards of the 2014 EU directives. Therefore, whilst the basic legal system is regarded as good, stable and effective, reform is nonetheless required in significant areas in order to update and enhance the legal environment as a whole.

See Annex 4 for a more detailed assessment of the legal environment.

2.6 Social context

Notwithstanding the deep recession, Cyprus remains a relatively prosperous country, with a GDP per capita (adjusted for Purchasing Power Standards) estimated by Eurostat at 86 per cent of the EU average in 2013. GDP per capita – PPS-adjusted – in the northern part of the

island was estimated in one recent study at 65 per cent of the EU average in 2012.⁴ However, the impact of the crisis was severe in terms of job losses, particularly for young people (age 15-24). Total unemployment in November 2014 was 15.3 per cent, while the level of youth unemployment was 34.8 per cent according to Eurostat; both indicators appear to be on a declining trend from historic highs. In 2013, the share of young people in neither employment nor education and training (NEET) represented 18.7 per cent of the total youth population (age 15-24). Whilst educational attainment levels are in line with EU averages, the quality of the education provided (as measured by the 2012 Programme for International Student Assessment, PISA) ranks low.

Important social reforms have been introduced to protect vulnerable groups. In light of rising unemployment and poverty during the crisis, the government introduced in 2014 a guaranteed minimum income scheme that balances poverty reduction objectives with incentives to seek or remain in work. In parallel, the government has made a number of reforms to the pension system, including an increase of two years to the statutory retirement age for many groups, with this retirement age to rise every five years, effective from 2018, in line with changes in life expectancy.

In terms of its ranking on the Gender Equality Index (GII), Cyprus takes 23rd place. According to the Labour Force Survey of Cyprus, in 2013 67.2 per cent of females and 80.6 per cent of males aged 15-64 were involved in the labour force. This is broadly in line with the EU average and higher than the EBRD average. According to Eurostat, in 2012 the gender pay gap in Cyprus was 16.2 per cent. Women are mainly concentrated in traditionally female-dominated sectors, such as public administration and social services while they are less represented in other sectors, such as construction, mining or gas and electricity. Judging by the limited data, there are fewer female entrepreneurs than their male counterparts. Cyprus is not among those countries of EBRD operations where the gender gaps are the largest. However, where appropriate, the Bank will endeavour to work with its clients to ensure that women, as well as men benefit equally from the Bank's investments and to encourage women entrepreneurs' access to finance, support equality of opportunity in the workplace and promote career advancement.

2.7 Energy efficiency and climate change context

Cyprus is relatively energy efficient compared to many other EBRD countries, with rather low levels of CO₂ emissions per capita/GDP (i.e. 0.36 CO₂/GDP compared to 0.24 for EU-28 and 2.8 for Kazakhstan). However, the energy sector across the island is characterized by the very high dependence on imported sources of energy, the dominance of fossil fuel products in the energy mix, the continuous rise of energy demand, and the rising degree of renewable energy sources exploitation and penetration, although further significant investment in renewable energy sources, and in particular solar power, is needed. In addition, the energy system is small and isolated with no interconnections. Cyprus has newly found limited amounts of offshore natural gas reserves. Energy security is overall a major matter to address.

In terms of supply, oil and oil products dominate, accounting for 94 per cent of total primary energy supply, and for 96 per cent of electricity production in 2013. The remaining 5 per cent are renewables, of which about 20 per cent are imported in the form of biomass. The high energy costs are further undermining private companies and significant investments in energy

⁴ Mullen et al (2014), op cit.

efficiency improvements as well as alternative sources of energy are urgently needed to increase competitiveness and help corporate restructuring efforts.

Since the EU crisis, corporate sector restructuring towards a sustainable and more diversified economic model in Cyprus is required, including support for SMEs, energy efficiency, and entry of private investors in sectors dominated by the state, particularly the energy sector. As an EU Member State, Cyprus' energy policy is aligned with the EU energy strategy. In line with the EU's 20-20-20 target, Cyprus aims to increase the contribution of RES to the final energy consumption to 13 per cent of the total by 2020, and increase the contribution of RES to 16 per cent of total electricity production and 10 per cent of energy use in the transport sector. The national indicative target for energy efficiency savings in primary energy consumption in 2020 is 14.5 per cent (375,000 tons of oil equivalent), compared to the national reference scenario.

Looking at renewable energy, solar power is more available than in almost all of the rest of the Europe although the current actual uptake is limited. The Republic of Cyprus target of solar power including both photovoltaics and concentrated solar power under certain conditions exceeds 10 per cent by 2020, which would be one of the top ones in the EU markets, if achieved. Electricity consumption in Cyprus has increased dramatically in the 10 years prior to the crisis mainly attributed to air conditioning. In this context, there is potential especially for energy savings in buildings sector. The building energy performance regulations include mandatory installation of a solar thermal system for hot water in dwellings and also provisions for the installation of a PV system. Wind power is also an area that could be further exploited under the 2020 targets. In addition, there is potential for biomass and biogas exploitation using agricultural residues, waste disposal plants, and the exploitation of landfill gas from the waste disposal plants.

Looking at the regulatory front, key areas of focus include the implementation of ESCO regulations, the upgrading of performance standards for buildings, appliances, to/above EU requirements as well as assisting the upgrading of waste management and renewable energy regulations.

In terms of resources, Cyprus across the island suffers from a shortage of water. The country relies heavily on rain to provide household water, and for many years now the average annual rainfall has been decreasing. The increasing stress on water has direct implications for water supplies, agriculture as well as water-intensive industries. Water demand has increased annually – a result of local population growth and incoming tourists. Dams remain the principal source of water both for domestic and agricultural use. Extreme climatic phenomena are more frequent than before, with droughts causing water shortage and scarcity, and adverse effects on the economy, the social life and the environment. These will have implications on residential and commercial buildings.

3 STRATEGIC ORIENTATIONS

3.1 Strategic Directions

The overarching strategic focus of the Bank in Cyprus is to support transition with institution and market enhancement and deep economic restructuring. This in turn should help the country to overcome the deep economic and financial crisis, in line with the objectives of the

EAP. Consistent with the Cypriot Government's request, that the Bank's engagement be temporary and that the Bank does not engage in new operations in Cyprus following 2020, the proposed strategy assumes significant early operations to support financial sector restructuring, privatisation, and corporate restructuring.

The Bank's operations will be focused within three principal themes as follows:

- Theme 1: support for financial sector restructuring, to increase resilience, restore confidence, and improve corporate governance;
- Theme 2: support for privatisation, integrates all activities through which the Bank could support the implementation of the Government's privatisation programme, as well as expanded use of private concessions and public private partnerships, to increase competition and standards of operational efficiency;
- Theme 3: support for corporate restructuring, incorporates assistance with corporate restructuring and financing in order to enhance competitiveness and diversification of the local economy, including finance and advice for SMEs. The Bank's selective and focused corporate restructuring efforts will be closely linked with financial sector restructuring as there is currently hardly any risk-taking capacity among Cypriot financial institutions following the crisis.

The Bank will be active on the whole territory of the island with both finance and business advisory for private sector restructuring and the expansion of markets. Should an opportunity arise, the Bank will also support bi-communal projects.

In the north of Cyprus, the Bank will primarily focus on improving the competitiveness of local private enterprises, expanding the range and quality of their products and services, strengthening their corporate governance, and improving their business conduct. The Bank's financing will be provided both through dedicated SME credit lines as well as directly, and will be complemented with business advisory services. The Bank will also explore the scope for and feasibility of private transport and energy projects, as well as municipal infrastructure projects that help improve service quality and promote the commercialisation of utilities.

3.2 Key challenges and Bank activities

Theme 1: Financial sector restructuring: Strengthening the financial sector to build up resilience, increase confidence, and improve corporate governance

Transition challenges

- Governance and internal controls in banks lag behind international standards and need to be improved. Significant bank deleveraging has taken place since the crisis hit, but a further reduction of Risk Weighted Assets is critical to retaining solvency in the banking sector.
- The three main banks (Bank of Cyprus, Hellenic Bank and Co-operative Central Bank) have been recapitalised but face considerable challenges in terms of managing the high level of NPLs (ca. 50 per cent of the portfolio). Almost all lending in Cyprus was historically collateral rather than cash flow based, restricting access to finance for

SMEs and making the recovery of substantial portion of NPLs over the coming years dependent on property valuations and liquidity in the property market.

- External capital controls remain in place, together with some limited deposit withdrawal restrictions. If not lifted as planned, these could further undermine confidence in the banking system but effects on financial stability remain a concern. Despite the abolition of all domestic deposit restrictions and the gradual relaxation of external transactions restrictions, funding remains a challenge for domestic banks.
- The Cypriot banking sector has limited access to capital markets since the recapitalisation of the two largest banks – Bank of Cyprus and Laiki Bank – through the bailing-in of their uninsured depositors and partial conversion of debt securities into shares.
- Non-bank sources of finance, such as leasing, factoring, and corporate bonds have limited outreach. Achievement of well diversified and stable market based funding for financial intermediation to support the real economy is a key transition challenge to overcome the crisis and restructure the financial sector.

Operational Response

- Early equity participation by the Bank to support confidence in the banking sector will be combined with significant efforts to improve corporate governance. Further engagement with banks would focus on expansion of access of local banks to the markets, through the support for the issuance of commercial banks' covered bonds and other market instruments. The Bank's participation in market securities issued by the local banks will be instrumental in supporting the re-entry of Cypriots banks into the capital markets.
- Dedicated credit lines, for instance for SMEs, energy efficiency and renewable power generation, will be used to introduce improved (cash-flow based) lending practices and to support corporate governance changes in banks where the EBRD will not engage with equity.
- As more time is needed to fully recover confidence in the banking sector and restore credit flows, the Bank may also consider support for restructuring of cooperative banks, capital markets engagements, financing to non-bank financial institutions, and support for diversified financial instruments to provide alternative source of funding for local corporates.
- The Bank may also consider co-financing / co-investment in property portfolios or equity investment in distressed property funds in order to stimulate liquidity in the property market which will ultimately assist banks to reduce their property-related NPLs.

Policy dialogue

Strengthening corporate governance, including improving anti-money laundering standards at partner banks, and increasing confidence in the financial sector will be also supported with focused policy dialogue, in line with the evolving European Framework for Bank Recovery

and Resolution, and coordinated with the SGCY. Such policy dialogue, including potential technical assistance, is expected to be concentrated mainly on restructuring the cooperative banks.

Results Framework for Theme 1: Financial sector restructuring: Strengthening the financial sector to build up resilience, increase confidence and improve corporate governance

CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
1.1 Governance and internal controls in banks lag behind international standards and lending has been traditionally collateral based	Improve corporate governance and introduce improved (cash-flow based) lending practices in banks	<ul style="list-style-type: none"> • Early equity participation in banks to be combined with support for improving corporate governance. • Dedicated credit lines to be used to introduce cash-flow based lending practices and to support corporate governance changes in banks where the EBRD will not engage with equity. 	<ul style="list-style-type: none"> • Evidence of the client banks' successful restructuring and the introduction of good corporate governance and business standards [<i>baseline set at project level in TIMS</i>] • Evidence of successful introduction & development of cash-flow based lending at client banks [<i>qualitative account based on TIMS</i>]
1.2 Need to achieve a well-diversified and stable market based funding for financial intermediation	Restore banks' access to capital markets, develop non-bank financial institutions and diversify financial instruments to provide alternative source of funding for local corporates.	<ul style="list-style-type: none"> • Support for the issuance of commercial banks' covered bonds and other market instruments • Participation in the restructuring of cooperative banks, financing to non-bank financial institutions, and support for diversified financial instruments for local corporates. 	<ul style="list-style-type: none"> • Evidence of successful re-entry of Cypriot banks in the capital markets [<i>baseline is the level of bank activities in capital markets</i>] • Qualitative account of sector level improvement in diversification of market based funding for banks and in non-bank financing for local corporates
Context indicator: Δ ATC indicator for banking sector and capital markets			

Theme 2: Privatisation: Supporting the authorities' privatisation programme to increase operational efficiency

Transition challenges

- Private sector involvement in the telecommunications sector has been limited to date. The state-owned Cyprus Telecommunications Authority (CyTA) is the dominant player in the fixed line and mobile business. CyTA is expected to be first corporatised and then privatised.
- The Electricity Authority of Cyprus (EAC) is the state owned vertical integrated utility, the sole thermal power generator owning and operating three power plants and responsible for the development and maintenance of the transmission and distribution networks. There are a number of important reforms required to facilitate the privatisation of EAC, while promoting liberalisation in the electricity sector, the take-up of renewable energy, and the reduction of the high electricity prices, starting with the unbundling and reorganisation of the operating activities of the company, the corporatisation of EAC, strengthening the independent operational activity of the Transmission System Operator, the Distribution System Operator, and the Energy Regulator CERA, and the adoption of a new electricity market model and rules. The Government of Cyprus has begun the process of reforming and privatising the power sector.
- Private sector participation in infrastructure development, including through concessions and PPPs in the transport and waterside infrastructure sector and municipal and environmental infrastructure, has seen moderate progress to date. Plans are under way for their extension and some of the sub-sectors, particularly ports and waterside infrastructure, and municipal and environmental infrastructure, could significantly benefit from regeneration and corporate restructuring via private sector participation. At the same time, capacity needs to be enhanced at the Cyprus Ports Authority to fulfil its new regulatory/supervisory role.

Operational Response

- The Bank will be ready to support corporatisation and privatisation of the Cyprus Telecommunications Authority. The Bank could assist with corporatisation efforts by providing pre-privatisation financing, helping enhance company value ahead of a sale with some “quick wins” in terms of organisation, capital structure, governance and capital expenditure, or else participate in the final privatisation.
- The Bank will consider providing support through pre-privatisation financing to the Electricity Authority of Cyprus (EAC), supporting unbundling and energy reform supporting investments, such as investment in smart metering, as well as participation in the final energy sector privatisation.
- The Bank will be ready to support privatisation of other state owned entities, such as the Cypriot Stock Exchange.
- The Bank will actively seek ways in which it could support an increased private sector participation in the port and waterside infrastructure sector as well as municipal and

environmental infrastructure on a concession basis. In the context of the new PPP related provisions, the Bank will be ready to support directly with financing well-structured PPPs introduced to the market.

- In the north of Cyprus the Bank will also explore the scope for and feasibility of private transport and energy projects, as well as municipal infrastructure projects that help improve service quality and promote the commercialisation of utilities.

Policy dialogue

The Bank will be ready to complement the current privatisation-related policy dialogue efforts of the international partners under the EAP and other MDBs, including through targeted assistance for relevant regulatory reform, such as the support for preparation and implementation of the national broadband program to accelerate the roll-out of high-speed and ultra high-speed broadband networks, concentrating on priority broadband users such as small and medium enterprises (SMEs), to maximize the benefits of telecom privatisation.

Results Framework for Theme 2: Privatisation: Supporting the authorities' privatisation programme to increase operational efficiency

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
2.1	<p>Privatizing the fixed-line incumbent telecom operator and further strengthening competition in the wireline segment</p> <p>Need to progress with the corporatisation and unbundling of the state-owned power utility and introduce private sector competition</p> <p>Strengthening the institutional capacity for deploying energy efficiency and renewable energy projects</p>	<p>Improve financial and operational efficiency in the power and telecommunication sectors and address institutional barriers to unlock potential for renewable energy and enhanced energy efficiency</p>	<ul style="list-style-type: none"> Support for the corporatisation and privatisation of the Cyprus Telecommunications, including improving organisation, capital structure, governance and capital expenditure (either pre-privatisation or at privatisation) Pre-privatisation financing to the Electricity Authority of Cyprus, supporting relevant regulatory reform, unbundling and value enhancing investments, as well as participation in the final energy sector privatisation. 	<ul style="list-style-type: none"> Evidence of <u>improvement</u> in efficiency and service delivery as well as in financial performance at client level as a results of pre-privatisation support or after privatisation [<i>baseline set at project level in TIMS</i>] Evidence & qualitative account of successful restructuring & privatisations in the energy sector [<i>baseline N/A</i>]
2.2	<p>Transport infrastructure, particularly ports, and municipal and environmental infrastructure, could significantly benefit from regeneration and corporate restructuring</p>	<p>Introduction of private sector participation on a wider scale in transport and municipal utilities to enhance operational efficiency</p>	<ul style="list-style-type: none"> Support an increased private sector participation in the port and waterside infrastructure sector as well as municipal and environmental infrastructure on a concession basis. Support directly with financing well-structured PPPs introduced to the market. 	<ul style="list-style-type: none"> Evidence of infrastructure services that were successfully outsourced to private sector (e.g. concessions/PPPs - number of successful projects and qualitative account) [<i>baseline set at project level in TIMS</i>]
	<p>Context indicator: Δ Relevant ATC indicators for the energy, ICT, transport and municipal sectors</p>			

Theme 3: Corporate restructuring: Support operational, managerial and financial restructuring as well as access to electricity and resource efficiency to enhance competitiveness and diversification of local enterprises across the island and facilitate introduction of new products and services, and reaching new markets.

Transition challenges

- The corporate sector suffers from fundamental flaws and is in urgent need of restructuring, partly as a result of previous indiscriminate lending practices. Restructuring in the corporate sector is also needed to support banking sector restructuring and NPL workouts. There are no private equity sources available in Cyprus. Strategic investors' interest is limited and FDI inflows, which were about EUR 1 billion in 2011, mainly in financial services and real estate sector, have collapsed during the crisis.
- SMEs have been hit particularly severely by the drastic contraction of credit from banks. This concerns both access to long-term funding and working capital, hindering diversification of the economy. Shielded by the relative isolation of an island, the competitiveness of the Cypriot SME sector remains limited, and the majority of SMEs have remained micro-enterprises. The lack of international competition and overreliance on the banking and real estate sectors among others have led to relatively low levels of productivity and business sophistication in some areas, limited managerial skills and sound corporate governance. The needs of SMEs vary from basic managerial skills, human resource management and financial reporting to more sophisticated energy efficiency, marketing, export promotion and support for the implementation of innovative processes and product development.
- Many companies suffer from high leverage. A small number of larger companies (construction, tourism and real-estate development companies in particular) constitute a majority of the value of NPLs in banks' balance sheets. Deep restructuring is needed, combining financial and operational aspects. However, the corresponding know-how and experience are missing and the legal framework needs improvements to facilitate debt restructuring in the current context of deep recession. Corporate governance can be also a challenge in companies closely held and run by families, a dominant model in Cyprus. Reluctance to open ownership and lack of financial transparency may harm restructuring and limit expansion prospects.
- High energy costs are further undermining private companies and significant investments in sustainability improvements (including energy efficiency improvements and better water management) as well as new energy sources are urgently needed to increase competitiveness and help corporate restructuring efforts. Cyprus has an isolated energy system with no interconnections with neighbouring countries, and small population dispersed across the island. The main fuel for the power generation of the island is imported heavy fuel oil while renewables are expected to account for approximately 20 per cent of the total generation capacity in line with the EU objectives. The regulatory framework and government schemes to support energy efficiency and renewable energy investments need to be strengthened.
- International oil companies have won the right to drill offshore Cyprus exploring for natural gas. Should this be found in substantial amount it could provide the basis for

the construction of a LNG facility on the island and, possibly, a downstream industry. Republic of Cyprus is making an effort to import natural gas as an interim solution until indigenous sources become available. Piped or liquefied/compressed natural gas could also be used to power the power plants replacing heavy fuel oil with great improvements in terms of energy efficiency and energy security. It remains to be demonstrated whether a small local market and limited potential for industrial use would provide the right economics for the usage of natural gas.

- Energy security is a paramount issue for a small and isolated energy system like Cyprus. Currently there is insufficient storage system infrastructure to store enough fuel for transportation and power production needs in case of an emergency. Infrastructures for strategic reserves need to be built to ensure the energy security of the island. Improving water efficiency is essential as Cyprus suffers from increasing shortage of water with direct implications for water supplies, agriculture as well as water-intensive industries as well as on residential and commercial buildings.

Operational Response

- The Bank would selectively engage, where feasible, in the financial and operational restructuring of larger enterprises, including completion of project developments and refurbishments, working closely with commercial banks with the purpose of demonstrating successful restructuring. The focus would be on a small number of corporates where there is a sound underlying business case but an unsustainable financing structure and where the Bank's investment may unlock growth potential. This would be accompanied by strong governance arrangements. In addition to restructuring of companies that contribute significantly to the high NPLs in the banking sector, the Bank will selectively support the introduction of new products and expansion into new markets as a part of its corporate restructuring efforts.
- The Bank will focus on sustainability improvements (including energy efficiency improvements, expansion of the renewable energy sector, upgrading of power infrastructure critical to support renewable energy generation, and better water management), and investments in new sources of energy to increase the competitiveness of local enterprises. The Bank would support the switch of electricity generation from heavy fuel oil to cleaner fuels, and selective financing of natural gas related investments, including financing for local SMEs that are part of the supply chain providing goods and services for the off-shore activities. The Bank will also consider supporting commercially run energy storage facilities and other measures to increase energy security.
- The Bank will, across the island, provide business advice and direct financing, on a selective basis and through equity/quasi-equity or debt financing, mostly to small and medium size enterprises that can act as role models and/or move to the next level in terms of corporate governance and business conduct. This effort will be complemented with dedicated SME credit lines that will be channelled through partner financial institutions. In particular in more advanced areas, the Bank will aim to promote energy efficiency amongst SMEs.

Policy dialogue

The Bank expects to have intense policy dialogue related to the implementation of debt restructuring and NPL management, as well as more sustainable and efficient use of energy and water resources. The Bank will also engage with the competent authorities of the Republic of Cyprus, in co-ordination with SGCY, to provide support to enable private investments that improve energy efficiency and promote renewable energy.

The Bank intends to offer business advice on the whole territory of the island, cooperating with the EU and other donors, the country authorities, and other stakeholders to ensure focused efforts on key areas of SME support as well as the sustainability of Bank's assistance given its temporary mandate.

Results Framework for Theme 3: Corporate restructuring: Support operational, managerial and financial restructuring, as well as access to electricity and energy efficiency, to enhance competitiveness and diversification of local enterprises across the island.

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
3.1	<p>The corporate sector suffers from fundamental flaws and is in urgent need of restructuring. Restructuring in the corporate sector is also needed to support banking sector restructuring and NPL workouts.</p>	<p>Help induce financial and operational restructuring in the corporate sector</p>	<ul style="list-style-type: none"> Support the financial and operational restructuring of larger enterprises, including completion of project developments and refurbishments, working closely with commercial banks. This would be accompanied by strong governance arrangements. In addition to restructuring of companies that contribute significantly to the high NPLs in the banking sector, the Bank will selectively support the introduction of new products and expansion into new markets as a part of its corporate restructuring efforts. 	<ul style="list-style-type: none"> Evidence of improvements in clients' efficiency and financial performance as well as increased productivity of client firms due to restructuring [<i>baseline set at project level in TIMS</i>]
3.2	<p>Access to both to long-term financing and working capital, by SMEs is severely constrained, including due to collateral based lending practices of banks and also due to lack of available non-bank financing and equity</p> <p>The competitiveness of the SME sector across the island remains limited</p>	<p>Facilitate access to finance for SMEs and support the enhancement of management skills, financial reporting and implementation of innovative processes and product development.</p>	<ul style="list-style-type: none"> SME credit lines channelled through partner financial institutions. Direct financing, on a selective basis and through equity/quasi-equity or debt financing, to enterprises that can act as role models and/or move to the next level in terms of corporate governance and business conduct across the whole island. SME business advisory services 	<ul style="list-style-type: none"> Evidence of improvement in productivity and/or financial performance at SMEs financed directly by the Bank or advised by SBS [<i>baseline set at project level in TIMS/SBS</i>]

3.3	High energy costs are further undermining private companies and significant investments in sustainability improvements as well as new energy sources are urgently needed to increase competitiveness and help corporate restructuring efforts.	Develop the institutional framework for and help scaling up energy efficiency programmes and energy source diversification	<ul style="list-style-type: none"> • Dedicated credit lines for energy efficiency and renewable energy • Support sustainability improvements at clients for direct financing • Support the switch of electricity generation to cleaner fuels, and selective financing of natural gas related investments, including financing for local SMEs that are part of the supply chain providing goods and services for the off-shore activities. 	<ul style="list-style-type: none"> • Number of renewable and energy efficiency investments reaching commercial operation with the Bank's support [<i>baseline 0</i>] • CO2 emissions reduction as a result of Bank's operations [<i>baseline 0</i>]
Context indicator: Δ Relevant ATC sub-indicators for corporate sector and MSME				

3.3 Potential Risks to Country Strategy implementation

The ability of the Bank to deliver on its strategy in Cyprus and achieve expected outcome may be affected by a number of factors beyond the Bank's influence and control. As best it can, the Bank will work to address and mitigate these risks through proactive and sustained engagement with the Government as well as with its international partners.

Potential risks to strategy implementation include:

- insufficient progress in legal and regulatory reforms necessary to work out NPLs and resume financing for the corporate sector;
- possible delays in the privatisation programme or potential reversals in political commitment as well as potential abandonment of intentions to increase the use of private concessions;
- potential adverse developments in inter-communal relations that may hinder the ability of the Bank to work across the island.

3.4 Environmental and Social Implications of Bank Proposed Activities

The Bank's Environmental and Social Policy and Performance Requirements will apply to all projects carried out in Cyprus. The Bank will work closely with clients in developing Environmental and Social Action Plans with the objective of mitigating potential negative impacts and ensuring compliance with Cypriot national standards and the applicable EBRD Performance Requirements. EBRD's approach to managing the environmental and social risks associated with the projects that it supports continues to be complementary to that of other IFIs (e.g. World Bank, IFC and the EIB); however, given the recent revisions to the Bank's Environmental and Social Policy (2014), it is envisioned that environmental and social capacity building with both public and private sector clients will play an important role in the overall success of the Cyprus country strategy.

One of the most pressing environmental issues facing Cyprus is the growing imbalance between the demand and availability of freshwater resources. Like other countries in the Mediterranean region, Cyprus has a semi-arid climate and limited water resources. During the last decade, the demand for water supplied by governmental water utilities has persistently exceeded existing supplies. According to the United Nations, the two main water-consuming sectors in Cyprus are agriculture (accounting for 70per cent of total use) and the domestic sector (20per cent). To address this, the Government has initiated numerous water conservation measures over the years including but not limited to the construction of dams and conveyance infrastructure, improved irrigation systems and desalination plants; however, Cyprus continues to suffer from the highest water stress in Europe.

The conservation and management of biodiversity is also a priority for Cyprus. The geographic location of the island places it along one of the region's major bird migration routes in the Mediterranean, making it a stop off point for over 300 species each year. In addition, the European Environment Agency estimates that 7per cent of the indigenous plants on the island (representing approximately 140 different species), are endemic to Cyprus. Of particular importance are the island's state forests, which cover 17per cent of the island and are mainly confined to the Troodos mountain range in the central part and the Kyrenia mountain range in the north. The Troodos mountain range is of particular ecological

significance, not only because it contains rich plant and avian diversity, but also because it feeds most river basins and aquifers of the island.

Given the political sensitivities in Cyprus concerning property titles, compliance with certain aspects of the Bank's Performance Requirement 5 on *Land Acquisition, Involuntary Resettlement and Economic Displacement* could present some challenges, especially for those projects that are located in the north. To address this issue, EBRD is committed to working closely with the Government, our clients and project affected persons to ensure that the Bank's requirements are met. EBRD will also work closely with all of its clients to maximise benefits in terms of access to employment and/or services, particularly with those who are considered to be vulnerable⁵. Whilst this presents a challenge to EBRD and its clients, the Bank's environmental and social due diligence will be designed to ensure that vulnerable groups, who might be disproportionately affected by a project, are identified. This will enable both adequate mitigation measures to be put in place as part of the project design as well as interventions that will enhance these groups' ability to benefit from the Project's activities. Moreover, stakeholder engagement will be carried out in a culturally sensitive manner that is aimed at including the participation of both men and women and/or those groups who might otherwise not have a voice.

Finally, many priorities that the Bank has currently set for Cyprus are anticipated to provide environmental and social benefits, such as energy efficiency, infrastructure and renewable energy projects (e.g. solar or wind power). These projects, along with environmental and social capacity building initiatives and specific measures to support both water and biodiversity conservation will be targeted for technical assistance. EBRD will also provide training to local banks to ensure that they are capable of implementing environmental and social due diligence procedures in accordance with the Bank's own stringent FI requirements, thus promoting sound development practices within the SME sector.

3.5 EBRD complementarity to and co-operation under the EAP and with MDBs

The Bank will work in the context of and complementing the EAP. Potential policy advisory and capacity building assistance will be therefore limited, and focused on narrow areas of financial sector restructuring, including private sector debt restructuring and NPL management as well as on privatisation and private concession related issues, more sustainable and efficient use of energy and water resources, and access to finance and advice for SMEs, and will be coordinated through the EU Support Group for Cyprus ('SGCY'), as well as through cooperation of the EBRD resident office with representatives of the international partners under the EAP and the EU resident experts in Cyprus. The Bank's SME operations through Cypriot commercial banks will seek complementarity with EIB Group facilities.

⁵ As identified in the Bank's Environmental and Social Policy (2014), vulnerable groups refers to "people who, by virtue of gender identity, sexual orientation, religion, ethnicity, indigenous status, age, disability, economic disadvantage or social status may be more adversely affected by project impacts than others and who may be limited in their ability to claim or take advantage of project benefits. Vulnerable individuals and/or groups may also include, but not be limited to, people living below the poverty line, the landless, the elderly, women and children headed households, refugees, internally displaced people, ethnic minorities, natural resource dependent communities or other displaced persons who may not be protected through national legislation and /or international law".

The Bank's activities in the northern part of Cyprus will be coordinated with the EU and other donors by sharing of information to ensure complementarity and avoid overlaps, and is expected to include donor co-financing of technical assistance for SME finance and advice, and potential co-financing of bi-communal projects. The EU activities in the northern part of Cyprus are managed by the Task Force for the Turkish Cypriot Community and are being implemented on the ground by a programme team, which uses a programme support office in the northern part of Cyprus to facilitate contacts with the beneficiary community.

ANNEX 1 – POLITICAL ASSESSMENT

Cyprus is committed to and applying the principles of multiparty democracy, pluralism and market economics in accordance with the conditions specified in Article 1 of the Agreement Establishing the Bank.

The constitutional and legislative framework for a pluralistic parliamentary democracy is in place. The separation of powers, checks and balances in the political system, and guarantees for fundamental rights and for a meaningful role of civil society are largely in line with international and European standards. Elections are conducted in a manner deemed by the OSCE to be free and in line with international standards.

Cyprus, which has been a Member of the European Union since 2004, was repeatedly assessed by the EU throughout the accession negotiations as meeting the Copenhagen political criteria, including in the final Progress Report of the European Commission and the Comprehensive Monitoring Report on Cyprus's preparations for membership adopted after the signing of the EU Accession Treaty⁶. These criteria focus on the stability of institutions guaranteeing democracy, the rule of law, human rights, and the protection of minorities, and are close to the criteria of the updated Political Methodology Procedures approved by the Board of Directors of the EBRD on 25 February 2013. In the period since joining the EU, Cyprus has made further progress in all areas of democratic reform covered in the four sections below.

At the same time, certain challenges remain, some of which are related to the impact on civil and political rights of Cyprus' history of conflict and the continuing *de facto* division of the island. Some progress has been achieved over the years in tackling these specific issues.

On 11 February 2014, the leaders of the Greek Cypriot and Turkish Cypriot communities agreed on the text of a Joint Declaration, paving the way to resuming fully-fledged negotiations on the comprehensive political solution. According to the Joint Declaration, "The settlement will be based on a bi-communal, bi-zonal federation with political equality, as set out in the relevant United Nations Security Council Resolutions and the High Level Agreements. The united Cyprus, as a member of the United Nations and of the European Union, shall have a single international legal personality and a single sovereignty, which is enjoyed by all member States of the United Nations under the UN Charter and which emanates equally from Greek Cypriots and Turkish Cypriots"⁷.

Free Elections and Representative Government

Free, fair and competitive elections

The existing legal framework provides a sound basis for democratic elections in accordance with international standards, as assessed by the OSCE's Office for Democratic Institutions and Human Rights (OSCE/ODIHR). However, certain aspects of the legislation could benefit from further refinement. The OSCE/ODIHR has, in particular, recommended introducing in the electoral law currently lacking provisions related to international and domestic non-partisan election observation.

⁶ Report on Cyprus' Progress towards Accession, EC, 2002; Comprehensive Monitoring Report on Cyprus's Preparations for Membership, European Commission, 2004.

⁷ <http://www.uncyprustalks.org>

Elections are generally competitive, starting with candidate registration procedures offering a diverse choice to the electorate, and are conducted in a calm atmosphere. The candidates are able to campaign freely. There is a high degree of public trust and confidence in the impartiality, professionalism, and transparency of the election administration. The last general elections, which took place in 2011, were positively assessed by the OSCE/ODIHR⁸.

Under the 1960 Constitution, Cyprus has a presidential system of government with a unicameral legislature elected for a term of five years. The parliament consists of 80 members (increased from 50 in 1985), 56 of which represent the Greek Cypriot community (initially 35), while 24 seats (vacant since 1964) are allocated to the Turkish Cypriot community.

Separation of powers and effective checks and balances

The constitutional and legislative framework for a parliamentary democracy – underpinned by the separation of powers and checks and balances in the political system, an independent legislature and well established procedures of legislative oversight in prescribed domains of decision-making – is in place in Cyprus and is in line with international and European standards. The scope of powers of the legislature to hold the government to account and to exercise parliamentary oversight is largely in line with international standards. An appropriate system to ensure the accountability of elected officials is in place.

The functioning of the parliament is in line with democratic practices. Members of the government respond in writing to enquiries from the members of the parliament (MPs) and participate in hearings at the parliamentary committees. There is no practice of regular participation of the executive in Q&A plenary sessions with MPs. The parliamentary committees and MPs actively exercise their right to initiate and amend legislation.

Effective power to govern of elected officials

Cyprus has established institutional, legal, and financial arrangements for elected officials to exercise effective power to govern, which are not constrained by any non-democratic veto powers or other undue influences.

Civil Society, Media and Participation

Scale and independence of civil society

There is a satisfactory legal framework for civil society organisations and a vibrant independent civil society.

The right to form trade unions is enshrined in the law and respected in practice. More than 70 per cent of workers belong to independent trade unions.

Independence and pluralism of media operating without censorship

The media environment in Cyprus is diverse and includes numerous public and commercial broadcasters and printed media, offering citizens a wide range of political views. Media operate freely and without censorship. A legal framework is largely in place and in line with international standards.

⁸ OSCE/ODIHR, Republic of Cyprus, Parliamentary elections, Election Assessment Mission, Final report, 7 September 2011

The public broadcaster – Cyprus Broadcasting Corporation (CyBC) – has two national television and four radio channels, as well as a satellite channel for Cypriots living abroad. Commercial television includes four private TV channels, a number of radio stations, as well as regional broadcasters. Television remains the predominant source of public information, since circulation of printed media is relatively narrow. While print media are self-regulated, the broadcast media are regulated by the Cyprus Broadcasting Authority (CBA).

Recent years have witnessed a rapid growth in internet access. According to the International Telecommunication Union (ITU), the percentage of the population with internet access grew from 15.26 per cent in 2000 to 65.45 per cent in 2013. Social media is playing an increasingly important role and by the end of 2012, 51.2 per cent of Cypriots were active Facebook users.⁹

Multiple channels of civic and political participation

Multiple channels of civic and political participation are in place. The system of public consultations is largely in place. For each new draft legislation the relevant social partners affected are consulted both before the approval of the bill by the government and prior to submitting it to the parliament (various opinions by the affected social groups are attached to the submission). Civil Society Organisations (CSOs) are regularly invited to hearings in the parliamentary committees.

Freedom to form political parties and existence of organised opposition

The freedom to form political parties is guaranteed by the Constitution and implemented in practice, as highlighted by the existence of a significant opposition able to campaign freely and oppose government initiatives. The main opposition political party currently holds more than 33 per cent of seats in the national parliament and its representatives head a number of parliamentary committees. 10 political parties participated in the last general elections in Cyprus, and six parties are currently represented in the parliament.

Rule of Law and Access to Justice

Supremacy of the law

Necessary legislative and institutional safeguards for the supremacy of the law are in place. Citizens have the right to a free and fair trial, and are free from arbitrary arrest or detention. In the years preceding accession to the EU, Cyprus made progress in comprehensive reforms of the judiciary and in aligning it with European standards and legislation. The work has continued since then.

Independence of the judiciary

The independence of the judiciary is guaranteed by the Constitution and key safeguards are in place to ensure its impartiality.

Government and citizens equally subject to the law

The Constitution guarantees the citizens equality before the law and that guarantee is generally upheld in practice, supported by an independent judiciary.

Effective policies and institutions to prevent corruption

⁹ ITU (2014), access under: <http://www.itu.int/en/ITU-D/Statistics/Pages/stat/default.aspx>; Internet World Stats (2013) <http://www.internetworldstats.com/europa.htm>

An adequate institutional and legal framework for fighting corruption is in place, as assessed by the Council of Europe's Group of States against Corruption (GRECO). According to the EU Anti-Corruption Report published by the EC in 2014, Cyprus has demonstrated commitment to prevent corruption by amending legislation and establishing a coordinating body, although further efforts are needed to strengthen the enforcement system.¹⁰

In its latest Compliance Report on the measures taken by the authorities to implement the recommendations issued in the previous evaluation reports, GRECO concluded that the Cypriot authorities implemented or partly implemented two-thirds of the recommendations. Among the measures requiring further implementation is adoption of amendments to the relevant law in order to ensure effective sanctioning of candidates in elections for violations related to the submission of financial statements.¹¹

The latest (2014) Transparency International Corruption Perception Index (CPI) placed Cyprus as 31st among 174 countries, which compares favourably with countries where the EBRD currently invests, and places Cyprus in this respect roughly in the middle of the list of the 28 EU Member States¹².

Civil and Political Rights

Freedom of speech, information, religion, conscience, movement, association, assembly and private property

Overall civil and political rights continue to be generally respected in Cyprus. Cyprus is a signatory to all major international human rights instruments. The Constitution guarantees the basic freedoms and rights of citizens recognised in international law. Freedom of speech, information, religion and conscience, movement, association and assembly, and private property are therefore fully guaranteed. The Constitution and relevant laws prohibit discrimination on grounds of sex, race, language, religion, national or social origin, property, or social status. The Office of the Ombudsman is relatively efficient and is well respected by the public.

Some of the issues in the area of human rights are related to the impact of Cyprus' history of conflict and the continuing *de facto* division of the island. Some progress has been achieved over the years in tackling these specific issues. For example, Turkish Cypriot residents in the areas under the control of the government of the Republic of Cyprus can now have their names added to the voter list; restrictions to the right to marry for Turkish Cypriots living in these areas have been abolished; and procedures for the protection of refugees have been improved. However, complaints continue to be filed by Turkish Cypriots to the United Nations Peace Keeping Force in Cyprus (UNFICYP) about living conditions in the areas controlled by the government of the Republic of Cyprus.

The latest assessment of the track record of Cyprus in the area of human rights in the framework of the United Nations Universal Periodic Review (UPR) was adopted in 2014. In the course of the previous cycle, conducted in 2009, the top three recommendations included Women's Rights (23.68 per cent of recommendations); International Instruments (22.37 per

¹⁰ EU Anti-Corruption Report, Report from the Commission to the Council and the European Parliament, 3.2.2014

¹¹ GRECO, Compliance Report on Cyprus, 5 April 2013

¹² Transparency International, Corruption Perceptions Index (CPI), December 2014

cent); and Rights of the Child (19.74 per cent). Cyprus accepted 88.16 per cent of a total of 76 recommendations made through the review process¹³.

Political inclusiveness for women, ethnic and other minorities

The key legislative elements for gender equality are in place in Cyprus. Cyprus is a signatory of the Convention on the Elimination of All Forms of Discrimination against Women (CEDAW) and has committed to creating an enabling environment for the advancement of women.

While the gradual harmonisation with EU legislation was a major force behind policies on gender, women remain underrepresented in political life. The share of women in the current national parliament is only 10 per cent, which is a decrease compared to the previous composition of the parliament (14 per cent). This is a reversal compared to the previous trend for the gradual increases in the number of female members of parliament along an increase in the share of female candidates running at national elections. Currently there is only one female Minister in the government.

Despite a legislation on equal treatment for women and men, including the law on equal pay, on average women earn less than men with an equal level of professional qualifications, and women's participation rates in the labour market are lower compared to that of men's.

Cyprus has ratified the Framework Convention for the Protection of National Minorities. According to the Constitution, all citizens are deemed to belong to either the Greek Community or the Turkish Community. Every person who becomes a citizen of Cyprus must opt to become a member of either Community. Every person under the age of 21 belongs to the community of his/her father; a woman becomes a member of her husband's community by marriage. There are three constitutionally recognised minority ethnic-religious groups: Maronites, Armenians, and Latins. Each of them has one reserved non-voting seat in parliament.

Freedom from harassment, intimidation and torture

Constitutional guarantees against harassment, intimidation, and torture are in place and are largely upheld in practice. A delegation of the Council of Europe's European Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment (CPT) carried out a periodic visit to Cyprus in September 2013 to assess progress made since the previous visit in 2008 and the extent to which the Committee's recommendations have been implemented. The report and government's response to the recommendations made by CPT have not been published to date. However, in the latest report following the committee's visit in 2008, which was published on 6 December 2012, while acknowledging the efforts made by the Cypriot authorities, also noted that conditions of detention and health care services in the police establishments and prisons remain difficult.¹⁴

¹³ United Nations, Universal Periodic Review (UPR), Cyprus, 2010 and UPR Info Statistics

¹⁴ Council of Europe, European Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment (CPT)

ANNEX 2 – SELECTED ECONOMIC INDICATORS

*Cyprus joined the Euro Area on 1 January 2008

Cyprus

	2007	2008	2009	2010	2011	2012	2013
Output and expenditure	<i>(Percentage change in real terms)</i>						
GDP	5.1	3.6	-1.9	1.3	0.4	-2.4	-5.4
Private consumption	10.3	7.9	-7.6	1.5	1.3	-1.9	-5.8
Public consumption	1.3	6.1	6.8	1.0	-0.2	-3.8	-5.0
Gross fixed capital formation	13.4	6.0	-9.7	-4.9	-8.7	-18.3	-21.6
Exports of goods and services	6.2	-0.5	-10.7	3.8	4.4	-2.5	-4.2
Imports of goods and services	13.4	8.5	-18.6	4.8	-0.2	-5.4	-14.1
Labour Market	<i>(Percentage change)</i>						
Gross average monthly earnings in economy (annual average)	3.8	6.0	3.9	2.4	2.8	1.7	-1.6
Real LCU wage growth ¹⁵	1.6	1.6	3.7	0.0	-0.7	-1.4	-2.0
	<i>(In per cent of labour force)</i>						
Unemployment rate	3.5	3.3	6.0	5.5	8.9	12.7	16.0
Prices	<i>(Percentage change)</i>						
Consumer prices (annual average), HICP	2.2	4.4	0.2	2.6	3.5	3.1	0.4
Consumer prices (end-year), HICP	3.7	1.8	1.6	1.9	4.2	1.5	-1.3
Fiscal Indicators	<i>(In per cent of GDP)</i>						
General government balance ¹⁶	3.5	0.9	-6.1	-5.3	-6.3	-6.4	-5.4
General government revenues	44.8	43.1	40.1	40.9	39.9	39.4	40.3
General government expenditure	41.3	42.1	46.2	46.2	46.3	45.8	45.8
General government debt	58.8	48.9	58.5	61.3	71.5	86.6	111.7
Monetary and financial sectors	<i>(Percentage change)</i>						
Broad money (M2, end-year) ¹⁷	...	...	3.9	10.4	-3.4	-0.8	-22.8
Credit to the private sector (end-year) ¹⁸	...	...	8.3	8.8	4.6	1.3	-5.6
	<i>(In per cent of total loans)</i>						
Non-performing loans ratio	...	...	...	11.7	16.0	26.6	42.1
Interest and exchange rates	<i>(In per cent per annum)</i>						
Euro deposit rate ¹⁹	...	2.00	0.25	0.25	0.25	0.00	0.00
Policy rate	...	2.50	1.00	1.00	1.00	0.75	0.25
Euro lending rate	...	3.00	1.75	1.75	1.75	1.50	0.75
	<i>(Euro per US dollar)</i>						
Exchange rate (end-year)	0.68	0.72	0.69	0.75	0.77	0.76	0.73
Exchange rate (annual average)	0.73	0.68	0.72	0.75	0.72	0.78	0.75
External sector	<i>(In per cent of GDP)</i>						
Current account	...	-15.6	-10.7	-9.8	-3.4	-6.9	-1.9
Trade balance	...	-11.4	-5.5	-6.2	-4.3	-3.1	1.9
Exports of goods and services	...	45.0	40.2	41.3	42.9	42.9	43.9
Imports of goods and services	...	56.4	45.7	47.5	47.2	46.0	42.0
Goods balance	...	-32.4	-25.5	-26.8	-24.3	-21.8	-17.8
Merchandise exports	...	6.9	5.9	6.5	7.9	8.1	9.1
Merchandise imports	...	39.3	31.4	33.3	32.2	29.9	26.9
Foreign direct investment	...	-5.2	13.2	0.4	0.7	6.8	1.0
External debt stock	328.0	447.4	544.1	491.9	468.2	448.5	348.0
Public external debt	13.5	13.7	23.6	30.3	37.9	43.7	67.9
Private external debt	314.5	433.7	520.5	461.6	430.3	404.8	280.1
Memorandum items	<i>(Denominations as indicated)</i>						
Population (end-year, thousands)	776	797	819	840	862	866	858
GDP (in millions of EUR)	15,901	17,157	16,853	17,406	17,878	17,720	16,504
GDP per capita (in EUR)	20,700	21,800	20,900	21,000	21,000	20,500	19,000
FDI, net (in millions of EUR)	...	-890	2,224	65	132	1,197	169
External debt (in million EUR)	51,919	76,760	91,705	85,618	83,709	79,470	57,440
External debt/exports of goods and services (ratio)	...	9.9	13.5	11.9	10.9	10.4	7.9
Broad money (M2, end-year in per cent of GDP)**	...	236.6	250.2	267.4	251.7	251.9	208.9

¹⁵ Average inflation rate deducted from the per cent change of gross average monthly earnings

¹⁶ Net lending/Net borrowing under the EDF

¹⁷ Cypriot resident broad money (M2)

¹⁸ Private sector credit excluding brass plates

¹⁹ Interest rates are as of December of each year

ANNEX 3 – ASSESSMENT OF TRANSITION CHALLENGES

Market Structure	Market Institutions	Key challenges:
CORPORATES		
Agribusiness		
Medium	Medium	<ul style="list-style-type: none"> Increasing water efficiency of agricultural production Supporting investments in product differentiation to add value and increase competitiveness
Manufacturing and Services		
Negligible	Negligible	<ul style="list-style-type: none"> Business environment remains generally favourable for enterprises but enforcing contracts remain a key challenge which could curtail the growth potential especially for SMEs. Cyprus needs to adopt insolvency legislation, a key EAP requirement.
Real estate		
Medium	Small	<ul style="list-style-type: none"> Increasing market penetration of innovative construction techniques and technologies, including energy efficiency and sustainability Further increasing the supply of modern commercial property and hospitality offer Further streamlining of the bureaucracy related to real estate
ICT		
Small	Small	<ul style="list-style-type: none"> Privatizing the fixed-line incumbent and further strengthening competition in the wireline segment Further developing the telecommunications infrastructure (broadband internet) Ensuring full implementation of the EU regulatory framework
ENERGY		
Natural Resources		
Medium	Medium	<ul style="list-style-type: none"> Strengthening the function and the independence of the regulator Ensuring transparent and non-discriminatory third party access to import and transport infrastructures in the oil and gas sector Supporting the entry of additional private and international players in the upstream oil and gas sector
Sustainable Energy		
Medium	Medium	<ul style="list-style-type: none"> Introducing cost reflective tariffs for all consumers Strengthening the institutional capacity for deploying energy efficiency and renewable energy projects Developing climate change related institutional project delivery capacity
Power		
Large	Medium	<ul style="list-style-type: none"> Increasing the corporatisation and unbundling of the state-owned utility Introducing competition from the private sector in both generation and retail energy supply Strengthening the function and the independence of the regulator Reducing the carbon intensity of generation

Market Structure	Market Institutions	Key challenges:
INFRASTRUCTURE		
Water and wastewater		
Medium	Small	<ul style="list-style-type: none"> ▪ Introduction of private sector participation on a wider scale ▪ Further reduction in the water losses
Urban Transport		
Medium	Small	
Roads		
Medium	Medium	<ul style="list-style-type: none"> ▪ Further improvements and introduction of performance based contracts for all maintenance contracts ▪ Development of PPP projects in line with international best practice
Railways*		
N/A	N/A	<ul style="list-style-type: none"> ▪
FINANCIAL INSTITUTIONS		
Banking		
Medium	Medium	<ul style="list-style-type: none"> ▪ Facilitating banking sector restructuring ▪ Decreasing high levels of NPL stock ▪ Addressing legal impediments to debt restructuring and NPL resolution ▪ Facilitating improvement in standards of corporate governance
Insurance and other financial services		
Small	N/A	<ul style="list-style-type: none"> ▪ Facilitating expansion of non-bank financing such as leasing and factoring to SMEs ▪ Facilitating resolution of NPLs through support of NPL asset management companies and debt servicing platforms
Micro, Small and Medium-sized enterprises		
N/A	Medium	<ul style="list-style-type: none"> ▪ Broadening access to finance to SMEs ▪ Facilitating improvement in lending practices from collateral-based to cash flow based lending ▪ Facilitating advisory to SMEs to improve firm competitiveness, particularly in northern Cyprus
Private equity		
N/A	N/A	
Capital Markets**		
Medium	Small	<ul style="list-style-type: none"> ▪ Restructure and recapitalize banking system and restore normal interbank markets ▪ Introduce an effective governance framework in the local private sector to boost investor confidence and drive investment ▪ Complete privatization programme in utilities, infrastructure and other sectors to add to investible equity in the local market.

* There is no train service in Cyprus

** Administrative restrictions and capital controls were imposed as a crisis response in March 2013. In parallel with the loss of investor confidence, these partially segregated Cyprus from Euro-area capital markets

ECONOMIC INCLUSION GAP RATINGS

ECONOMIC INCLUSION		
Inclusion gap dimension	Inclusion gap	Key challenges
Regions		
Access to Services	Large	<ul style="list-style-type: none"> increasing access to infrastructure and services that substantially enhance the economic opportunities of the local population, specifically in relation to improved health, access to employment, training or entrepreneurial activities
Labour Market	Medium	<ul style="list-style-type: none"> improving access to local jobs and the continuing skills mismatch strengthening measures to formalise employment, especially in rural areas
Youth		
Labour Market Structure and Opportunities for Youth	Medium/Large	<ul style="list-style-type: none"> increasing labour market flexibility to reduce barriers to entry, particularly in relation to hiring / firing flexibility developing effective progression routes from training into employment through partnerships between employers and education providers (at secondary and vocational levels), for better job matching and the establishment of apprenticeships
Quantity and quality of education	Medium/Large	<ul style="list-style-type: none"> encouraging the private sector to engage more closely on the design and implementation of training curricula to address the skill mismatch and improve the employability of young labour market entrants, e.g. through Sector Skills Councils creating stronger progression routes from training into employment by fostering partnerships between employers and education institutions through scholarships, internships and the introduction of work based learning opportunities improving quality and availability of education
Gender		
Legal regulations	Medium	<ul style="list-style-type: none"> improving the enforcement of Law on State Guarantees for Ensuring Gender Equality, especially in relation to equal property ownership rights
Access to health services	Large	<ul style="list-style-type: none"> strengthening measures to reduce the maternal mortality rate in the country through improved awareness of and access to quality medical care

Labour policy and practice	Medium/Large	<ul style="list-style-type: none"> ▪ reducing discrimination on the basis of gender in employment and support non-discrimination policy development
Employment and firm ownership	Medium	<ul style="list-style-type: none"> ▪ strengthening the provision of career guidance at secondary and tertiary education levels in order to attract more female students into careers ▪ incentivising the private sector to adopt equal opportunities employment standards ▪ improving access to child care in order to attract more women to participate in the labour force
Access to finance	Small	<ul style="list-style-type: none"> ▪ supporting FIs in the development of financial and particularly non-financial products (e.g. business skills and financial literacy training) specifically aimed at female entrepreneurs in the SME segment. ▪ incentivising FIs to review collateral requirements for women-led businesses, e.g. by accepting the applicant's salary (in lieu of land or property) as collateral

ANNEX 4 – LEGAL TRANSITION

Introduction

This annex offers critical analysis on selected legal topics relevant to the Bank's investment strategy in Cyprus during the forthcoming period. It is based on the assessments of commercial laws conducted by EBRD Legal Transition Programme.²⁰ For ease of reference, the analysis is presented along the three main strategic orientations defined in this country strategy.

1. Strengthening the financial sector

Securities markets legislation

The main framework governing the issuance of and trading in securities in Cyprus comprises, in particular, the Public Offer and Prospectus Law of 2005, the Insider Dealing and Market Manipulation (Market Abuse) Law of 2005, the Investment Services and Activities and Regulated Markets Laws of 2007 to 2012, the Transparency Requirements (Securities Admitted to Trading on a Regulated Market) Laws of 2007 and 2009 and the Covered Bonds Law of 2010, among others.

As a member of the EU, Cyprus enjoys a relatively high level of sophistication of capital markets-related laws. The preliminary results of an assessment recently undertaken by the Bank indicate that local legislation provides for a comprehensive regulation of both equity and debt issuances, associated disclosures, listing requirements and safeguards against insider trading. The preliminary results also show that there are laws in place providing for a multi-tier pension framework, which have been updated in 2006 in line with the EU Pension Funds Directive. However, there is no “traditional” tier 2 in the pension system. International Financial Reporting Standards (IFRS) compliance is mandatory for publicly traded companies.

Despite the presence of a robust regulatory framework in the above areas, the current economic crisis in Cyprus is thought to be related to poor standards of corporate governance and supervision in the banking sector. Government policies have recently been dominated by the response to the crisis, in particular, the strengthening of the legal framework for public finance management and addressing the legal aspects of restructuring of the failed banks. Furthermore, new capital controls rules restrict the amount of funds that can be transferred abroad.

The preliminary results of the EBRD assessment show that Cyprus might benefit from clearer rules protecting bondholder rights in default scenarios. In addition, the procedure for registering qualified investors established by the Public Offer and Prospectus Law of 2005 could be enhanced.

2. Supporting the authorities' privatisation programme

Telecommunications

The main legal basis for electronic communications regulation in Cyprus is the amended Electronic Communications Act (Law 51(I)/2012), published on 18 May 2012. This act

²⁰ See www.ebrd.com/law

transposed the European Union (EU) 2009 electronic communications framework into domestic legislation. The policy maker for the sector is the Ministry for Communications and Works, and the regulatory authority is the Office of the Commission for Electronic Communications and Postal Regulation (OCECPR).

Cyprus is a member state of the EU, with fully liberalised electronic communications markets. As a member state it has undertaken to apply the necessary implementing measures relevant to the EU's Digital Agenda for Europe (DAE). To comply with its obligations in this respect Cyprus has adopted a comprehensive plan (2012-2020) to boost the uptake of information and communication technology (ICT), developing Cyprus into a knowledge-based economy, entitled "Digital Strategy for Cyprus", approved in February 2012.

While both mobile and fixed markets were formally liberalised in 2003, meaningful competition only began to take hold in 2006 following the imposition of regulatory remedies on the incumbent Cyprus Telecommunications Authority (Cyta), following OCECPR's completion of relevant market analyses. Many such measures have continued, in the absence of a fully competitive market, as OCECPR have conducted successive market analyses.

Cyta's main competitors are (a) South African based MTN, (b) Primetel, a fixed operator and mobile virtual network operator (MVNO) which recently acquired the third mobile network licence; and (c) Cablenet, a cable TV operator which recently bought out a local niche MVNO. Fourth generation mobile licences have already been issued and service is expected to begin in 2015.

While all required competitive safeguards are formally in place, and other operators have entered the market, incumbent Cyta still maintains a sizeable market share both in the fixed and mobile markets. Though decreasing, Cyta's fixed market share is the highest of an incumbent in the EU and its mobile market share is one of the highest. One of the key issues which competing operators report as an inhibitor to better competition is their inability to gain easy and timely access to Cyta ducts at a viable cost.

A privatisation plan for Cyta was approved by the Council of Ministers on December 2013. A legal framework for the privatisation procedure was enacted in March 2014 and the privatisation is scheduled to be completed by the end of 2015.

While electronic communications is an important contributor to the Cypriot economy in itself, it is the sector's role as an engine of growth and development across all sectors of the economy, particular in the small and medium enterprise market, that makes continued and vigorous implementation of the ever evolving EU framework critical as a means of attracting the investment necessary to install next generation technologies. Though EBRD is currently without any direct investments in the electronic communications sector in Cyprus it is nonetheless keen to see a transparent, investment friendly and fully EU-compliant regulatory regime maintained as a means to enhance the attractiveness of the sector to private investors and the security of their investments, and is ready to provide technical assistance to the authorities in that sector.

The main sector development anticipated over the short-to-medium term is the privatisation of Cyta. Otherwise, on the regulatory front, attentions will likely be focused on the continued implementation of the EU framework and efforts by OCECPR to best facilitate the sector environment for the achievement of the DAE through the implementation of the Digital Strategy for Cyprus.

In common with most EU peers, among Cyprus's challenges into the future is keeping pace with the evolving EU framework and ensuring its effective implementation as part of the DAE. Of particular importance in this respect are the regulatory enablers surrounding Cyprus's initiatives on broadband and the creation of an environment that is sufficiently conducive to both attract new investment and accelerate planned investment. Vigorous enforcement of timely access to ducting on viable terms, effective implementation of provisions on rights-of-way and ensuring continued effective regulation of operators with significant market power following the privatisation of Cyta will greatly contribute towards achievement of the DAE targets.

3. Support for corporate restructuring

Insolvency legislation

The insolvency and restructuring are mainly regulated by the Companies law (Chapter 113). The Companies law is largely inspired from the England and Wales Companies Act of 1948. Although it has been extensively amended in order to bring it into line with EU legislation, large sections, including those relating to receivership and liquidation, remain unchanged since before the independence from UK in 1960. In Insolvency cases, courts in Cyprus follow English law precedents where no local precedent exists and there is an abundance of such precedent which makes Cypriot insolvency law a comfortable territory for most British practitioners.

Insolvency refers to the inability of a company to repay debts which it has incurred. Insolvency is defined as the procedure whereby a company which has incurred debts is wound up, and its liquidator aims to settle the debts from the assets of the company.

Despite the strong English law heritage, Cyprus does not have any modern form of re-organisation procedure in insolvency such as the UK Company Voluntary Arrangement (CVA) and Administration. However, Cyprus recognizes the 'scheme of arrangement' which can be a flexible tool in restructurings, although it does not have the benefit of a moratorium on creditor actions. Moreover, receivership may be used to sell business as going concern by secured creditor but this remains a self-help remedy and not a collective insolvency proceeding for the benefit of all creditors.

Insolvency practitioners call for reforms mainly through adopting effective restructuring tools used under the law of England and Wales that are not currently applicable under the Cypriot insolvency law. The insolvency and restructuring framework in Cyprus could thus benefit from the recognition of CVA and Administration procedures.

The CVA aims to achieve a rescue plan for the company or simply to facilitate the distribution of the company's assets to creditors.²¹ The CVA seeks to bind dissenting creditors to the proposals formulated by the company so that it can come to an arrangement with its entire creditors. In order for the proposal to be approved, more than one half majority in value of the shareholders and more than three quarters in value of the creditors must vote in favour of the CVA. CVAs have the benefit of a moratorium that is crucial to achieve its objective. During the moratorium, security cannot be enforced and proceedings cannot be commenced or continued against the company or its property except with the consent of the court. The English law Administration has the merit of allowing the rescue of companies in

²¹ Clifford Chance, *A Guide to European Restructuring and Insolvency Procedures*, pp 25-26.

financial difficulties and allowing them (or at least their business) to continue as a going concern.

Contract enforcement / judicial capacity

The Cypriot Constitution prescribes a strict separation of powers, and the system of justice is generally heavily influenced by the English common law.

The Cypriot Judiciary is generally seen as independent and impartial, and government authorities are believed to respect judicial independence. Accordingly, there is evidence of high public confidence in the judiciary. There are no structural problems enforcing domestic court orders. The main concerns relating to the Cypriot judiciary are the slow pace of judicial proceedings and the resulting backlogs, problems recently identified under the EAP as requiring attention. In response, the authorities have undertaken to provide more detailed statistics on court backlogs and the duration of court proceedings, and to enact legislation to establish an Administrative court, in order to ease the caseload burden on the Supreme Court.

Reforms to the Cypriot justice system are ongoing and are likely to include: the introduction of an e-justice system; the creation of commercial courts; the promotion of small claims procedures; the establishment of an Administrative Court; and a new system for evaluating judicial output. A further measure which would enhance the functioning of the judiciary would be to establish a comprehensive database of all court decisions; at present, only a selection of recent judgments is published on the website of the Supreme Court. In addition, important upcoming commercial law reforms, such as the passing of an effective foreclosure law, will need to be accompanied by appropriate judicial training.