

Cyprus: Banking Sector Lessons from Restructuring and Current Challenges



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Cyprus accumulated large imbalances in the run-up to the 2008 global crisis

- ❑ Large imbalances
- ❑ Banking sector up to over seven times GDP
- ❑ Private-sector debt up to over 300 percent of GDP
- ❑ Financial sector deeply interlinked with that of Greece
- ❑ Current account deficit up to about 16 percent of GDP

The imbalances eventually culminated in a banking sector collapse

- ❑ Cycle in reversal
- ❑ Foreign inflows down
- ❑ From housing boom to bust
- ❑ Loss of market access
- ❑ BoC and Laiki losses up to 25 percent of GDP; ELA up to 60 percent of GDP

Unprecedented measures were taken to stem the crisis

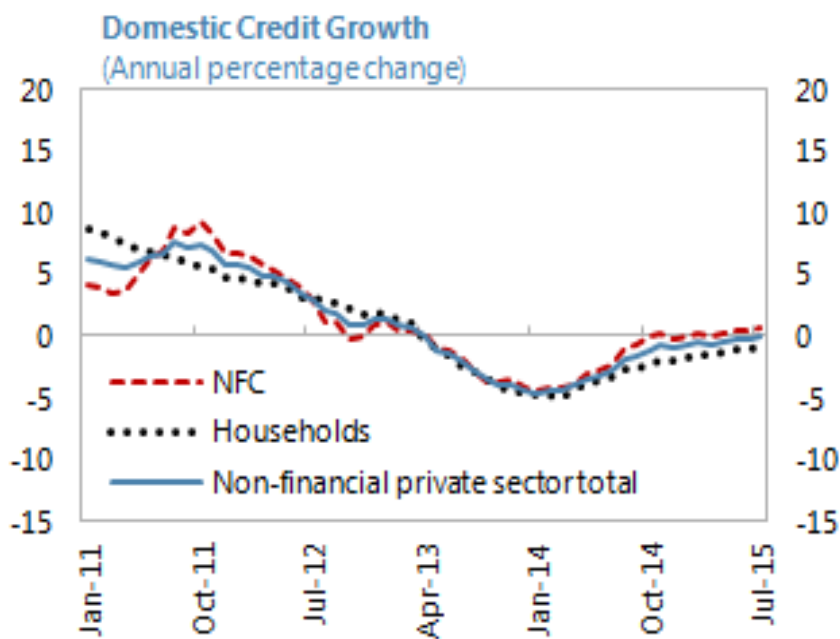
- ❑ Request of financial assistance
- ❑ Protracted negotiations
- ❑ Resolution of two systemic and by-then insolvent banks
- ❑ Recapitalization at no fiscal cost through bail-in
- ❑ Domestic and external payment restrictions

Lessons from Restructuring

Capital and liquidity conditions in the banking system continue to normalize

- ❑ Adequate capitalization, in line with the ECB Comprehensive Assessment: average CET1 ratio of core banks at 14.2 percent at end-June 2015, compared with 13.7 percent at end-March and 10.4 percent at end-2013
- ❑ Deposits in core domestic banks up modestly in the first nine months of 2015; deposits outflows from Greek subs stopped after Euro summit agreement
- ❑ Overall, broadly stable liquidity conditions

Credit conditions continue to normalize too

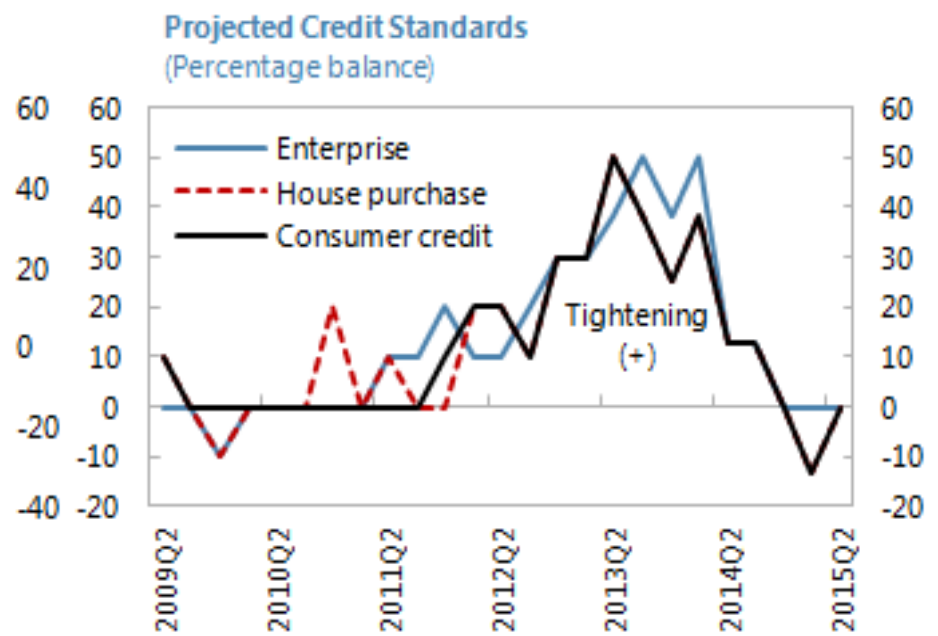
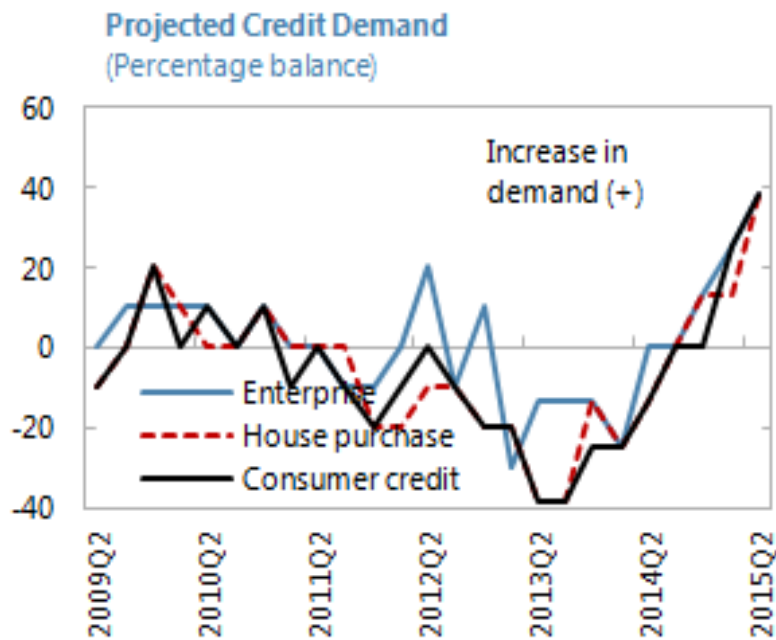


❑ Credit to the private sector stabilized in H1/15

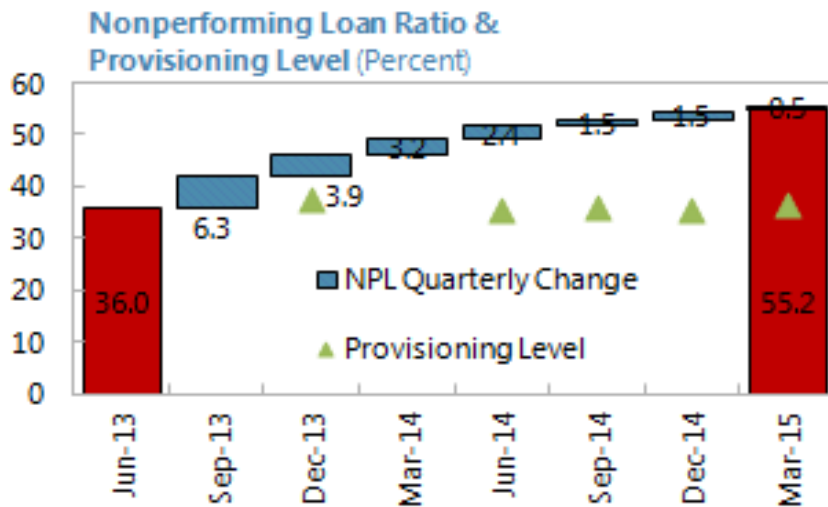
❑ Credit to corporates up slightly; credit to households still declining, although at a lower rate

❑ Around €580 million of new lending in the first five months of 2015

Credit demand is expected to increase, standards to be less tight



NPLs are very high and broadly unchanged since end-2014

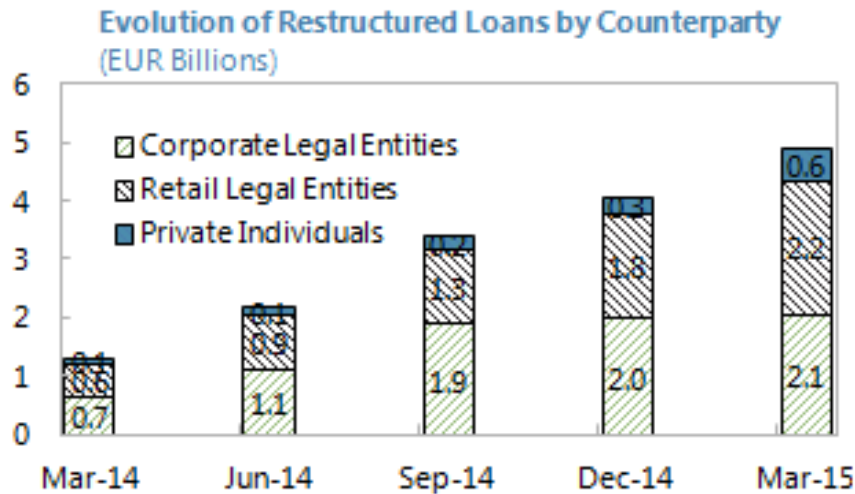


❑ NPL ratio in the core domestic banking system at 60 percent at end-June

❑ New NPLs largely representing interest arrears on existing NPLs

❑ Currently performing loans remained as such

The pace of NPL restructurings has accelerated



❑ Stock of restructured loans up from €1.3 billion in Q1/14 to €5.9 billion in Q2/15

❑ Increasing proportion of agreements based on long-term sustainable solutions

❑ Still, restructured loans only 23 percent of NPLs: much more to go

Significant progress has been achieved in laying the ground for NPL resolution

- ✓ Set up the new legal framework for private debt restructuring and made it operational
- ✓ Had banks put in place large-scale internal workout units and policies in line with AMF and CoC
- ✓ Set up a NPL targeting framework and published results for the first time in September
- ✓ Had temporary tax relief for capital gains on property transactions and halving of property transfer fees to increase incentives for creditors and borrowers

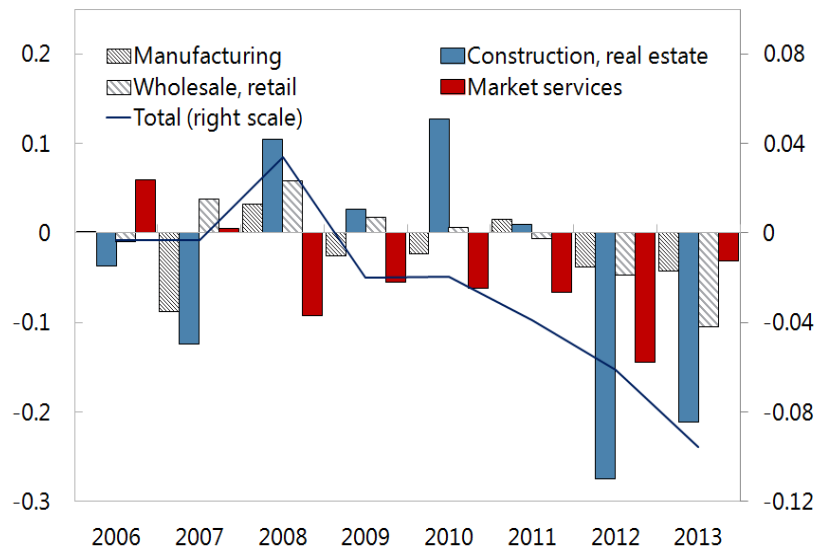
Current Challenges

The focus remains on NPLs

- ❑ Cyprus must deal with its NPL problem effectively
- ❑ Not only about the impact of NPLs on banks' balance sheet and capital, but also on the broader implications for the economy
- ❑ NPLs approaching 60 percent of all loans preventing “banks from being banks”
- ❑ Only by lowering NPLs, banks allowed to extend new credit to families and corporations, and to do that on better terms. In turn, supporting growth and jobs

Weak corporate balance sheets negatively affect investment

NFC Net Investment Rate



Sources: Orbis, and IMF staff estimates.

❑ **Debt overhang** - Earnings-to-debt ratio down from 15% in 2010 to 9% in 2013

❑ **Leverage** - Debt-to-assets ratio down only from 60.5% in 2011 to 57.5% in 2013

❑ **Debt maturity** - Long-term debt up from 20% of total debt in 2005 to 30% in 2013

Conducting a review of the private debt restructuring framework

- ❑ New insolvency framework allowing borrowers to restructure; new foreclosure regime to facilitate sale of collateral if no sustainable solution found
- ❑ Cross-country evidence showing that stronger legal and institutional framework for private debt restructuring associated with lower NPLs
- ❑ New insolvency and foreclosure frameworks major step forward, but some provisions deviating from best practices
- ❑ Comprehensive framework review to be conducted

Improving the efficiency of court processes

- ❑ Changes made to court rules to facilitate the implementation of the foreclosure framework
- ❑ Scope to improve efficiency of court processes and post-court enforcement of commercial claims:
 - Limiting interim applications and interlocutory measures, that in the past led to significant delays in court procedures
 - Increasing availability of information on debtors' financial situation

Enabling the sale and securitization of bank loans

- ❑ Legislation on sale of loans to allow third parties to acquire loans in Cyprus with minimal regulatory burden
- ❑ Also to ensure that small borrowers continue to be protected under the Code of Conduct
- ❑ Legal framework enabling bundling of loans and other assets and facilitate their securitization also to speed up balance sheet clean-up

Dealing with title deeds

- ❑ Significant disconnect between economic and legal ownership of properties, arising from practice of conducting transactions without transferring titles
- ❑ Considerable obstacle to smooth functioning of debt restructuring framework and property market.
- ❑ Legislation recently adopted to allow for transfer of titles in “legacy cases”
- ❑ Additional legislation needed to deal with transfer of titles in new transactions

Continuing to strengthen bank supervision and regulation

- ❑ Streamlining loan origination directive to ensure procedural requirements to be proportionate to risk of borrowers and loans
- ❑ Expanding reach of centralized credit register with ultimate aim of setting up credit scoring system

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Thank you