

# 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

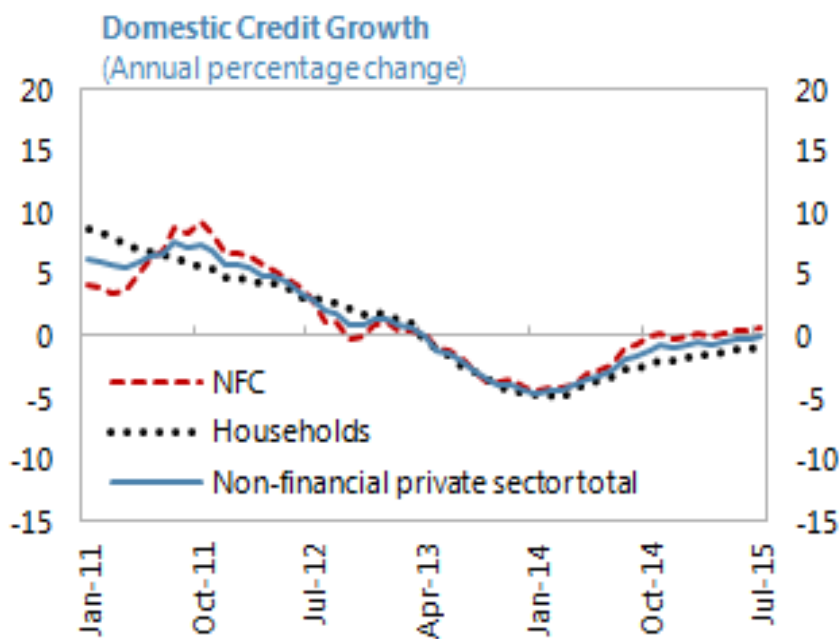
- ❑ Request of financial assistance
- ❑ Protracted negotiations
- ❑ Resolution of two systemic and by-then insolvent banks
- ❑ Recapitalization at no fiscal cost through bail-in
- ❑ Domestic and external payment restrictions

# 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



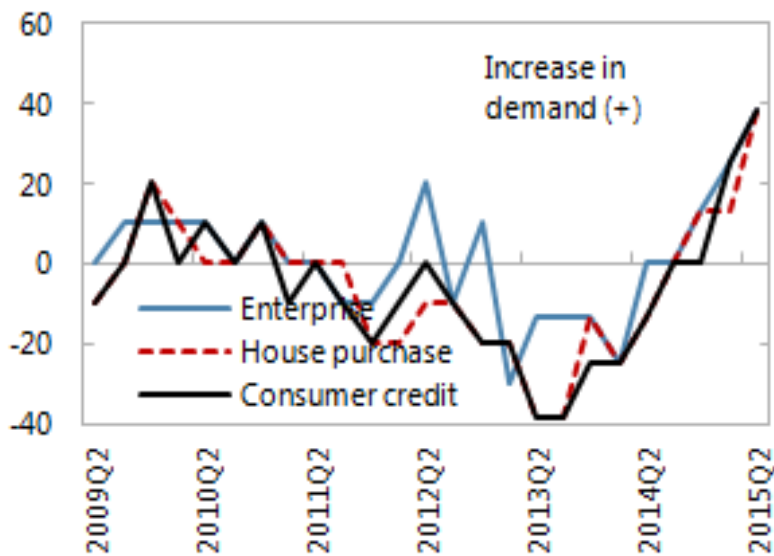
❑ Credit to the private sector stabilized in H1/15

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

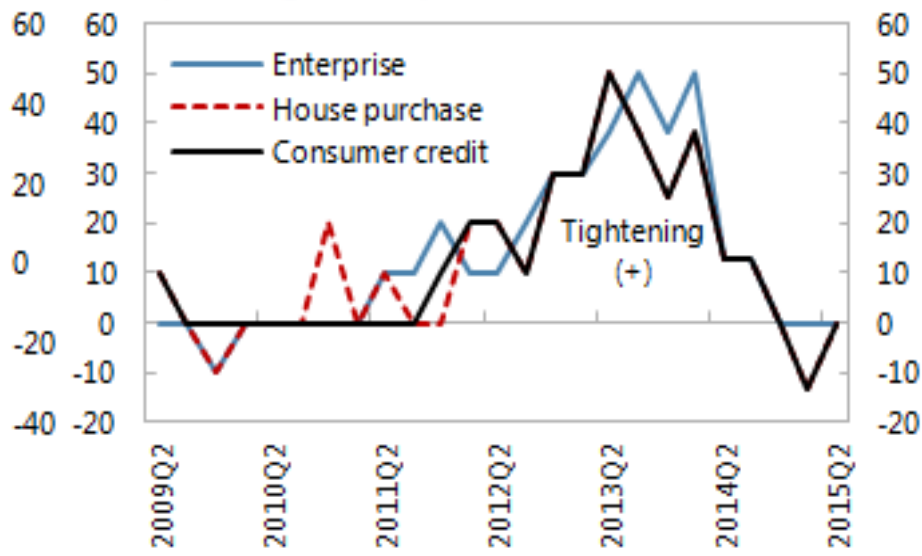
❑ Around €580 million of new lending in the first five months of 2015

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

**Projected Credit Demand**  
(Percentage balance)

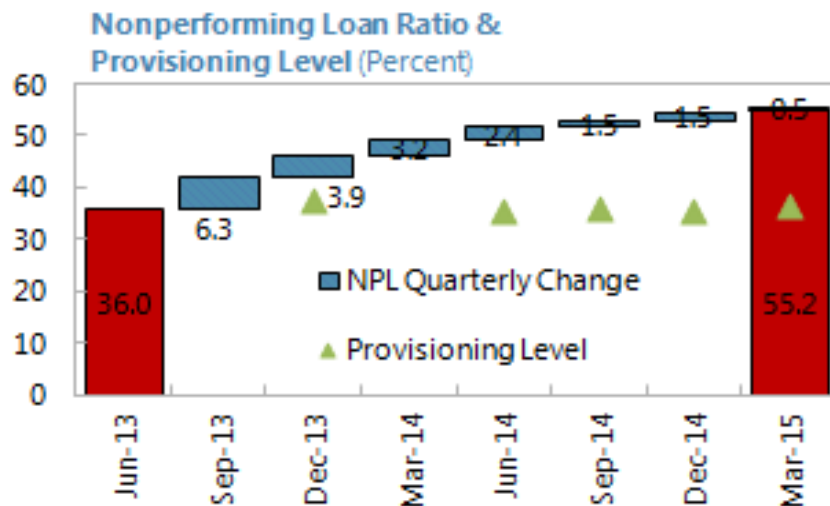


**Projected Credit Standards**  
(Percentage balance)





# NPLs are very high and broadly unchanged since end-2014

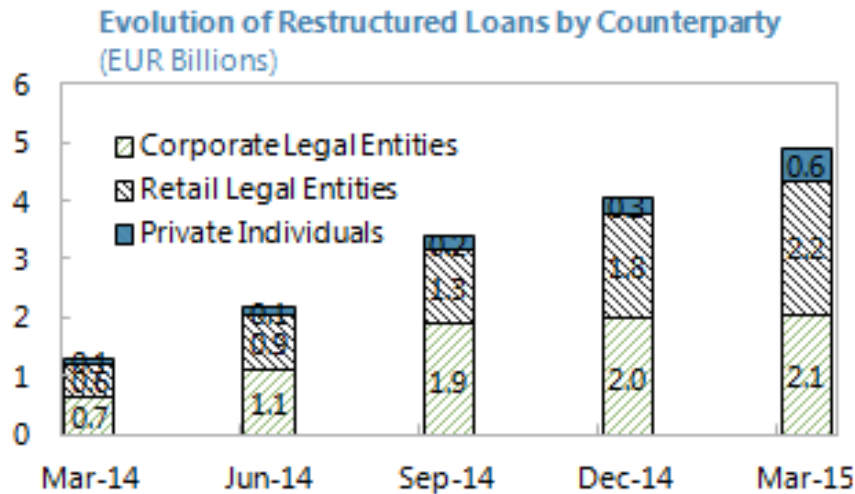


❑ NPL ratio in the core domestic banking system at 60 percent at end-June

❑ 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

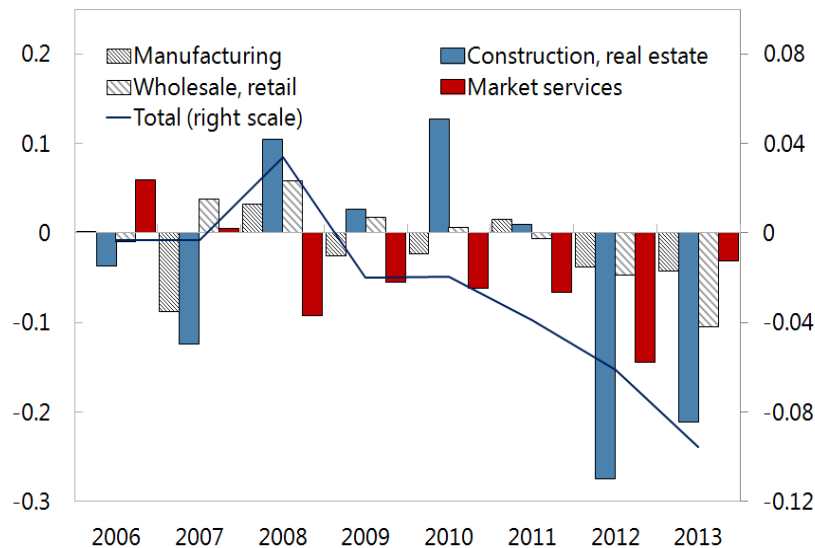
# Current Challenges

# 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

# **Cyprus: Banking Sector Lessons from Restructuring and Current Challenges**

**Thank you**