



At A Glance...

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Operating Environment

The near term outlook of the banks operating in Cyprus is improving but it remains challenging. Its key characteristics are as follows: Deleveraging, inadequate liquidity, decrease in borrowers' repayment ability, tightened lending criteria and rising Non-Performing Loans (NPLs).

All these characteristics cause a shortage in liquidity in the real economy, compromising any potential growth in key sectors. Notwithstanding the significant progress achieved in the financial sector as a result of the recapitalisation of Bank of Cyprus (BOC), Hellenic Bank (HB) and the Cooperative sector (Coops), Cypriot banks still have some way to go in regaining their credibility with investors in order to help drive the economic recovery. Importantly, banking institutions have to deal with the increasing NPLs trend and the management and administration of insolvent borrowers. The €1bn capital increase completed recently by the BOC provided a much needed boost to the confidence in the Cypriot banking system.

Structure & Supervision

The Cypriot banking sector comprises of domestic banks, international banks with subsidiaries or branches based in Cyprus and Coops which hold as of June 2014 47%, 34% and 19% of the total banking assets respectively. Since September 2013, the Central Bank of Cyprus (CBC) is the sole regulatory body, overseeing all the banks in Cyprus, including Coops.

Lifting of Capital Control Measures

On May 2014, the Ministry of Finance (MoF) announced that all restrictions on transactions within Cyprus would be abolished. The cashing of cheques is now permitted and the limits on transfers and payments of €50,000 for individuals and €200,000 for legal persons per institution have been abolished. The restrictions in the opening of new accounts have been removed. The cashless payment and transfer of deposits/funds to accounts held abroad are still prohibited with some exceptions. The abolition of restrictive measures is expected to help increase liquidity in the market and boost the overall economic activity and competitiveness.



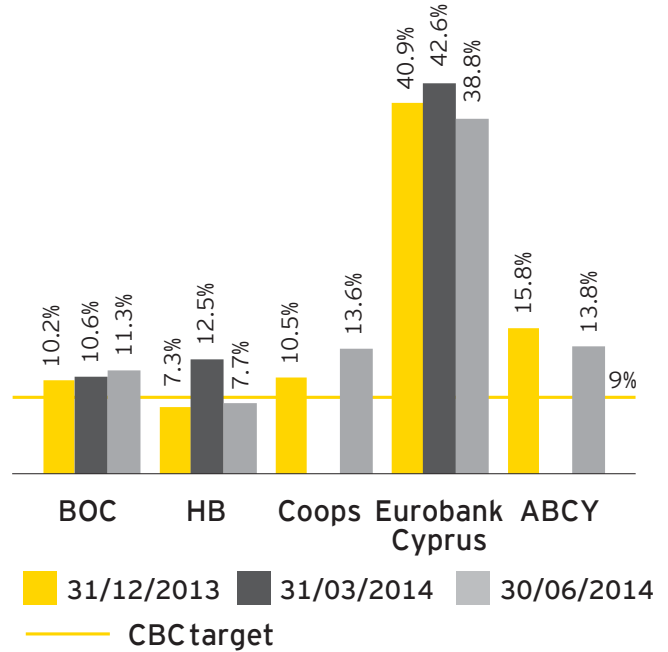
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Capital Adequacy

As of YE2013, the Core Tier 1 (CT1) ratio of the Coops and BOC was at 10.5% and 10.2% respectively, above the CBC target of 9%, whilst the relevant ratio for HB was at 7.3%. Eurobank Cyprus and Alpha Bank Cyprus (ABCY) were more than adequately capitalised for 2013, with their ratios being at 40.9% and 15.8% respectively. For the 1H2014, BOC increased its CT1 ratio to 11.3% while the CT1 ratio of HB, ABCY and Eurobank Cyprus were at 7.7%, 13.8% and 38.8% respectively.

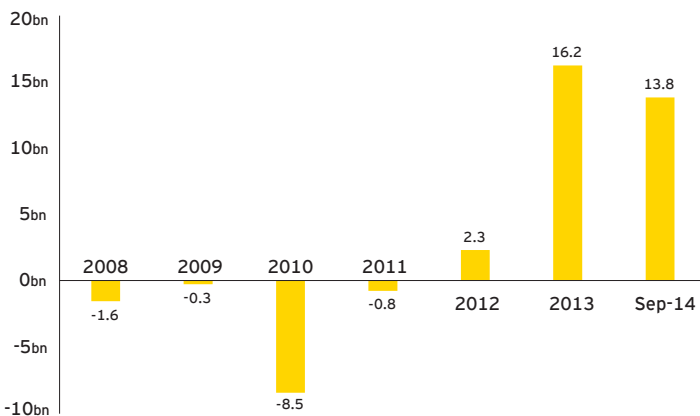
In September 2014, BOC completed a €1bn share capital increase through a process that included a private placement. The issue provided a further boost to the capital adequacy of the bank and lifted its CT1 ratio to 15.1% from 11.3% (1H2014). After the capital increase, the main shareholders of BOC are the special administrator of Cyprus Popular Bank (CPB), which holds 9.6% of the BOC share capital, the two funds introduced by Wilbur Ross, Renova Group with 5.45% and TD Asset Management with 5.23% and the European Bank for Reconstruction and Development (EBRD) with 5.02%.

Figure 1: CT1 ratios



Source: CBC (2014), BOC (2014), HB (2014), ABCY (2014), Eurobank Cyprus (2014)

Figure 2: Funding Needs of the Cypriot Banks (€bn)



Source: CBC (2014)

Funding Needs of the Cypriot Banks (Total Loans - Total Deposits)

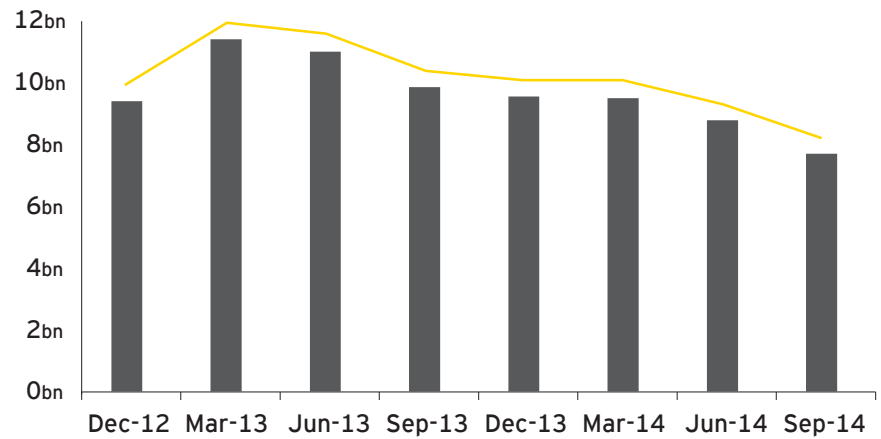
Since 2011, Cypriot banks have had rising funding needs. The exposure of both BOC and CPB to the Greek market led to a rapid increase in the funding needs of both banks. As the Greek financial crisis was unfolding (2008-2012), the Cypriot banks were forced to transfer a total amount of about €10bn to Greece, putting great pressure on the domestic rates structure. The total funding needs of the Cypriot banks in September 2014 were €13.8bn, down from €16.2bn at YE2013.

¹ Capital Adequacy Ratio instead of Core Tier 1 Ratio.

Emergency Liquidity Assistance (ELA)

The bank that started making significant use of the ELA was CPB. In a period of ten months from September 2011, the ELA use by CPB increased sharply from €0.5bn to €9.6bn. The dependence of Cypriot banks on ELA was at its highest point in March 2013, reaching €11.4bn. In July 2013, BOC exited the resolution process, and gained access to direct funding from the ECB for monetary policy operations. The ELA exposure has since been declining, and stood at €7.7bn in September 2014 (a decrease of €3.7bn or 32.6%). ELA is expected to decline to €3bn by 2017 as provided in the restructuring plan of BOC. The Cypriot banks are striving to access liquidity from the international credit markets.

Figure 3: ELA - Cypriot banks (€bn)



Source: CBC (2014)

Key Banking Sector Indicators

As of YE2013, BOC suffered significant losses (c.€2bn), due to the disposal of its Greek operations and significant provisions for the impairment of loans and advances. However in the 1H2014, profits of c.€81mn were reported. HB also recorded losses in 2013 (c.€191mn). These losses were a result of increased provisions for loan impairment, loss from the sale of its Greek operations, as well as the cost of the Special Early Retirement Plan for its staff. During the 1H2014, HB continued recording losses (c. €95.5mn), while the Coops registered an after tax profit of €85.6bn. For the same period, ABCY reported a loss of €31.7mn, while at the end of the YE2013, its cumulative losses amounted to €104mn. Eurobank Cyprus recorded profits of €26.3mn in 1H2014, while at YE2013 its after tax profits stood at €35mn.

Table 1: Bank Financials

YE2013	BOC	HB	Coops	ABCY	Eurobank Cyprus
Total Assets (€mn)	30,349	6,384	15,423	3,803	3,682
Net Loans (€mn)	21,764	3,564	12,478	3,467	1,743
Deposits (€mn)	14,971	5,513	13,933	2,032	2,471
Profit/Loss after tax (€mn)	(2,040)	(190)	41	(104)	35
NPLs (€mn)	14,040	2,000	6,044	1,820	106
NPLs (% of gross loans)	53%	46%	45%	42%	6%
Net Loans/Deposits (%)	145%	65%	90%	171%	71%
Core Tier 1 (%)	10.2%	7.3%	10.5%	15.8%	40.9%

1H2014	BOC	HB	Coops	ABCY	Eurobank Cyprus
Total Assets (€mn)	28,588	6,621	14,219	4,122	3,313
Net Loans (€mn)	20,063	3,347	10,537	3,394	1,122
Deposits (€mn)	13,803	5,852	12,604	2,069	2,842
Profit/Loss after tax (€mn)	81	(96)	85	(32)	26
NPLs (€mn) *	14,581	2,332	7,031	1,970	107
NPLs (% of gross loans)	58%	53%	53%	47%	9%
Net Loans/Deposits (%)	148%	57%	84%	164%	39%
Core Tier 1 (%) **	11.3%	7.7%	13.6%	13.9%	38.8%

* For Eurobank Cyprus are 90+DPD (Due past Due) loans

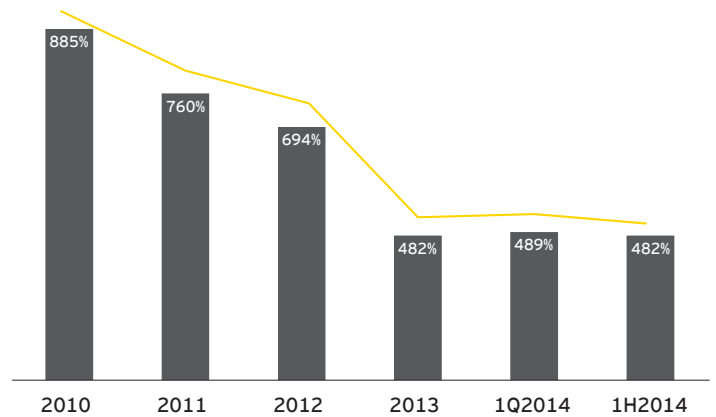
** For Eurobank refers to the Capital Adequacy Ratio

Source: BOC (2014), HB (2014), CBC (2014), ABCY (2014), Eurobank Cyprus (2014)

The Deleveraging Continues

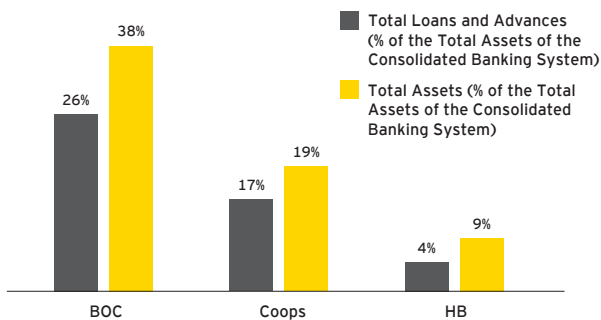
The outlook of the Cypriot economy is highly linked to that of its banking sector. The banking sector is still almost 5 times bigger than the country's GDP. Although the ratio of total bank assets to GDP narrowed to 482% in 2013 (compared with 694% in 2012), it remains higher than the EU average (2013: 337%, 2012: 352%). The decrease in the total assets of the banking sector from 2012 to 2013 by 212% of GDP partly came about from the sale of the Greek branches of BOC and CPB, and partly from the resolution of CPB that took place in April 2013. In the first half of 2014 the total assets to GDP ratio decreased slightly to 482%² (a QoQ decrease of 9%). Under the MoU signed with the Troika in March 2013, the size of the Cypriot domestic banking sector (as a ratio to GDP), excluding branches and subsidiaries of foreign banks in Cyprus, will reach the EU average of around 3.5 times of the country's GDP by 2018.

Figure 4: Total Assets (as % of GDP)



Source: CBC (2014), Eurostat (2014)

Figure 5: Assets of Domestic Banks - 1H2014



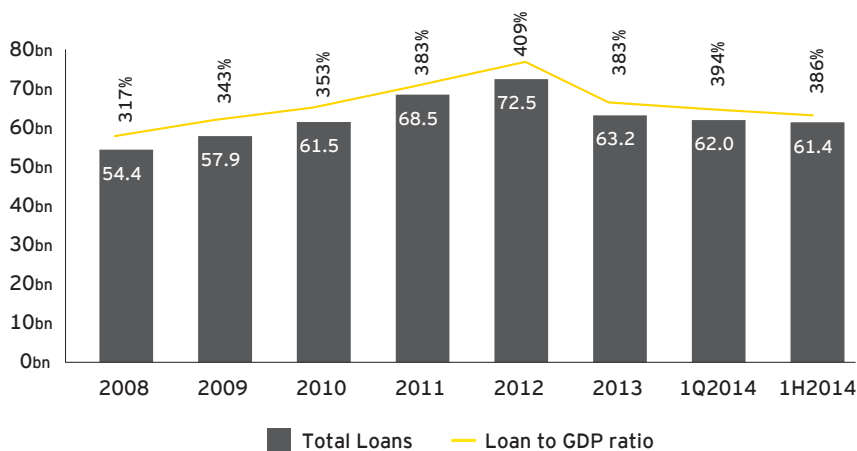
Source: CBC (2014), BOC (2014), HB (2014)

Total Assets

BOC, Coops and HB are in control of more than 50% of the total assets of the Cypriot banking sector. The total assets of the banking system as at 30/06/2014 stood at €76.7bn. BOC's share of these assets was 38% (or €28.9bn). Out of the total assets of BOC, 70.3% (or €20.1bn) were loans and advances granted to customers. Coops had 19% (or €14.2bn) of the total assets of the banking system. Of these, 74.1% (or €10.5bn) were loans and advances. For the same period, HB had 8% (or €6.6bn) of the total assets of the banking system, with 51% of those being loans and advances.

² The GDP for the first quarter and the first half of the year is calculated as the quarterly GDP multiplied by 4 and by 2 respectively.

Figure 6: Total loans (€bn) and Loans to GDP ratio (%)



Source: Eurostat (2014), CBC (2014)

Total Loans

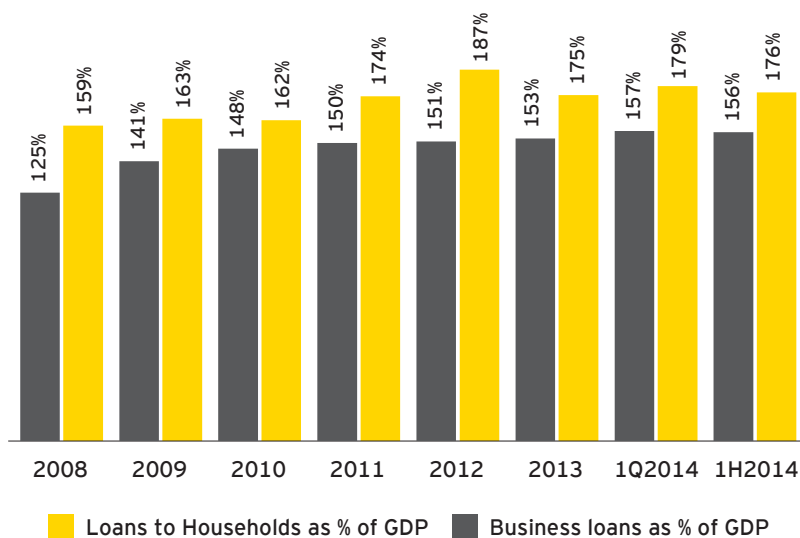
As of YE2013, the total loans of the Cypriot banking system were €63.2bn, compared to €72.5bn at YE2012. The ratio of total banking loans to GDP declined to 383% in 2013 compared to 409% in 2012. As of the end of the 1H2014, the total loans to GDP stood at 386%, compared to 394% at the end of the 1Q2014.

During September 2014, the deleveraging continued, with the outstanding amount of loans dropping to €59.8bn.

Household and Business Loans (as % of GDP)

At YE2013, the banking sector reported total household loans of €25.2bn, equivalent to 153% of GDP, while business loans for the same year stood at €28.8bn, or 175% of GDP. At the end of 1H2014 the household loans stood at 156% of GDP and the business loans at 176% of GDP. These figures remained well above the Euro area average ratios for both household and business loans to GDP (Euro area average: 107% and 89% respectively).

Figure 7: Loans to Households and Businesses (as % of GDP)



Source: CBC (2014), Eurostat (2014)

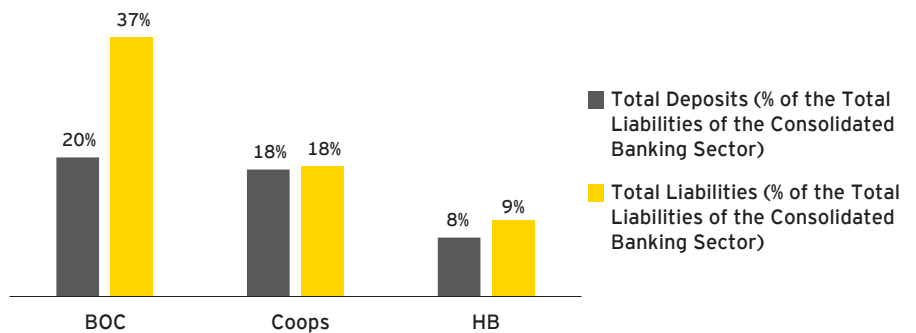
Total Deposits & Liabilities

At the end of 1H2014, BOC was holding 37% (or €25.7bn) of the total liabilities of the consolidated banking sector, with the total deposits constituting 20% (or €13.8bn) of the total liabilities of the banking sector. The Coops for the same period had 18% (or €12.9bn) of the total banking sector liabilities. The main component of the Coops liabilities was their customer deposits (€12.6bn). HB reported total deposits of €5.9bn or 8% of the total liabilities of the banking sector.

The total amount of deposits at YE2012 was €70.2bn, whilst at YE 2013 the total deposits declined by €23.2bn to €47.0bn (33% YoY decrease). On a monthly basis, the total amount of deposits in September 2014 declined by €398.2mn reaching €46bn. The monthly decline is due to decrease in deposits by domestic residents, (monthly decrease of €263.4mn, and a monthly decrease in deposits by non residents of €130.1mn adjusted for exchange rate fluctuations). On an annual basis, the decline in deposits was 3.2% (€1.5bn). The decline in deposits is mainly attributed to the deposit outflow in US dollars, which followed a significant deposit inflow recorded in May 2013.

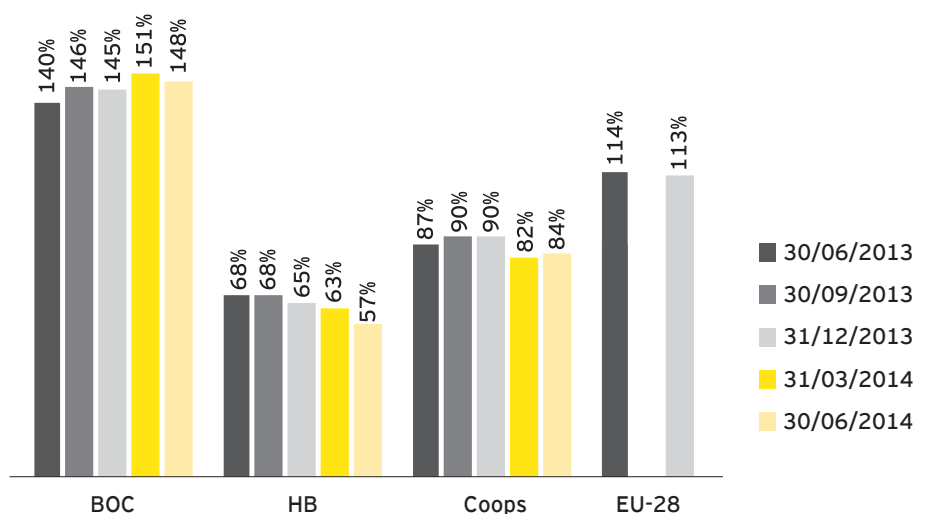
As at 1H2014, HB recorded a Net Loan-to-Deposit ratio (LTD) of 57.2% with zero funding from the ECB. The LTD ratio of BOC stood at 148% in 1H2014, whilst the Coops recorded a LTD ratio equal to 84% for the same period.

Figure 8: Total liabilities - 1H2014



Source: BOC (2014), CBC (2014), HB (2014)

Figure 9: Net Loan-to-Deposit ratio (LTD)



Source: BOC (2013,2014), HB (2013,2014), CBC (2014), EBA (2013)

Deposit & Lending Rates

After March 2013, the deposit interest rates for both households and businesses posted a significant decline. The deposit rate (for new deposits) for households in March 2013 was 4.34% while the equivalent business rate was 4.15%, reaching their lowest levels in September 2013 (2.2% and 1.9% respectively). In September 2014, the interest rates for deposits with agreed maturity of up to one year stood at 2.59% for households and at 2.53% for non-financial corporations.

Despite the decline in the deposit rates, the lending rates remained at relatively high levels, maintaining a large spread between the deposit and lending rates. In September 2013, the lending rates for new consumer loans were at 7.17% declining to 5.59% in September 2014. The housing lending rates declined by 55 basis points from September 2013 to September 2014 reaching 4.31%. The business lending rates for amounts up to €1.0mn fell to 5.48% in September 2014 (September 2013:6.47%). The Cypriot business lending rates are the highest in the Euro area. In September 2014, the average business and mortgage rates in Cyprus were at 5.48% and 4.31% respectively. At the same time, the corresponding rates in the Euro area were at 2.51% and 3.31% respectively.

One of the Biggest Challenges - NPLs

After adopting the new NPL definition in June 2013³, the NPLs reached 41.3% of the total credit facilities granted by banks and the Coops, and further increased to 46.5% in June 2014, equivalent to €20.2bn and €27.8bn respectively. As of June 2014, the NPLs of the banks were €20.8bn, whilst those of the Coops were €7.0bn. In September 2014, the NPLs of the consolidated banking sector, including the Coops, stood at €28.1bn or 47.7% of the total granted credit facilities. Out of those, NPLs related to credit facilities granted to corporations were €15.8bn, while NPLs related to credit facilities granted to private individuals were the remaining €12.3bn.

The most challenging component of the banks' loan portfolio is corporate credit facilities (NPLs: €15.2bn in June 2014). Out of those, NPLs related to credit facilities granted to the construction sector represented 16.5% of the total loans given to corporates, or €5.1bn (18.3% of total NPLs). The total amount of NPLs in the personal credit facilities segment were €6.3bn with the most problematic of them being loans extended for the purchase or construction of property (€3.8bn). On the other hand, the most problematic loans on the Coops balance sheet are credit facilities to private individuals (June 2014:€5.7bn), with the NPLs on consumer loans reaching €2.7bn. The corporate NPLs of the Coops were €1.3bn, as of June 2014.

Table 2: NPLs in the Cypriot Banking System

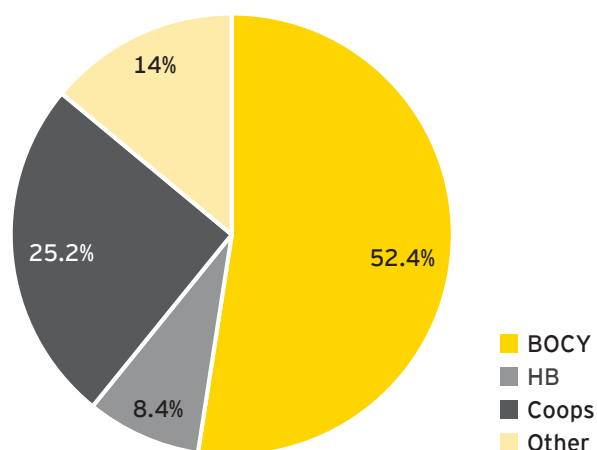
	OUTSTANDING AMOUNTS OF NPLS IN BN €'S		
	All Banks Consolidated	Coops	Total Amount
09/2013	18.4	5.7	24.1
10/2013	18.7	5.9	24.6
11/2013	19.2	6.0	25.2
12/2013	19.8	6.0	25.8
01/2014	20.1	6.3	26.4
02/2014	20.2	6.4	26.6
03/2014	20.0	6.8	26.8
04/2014	20.4	6.9	27.3
05/2014	20.5	7.0	27.5
06/2014	20.8	7.0	27.8
07/2014	N/A	N/A ⁴	28.0
08/2014	N/A	N/A	27.9
09/2014	N/A	N/A	28.1

Source: CBC (2014)

³ A loan is considered as non-performing when it shows arrears of more than 90 days or if has been restructured and at the time of restructuring presented arrears for a period of more than 60 days, regardless of tangible or other collateral.

⁴ As of July 2014, the Coops NPLs are reported along with those of the other banks.

Figure 10: NPLs in the Cypriot Banking System - 1H2014



Source: BOC (2014), HB (2014), CBC (2014)

NPLs by Bank

A breakdown of the NPLs per bank, as of the end of the 1H2014, shows that BOC accounts for 52% of the total NPLs of the Cypriot banking system (equivalent to €14.6bn), up by €0.5bn compared to the year end 2013. €10.7bn (73%) of the NPLs of BOC were attributed to loans to corporate clients and €3.9bn (27%) to loans to individuals. The total NPLs of HB increased by €332mn reaching €2.3bn in 1H2014 (31/12/2013: €2.0bn). €1.7bn (73%) were attributed to loans to corporate clients and €642mn (27%) to loans to individuals.

Table 3: Credit Agency Ratings

MOODY'S			
	Long-term deposit ratings	Short-term deposit ratings	Standalone Bank Financial Strength (BFSR)
BOC	"Caa3", outlook stable	"Not-Prime", no outlook	"E" (stable outlook, equivalent to a Baseline Credit Assessment (BCA) of "caa3")
HB	"Caa3", outlook changed to positive from negative	"Not-Prime", no outlook	"E" (no outlook, BCA of "caa3", within the E BFSR category)
FITCH			
	Long-term Issuer Default Rating	Short-term Issuer Default Rating	Viability Rating
BOC	CC	C	cc
HB	CCC	C	ccc

Source: Moody's (2014), Fitch (2014)

EU-Wide Stress Testing

BOC, HB, Coops and RCB were amongst the 130 Eurozone banks that participated in the EU-Wide Stress test in 2014. Out of those, 25 banks did not have adequate capital buffers to withstand certain extreme future scenarios. The Stress Tests covered the banks' capital composition, risk weighted assets, profit and loss, exposures to sovereigns, credit risk and securitisation. According to the baseline scenario, the CT1 ratio of the banks had to be at least 8%, and at least 5.5% according to the adverse scenario.

The results of the tests, taking into consideration the recapitalisations made during 2014, showed that HB had a deficit equal to €176mn, while the remaining banks showed capital surplus. The actual capital needs of HB however are €105mn, after taking into consideration actions that have already been taken by the bank. The capital shortfall will be covered through a rights issue to which the bank's major shareholders have already expressed their commitment to participating. HB will proceed with a share capital increase through subscription rights issue, of up to €221,433,706.

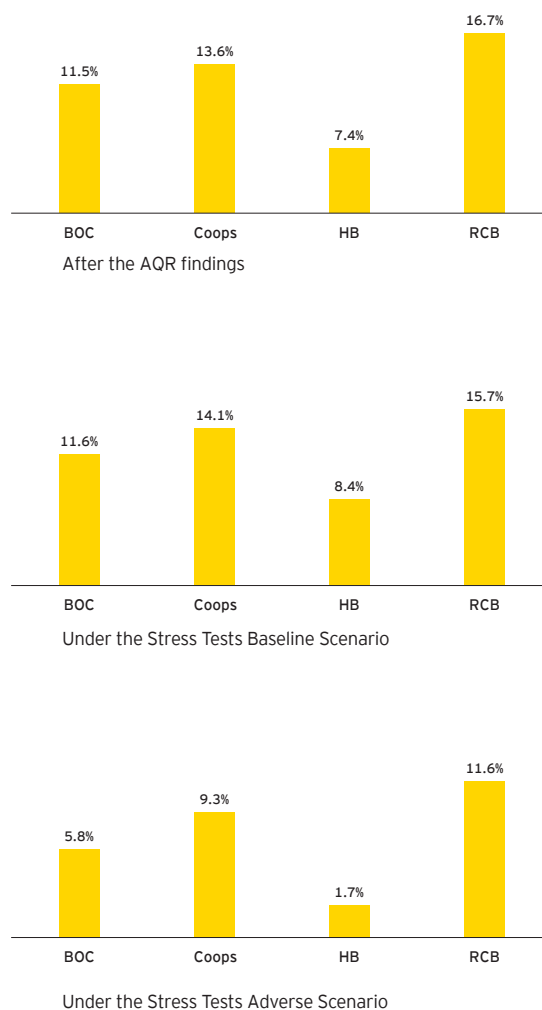
The Coops have a capital buffer equal to €331mn while RCB and BOC have €112mn and €81mn respectively. It is of note that all the Cypriot banks meet the capital threshold of 8% under the baseline scenario.

Table 4: Stress Tests Results

	CT1			Capital Surplus/ Deficit (€mn)
	After the AQR findings (%)	Under the stress tests baseline scenario (%)	Under the stress tests adverse scenario (%)	
BOC	11.5	11.6	5.8	81
Coops	13.6	14.1	9.3	331
HB	7.4	8.4	1.7	(176)
RCB	16.7	15.7	11.6	112

Source: CBC (2014)

Figure 11: CT1 Ratios



Source: CBC (2014)

Recent Developments

July

- ▶ The Government repaid BOC €950mn out of a €1,987mn sovereign bond, which was originally issued as part of the recapitalisation of CPB.
- ▶ Fitch upgraded the long and short-term ratings of BOC and HB from RD (Restricted Default) to CC and C respectively.
- ▶ Bank Zenit (Open Joint Company) of the Russian Federation established a Representative Office in Cyprus.
- ▶ BOC released the twelve-month term deposits of about €927mn maturing on the 31st of July 2014 that were blocked as per the decrees relating to the recapitalisation of the Bank in July 2013.
- ▶ BOC announced the successful private placement of €1bn at a price of €0.24 per share.
- ▶ CBC announced that, based on the powers afforded to it by the relevant legislation, it took over the administration of operations of the Cyprus branch of the Federal Bank of the Middle East (FBME).

August

- ▶ The Supreme Court rejected the application of FBME regarding the suspension of decree for the sale of the operations of the branch.
- ▶ BOC proceeded with a reduction of its lending base rates as of August 4.
- ▶ The European Banking Authority (EBA), announced the final templates for the 2014 EU-wide stress test.
- ▶ BOC received €104mn in offers for new shares from existing shareholders during the “claw back” phase of its capital increase.
- ▶ HB, along with BOC and the Coops, took measures for dealing with NPLs.⁵
- ▶ The increase of the share capital of the BOC by €1bn through the Placing and the Open offer was approved.

September

- ▶ The CBC levied an €89,000 fine on ABCY Ltd for “failure to comply with Sections of the Prevention and Suspension of Money Laundering Activities Laws”.
- ▶ BOC repaid €800bn towards its ELA balance with the CBC, after the completion of its share capital increase.
- ▶ The Council of Ministers approved a draft scheme for the provision of state guarantees of up to €150mn to the Cypriot banks by the European Investment Bank (EIB) aimed at providing trade finance facilities to SMEs.

October

- ▶ Launching of the Central Credit Register.
- ▶ The ECB kept its benchmark interest rate at 0.05%.
- ▶ The Supreme Court ruled four out of the six bills relative to the foreclosure legislation previously voted by the Parliament, as unconstitutional.

November

- ▶ BOC completed the sale of the relevant UK portfolio largely composed of residential and commercial real estate - backed facilities to Mars Capital Finance Ltd.
- ▶ The Cyprus Securities and Exchange Commission (CySEC) levied a €100,000 fine on HB in relation to land acquisition in the Amathus area in Limassol.
- ▶ CySEC approved the prospectus for a share capital increase of up to €221,433,706 of HB, through the issue of rights.
- ▶ The new board of directors of BOC was elected.

⁵ For dealing with NPLs, HB extends the repayment period for up to a maximum of 15 years, with a maximum client age set at 70 years, also providing a grace period of up to 2 years. Additionally, to help restructure an NPL, HB will decrease the interest rates depending on the actual financial status of each borrower. With regard to SMEs, similar policies have been put in place. BOC introduced measures to help borrowers that are unemployed and / or have lost more than 25% of their family income. These measures include a grace period of 15 months (until early 2016), a nominal monthly instalment of as little as €10, interest-

only payments, etc. Similar policies have been introduced for SMEs whose turnover reduced by 25% YoY. Coops also introduced measures to help borrowers that were fulfilling their obligations in the past and they have proven to be affected by the economic crisis. The grace period is set until early 2016, which can be extended in special cases. After exhausting all the available tools (extension of the repayment period, reducing of interest rates, prospects of returning to employment or increased income in a future period), the restructuring process should lead to a sustainable outcome.

Abbreviations

ABCY	Alpha Bank Cyprus
BCA	Baseline Credit Assessment
BFSR	Bank Financial Strength Rating
BOC	Bank of Cyprus
CBC	Central Bank of Cyprus
CET1	Common Equity Tier 1
Coops	Cooperative Central Bank and Cooperative Credit Institutions
CPB	Cyprus Popular Bank
CySEC	Cyprus Securities and Exchange Commission
EBA	European Banking Authority
ECB	European Central Bank
EIB	European Investment Bank
ELA	Emergency Liquidity Assistance
EBRD	European Bank for Reconstruction and Development
ESM	European Stability Mechanism
FBME	Federal Bank of the Middle East
GDP	Growth Domestic Product
HB	Hellenic Bank
LTD	Loan-To-Deposit Ratio
MFI	Monetary Financial Institution
MoF	Ministry of Finance
MoU	Memorandum of Understanding on Specific Economic Policy Conditionality
NPL	Non-Performing Loan
QoQ	Quarter on Quarter
RCB	Russian Commercial Bank
RD	Restricted Default
SMEs	Small and Medium Size Enterprises
SSM	Single Supervisory Mechanism
TROIKA	EC, ECB, IMF
YoY	Year on Year

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