Speech by the Chairman of the Board of Directors of Bank of Cyprus at the Annual General Meeting of the Shareholders
20 November 2014

Dear shareholders, dear guests

It is with particular pleasure that I welcome you today, to the Annual General Meeting of the shareholders of Bank of Cyprus. I would also like, separately, to welcome the new shareholders, who with their investment have demonstrated in real and substantive ways, their trust in the Bank and in the economy of our country also.

Today, 14 months after we had assumed office as the Board of Directors, I feel greatly satisfied about the work we had accomplished.

In September 2013, memories of the near collapse of the economy of our country were still very fresh. We received the biggest bank of the country in September 2013 deeply wounded. Confidence in the Group was almost totally missing and many were those who believed that the Bank would not survive. People were rushing, often daily, to withdraw deposits from the automated teller machines of all banks, fearing about tomorrow. Ten days before, the voluntary retirement scheme had been completed and 1.300 people left the Group which created problems in its executive and organisational structure. Staff morale was very low. There was no Chief Executive Officer. Neither were there any audited financial accounts for 2012. There was no completed restructuring plan either.

Thinking about the condition the bank was in when we assumed office, and where it is today, I feel great satisfaction about what has been accomplished. From my heart, I want to say a big ‘well done’ to the management team and to all of the staff for working tirelessly under very difficult conditions, to bring us where we are today. I can say with satisfaction that we are delivering to the shareholders and to the new Board of Directors, a Bank with real and substantial capabilities.

It wouldn’t be imaginable for the biggest bank in the land to be absent from the evolution and further development of the Cyprus economy after the crisis. Such was the bet for the organisation and for the country also. We are winning this bet!

Ladies and Gentlemen

2013 has been a particularly difficult year for the Bank and for the Cyprus economy also. The Eurogroup decisions of March 2013 and the signing of the Memorandum of Understanding between the Government of Cyprus and the Troika were extraordinarily traumatic for the Cyprus economy and its banking system. The European Union had taken a harder line with Cyprus in comparison with other bailout countries. The decisions for the resolution of Laiki Bank and the recapitalisation of Bank of Cyprus by bailing in uninsured depositors were extremely destabilising, especially for a small open economy like Cyprus heavily dependent on its banking system.

The conditions of instability were very visible especially during the early stages of the crisis. The economy had entered into a deep recession and the official forecasts were extremely negative. The Gross Domestic Product declined by 5.4% in real terms in 2013, less than initially anticipated, but nonetheless quite steep. The unemployment rate jumped to 15.9%. Price inflation turned negative while employee costs dropped significantly. In the public sector tight fiscal consolidation measures were implemented with the ultimate objective of reducing the deficit and restoring the sustainability of public debt. In the banking sector insecurity was great among both clients and staff. Restrictive internal and external measures on banking transactions were implemented, despite of which, there was continuous and significant outflow of deposits.

Bank of Cyprus took a heavy blow to its credibility and operations. The Bank had to close its operations in Greece. By decree of the Central Bank all debt securities were converted into ordinary shares and the nominal value of all of the Bank's ordinary shares was reduced. Decrees were also issued for the partial conversion of uninsured deposits into new shares. In total 47,5% of uninsured deposits were converted into new shares whilst another 37,5% of uninsured deposits was blocked in the bank in the form of term deposits of six, nine and twelve months maturities.

Bank of Cyprus also assumed the Cyprus assets of Laiki Bank, all of its insured deposits and all of its €9 billion of Emergency Liquidity Assistance, known as ELA, obtained through the Eurosystem. In consideration of the insured deposits and the assets, Bank of Cyprus issued shares to Laiki Bank equal to 18,1% of issued share capital.

As a result of these developments Bank of Cyprus lost the trust of its customers most of whom had become shareholders irrespective of their will. Management and staff suffered a considerable blow to their morale and pride. The future had become uncertain and the Bank had to operate under excessively difficult conditions. Deposits outflows were substantial and dependence on external funding increased excessively. Total loans exceeded the country's GDP and non-performing loans were rising at an alarming rate. The voluntary retirement of a large number of employees, necessary though it was, created additional problems. The Bank's work culture had to be revamped and strategy had to be refocused. The fundamental challenge that had emerged was to regain the trust of our clients and to restore the Bank to financial accountability.

In this constricting environment the Board of Directors of the Bank had to operate quickly and with resolve. The time limits were very tight and there was no room for mistakes or failures. These could further burden the negative climate, sustain uncertainty and feed further instability into the whole system.

Ladies and Gentlemen

The particularly adverse economic environment that prevailed in the year, continued to impact the Bank's balance sheet negatively as asset quality had been deteriorating acutely and non-performing loans had risen significantly. As a result, provisions for the impairment of loans and advances for 2013 were €1,1 billion, compared with €1,3 billion the year before. Profit before impairments, restructuring costs and discontinued operations amounted to €622 million. Loss after tax and before restructuring costs and discontinued operations amounted to €426 million. Loss after tax including restructuring costs (€168 million), losses from discontinued operations (€90 million) and losses from the disposal of the Greek operations (€1,4 billion), amounted to €2,05 billion.

The banking sector has undergone considerable transformation over the past year and a half. It is now significantly smaller and considerably better capitalised. Domestic payments restrictions have been eliminated without major disruptions. Deposits have broadly stabilised and dependence on Eurosystem funding has been reduced significantly.
The regulatory framework and supervision has been greatly enhanced. The Cypriot banks with one minor exception have successfully completed the Asset Quality Review and the stress exercise of the European Central Bank and the European Banking Authority. Cypriot systemic banks including the credit cooperative sector now come under the European Central Bank's Single Supervisory Mechanism.
The Bank's deposit base is stabilising, which is very encouraging, in view of the abolition of all internal restrictions on bank transactions and the gradual release of the decree deposits earlier than what was provided for in the Restructuring Plan.

The capital increase we achieved last September adds significantly to the capital adequacy of the Bank and it was undoubtedly critically important in the successful completion of the Asset Quality Review and the stress exercise of the European Central Bank and the European Banking Authority.

As already announced, the Common Equity Tier 1 ratio of the Bank was 11.3% as at 30 June 2014. Taking into account the capital increase by €1 billion, indicatively the Common Equity Tier 1 ratio rises to 15.6%. These developments instil greater confidence in our deposit base and create the preconditions for drawing funding from international markets on favourable terms.

Over the past 14 months we have taken extensive measures for the strategic refocussing of the Group, the restructuring of its operations in Cyprus, the reduction of operating costs and the improvement of profitability. The integration of the operations of ex Laiki Bank has been completed this past June. The branch network has been reduced to 130 branches from a total of 203 at the end of 2012.

The management of non-performing loans was from the outset our main priority. The trend of rising non-performing loans had to be stopped and reversed which required intensive work, time and perseverance. The establishment and continuous upgrading of the Restructuring and Recoveries Division, has already brought a major change in the way the bank manages its portfolio of non-performing loans. The Bank, where possible, implemented deleveraging of its portfolio, with primacy and decisiveness, disposing of non-core assets including the operations in Ukraine, its investment in Banca Transylvania in Romania, other investment in Romania, a loan in Serbia and more recently loan portfolio in the UK.

The Bank continues to face serious and substantive challenges. However, the proposal for the assumption of the Chair of the Board of Directors by Professor Dr. Josef Ackermann, a banker with international scope and calibre, constitutes an important step in efforts for successfully addressing these challenges and for the ability of the Bank to continue in its traditional role in funding the real economy.

Despite the better performance of the Cyprus economy in relation to what was initially anticipated, recessionary conditions continue, and unemployment remains high. The ratio of non-performing loans is also very high. Regarding the framework for the effective management of delayed payments, this is regulated by the Central Bank of Cyprus directive and a corresponding Code of Conduct has been instituted, which the present Board of Directors asked for its faithful implementation. The objective is to do fair and balanced restructurings for viable debtors who may be facing financial difficulties preventing them to honour their contractual obligations. Banks would have to examine and evaluate each case separately and propose solutions preferably over a long horizon that would properly respond to the specific conditions and financial circumstance of each debtor. Foreclosures should be implemented with caution in the non-viable cases. The effectiveness of the foreclosure and insolvency framework will determine the cooperation of the debtors who can pay but strategically avoid servicing their debts.

At the same time, the required repayment of Eurosystem funding not over an adequately long horizon, limits the potential for credit expansion and funding of the real economy that would help accelerate economic recovery and allow the economy to return to healthy rates of growth. The Bank should also continue with its banking operations enhancing its customer centric approaches and to show understanding for the particular situations that many businesses and households find themselves in, and naturally to meet the expectations of society.

Ladies and Gentlemen

The progress that has been achieved in the implementation of the programme so far, the visible improvements in the fiscal position of the government and the stabilisation of the banking system have started to bear fruit. In manifestation of this are the recent upgrades of the credit ratings of the government, the attraction of foreign investments and the performance of the economy where the recession is receding and the unemployment rate starting to stabilise.

According to the forecasts of the European Commission and of the International Monetary Fund also, there will be a small recovery of economic activity in 2015. The rate of growth of the Cyprus economy will gradually rise to 2% by 2018. In addition, structural reforms in the labour market and elsewhere significantly improve the competitiveness of the Cyprus economy and create the preconditions for further improvement of the foreign balance.

In the banking sector there is significant improvement in all levels: increases in the capital adequacy of the bigger banks, continued deleveraging mainly through the disposal of non-core assets, and improvements in liquidity. The regulatory and supervisory framework in the banking sector has improved considerably. The effective reform of the foreclosure framework betters the ability of banks to be able to recover their non-performing loans.

There remain of course problems and challenges. The years ahead will be difficult both for the banking sector and for the economy more generally.

Bank of Cyprus remains the most important pillar of the banking system with all the capability to play the leading role in the economic recovery of the country. The robustness of the Bank and its capability to perform its main role which is funding the real economy depends on the quality of its balance sheet, the adequacy and the depth of its capital base, and the extent of its access to capital markets. We have come a long way and we have a long way to go still. With mutual trust between the bank and its clients and the support of its shareholders, there is no doubt that Bank of Cyprus will continue to play the leading role in the economy, as it has done for more than one hundred years before.