Speech by the Chairman of the Board of Directors of Bank of Cyprus at the Extraordinary General Meeting of the Shareholders
28 August 2014

Dear shareholders, dear guests.

It is indeed with great pleasure, that I welcome you, on behalf of the Board of Directors, to today's Extraordinary General Meeting of the shareholders of Bank of Cyprus. The Extraordinary General Meeting is of major importance because it affords the present and the future of the Bank at a critical juncture of its restructuring path. After a year of a lot of hard work and many and difficult decisions, we can say with more certainty that we have turned page. We now look forward to the future with more optimism and conviction, eventhough there is still a lot that remains to be done, and the challenges in front of us are daunting.

Before we embark on the day's deliberations, allow me a brief account on what the Board of Directors and the Management team working together with shared objectives have achieved in the course of the last twelve months, the economic environment as it is unfolding, the challenges we still have to face as a Bank, and how we intend to move forward.

Ladies and Gentlemen

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 decisions for the resolution of Laiki Bank and the recapitalisation of Bank of Cyprus by bailing in its uninsured depositors were extremely destabilising, especially for a small open economy like Cyprus heavily dependent on its banking system.

Bank of Cyprus had to close its operations in Greece. By decree of the Central Bank all debt securities were converted to 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.

The recapitalisation of the bank was completed by the end of July 2013.

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 pace. 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.

A Restructuring Plan was quickly prepared. The Plan was approved by the Central Bank of Cyprus in November 2013 in accordance with the relevant provisions of the Memorandum of Understanding. The primary objectives of the Plan were to restore investor and depositor trust, to smoothly integrate the ex Laiki operations so as to take full advantage of the synergies involved, and to build a resilient and robust institution for the effective management of assets and for continuing to perform its role as the primary financier of the domestic economy.

Ladies and gentlemen

Over the past twelve 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. Staff costs will have been reduced by 35% on an annual basis. The cost to income ratio for the six months that ended on 30 June 2014 had been reduced to 38% compared with 46% in December 2013 whilst profit turned positive. Specifically, profit after tax, provisions for loan impairment, restructuring costs and discontinued operations attributable to shareholders, for the six months that ended on 30 June 2014, rose to €81 million.

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 number of financial specialists dedicated to the Restructuring and Recoveries Division almost tripled whilst specialists from abroad are adding strength through their knowledge and experiences. The amount of loans under management at the Division exceeds €11 billion whilst there are now specialised units totally dedicated to managing different categories of delinquent clients, of individuals and businesses, offering customised solutions.

The management of the non-performing loans requires the effective cooperation between bank and client. Our objective is on the one hand to support the Bank and on the other to protect our viable clients. Our approach is necessarily credit intensive. We are looking to diversify our risks and structure our loan portfolio is such a way so as to give us a much higher credit rating in a more normal environment.

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, and a loan in Serbia. This last June the Government of Cyprus proceeded with the early and partial repayment of a government bond issued by the Republic of Cyprus, for €950 million.

As a result, shareholder funds rose to €2,7 billion as at 30 June 2014 and the Common Equity Tier 1 capital ratio rose to 11,3% compared with 10,6% as at 31 March 2014. The Common

Equity Tier 1 capital ratio rose by 70 basis points as a result of second quarter profitability itself positively affected by the profit from the disposing of noncore assets and the early repayment of the government bond.

At the same time, the continuous and persistent efforts by the Bank to improve its liquidity position are bearing fruit. Following the absorption of Laiki Bank and its €9 billion ELA, the total of ELA borrowing at Bank of Cyprus rose to €11,1 billion as at 30 June 2013. Following its exit from administration as of 30 July 2013 and having been accepted as a counterparty credit institution for actions of monetary policy, the Bank drew €1,4 billion of funding from the European Central Bank and reduced its ELA to €8,8 billion as at 30 June 2014. In sum between April 2013 and June 2014, the Bank managed to reduce its total borrowing from the Eurosystem whilst at the same time absorbing a substantial reduction in its deposits.

The Bank's deposit base is stabilising, which is very encouraging. Net customer outflows have been substantially reduced in the second half of 2013 and in 2014. It is worth noting that there were net inflows of deposits in the second quarter of 2014 despite 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. As at 27 August 2014 blocked deposits at the Bank amounted to €900 million. These deposits will all be gradually released by January 2015. It is also worth noting that the behaviour of our customers with blocked deposits had been very satisfactory and the proportion of released deposits that remains with the bank continues to be very high.

Despite the improvement, I must say, the liquidity position of the bank remains heavily reliant on funding through the Eurosystem. This is a concern but also an unavoidable consequence of the bail-in of uninsured depositors and the folding of Laiki Bank into Bank of Cyprus.

Ladies and Gentlemen

Our country has come a long way since the crisis began and much has been achieved. But formidable challenges remain.

The implementation of the Economic Adjustment Programme is progressing steadily and targets are typically met most of the time. The performance of the economy has been better than initially anticipated in 2013 and both the European Commission and the International Monetary Fund have revised their forecasts for 2014 upwards whilst the recession will ensue.

The financial sector has been stabilising and a substantial fiscal consolidation has been implemented. Important structural reforms are under way and the authorities remain committed to the full and timely implementation of the Economic Adjustment Programme. It is in this context that the government succeeded in selling a five year bond in international markets at a favourable interest rate.

Equally important is the fact that in Europe the management of the crisis is bearing fruit. The significant changes that are taking place in the essential redesign of the Eurozone, and the evolution of the regulatory framework, including the steps toward a banking union, have a catalytic impact in the perception of stability and crisis management in the individual member states.

Cyprus continues to enjoy a number of important advantages including its membership of the EU and the Eurozone, its strategic location and its proven economic flexibility. These advantages underpin the resilience of the international business sector.

Cyprus remains an attractive tourist destination with considerable potential whilst the natural gas sector also holds considerable promise.

However, Cyprus continues to face enormous challenges. Public sector debt remains high in relation to GDP. At the same time private sector indebtedness in relation to GDP is also high and deleveraging, which is a prerequisite, may take longer than now anticipated. Non-performing loans have risen to new highs and pose considerable risks for the banking system and the economy at large.

Our job is not done yet!

In the banking sector there are particular challenges that need to be effectively addressed in order to ensure the long term viability of banks and restore their ability to supply credit in the economy. These challenges include non-performing loans, capital buffers and the restructuring process.

Effectively addressing the problem of non-performing loans is a prerequisite for strengthening the banks' balance sheets. Progress in this area I must say, has been slow despite the arrears management framework put in place by the central bank and despite the structures and policies banks had put in place to implement it. Slow progress has been the result of weak incentives for both lenders and borrowers to come to mutually agreeable solutions through negotiation. The importance thus of an efficient and effective foreclosure framework is indisputable.

Financial institutions have been recapitalised on the basis of independent assessments. However, the high degree of macroeconomic uncertainty prevailing and given also the ongoing pan-European comprehensive assessment tests, banks need to ensure adequate capital buffers to deal with potential additional shocks.

This brings me to the issue of our capital position.

Non-performing loans at Bank of Cyprus according to the new definition of the Central Bank rose to 58% as at the end of June 2014 compared with 53% as at end December 2013 and 46% in the banking system as a whole. A significant part of the balance of non-performing loans consists mostly of real estate collateral. The fact that real estate prices continue to drop, according to the price indices compiled by the Central Bank, adds further uncertainty and stress in the banking system. Any need to increase our loan loss reserves will be curtailing Group profitability with the potential to increase capital reserves also limited.

For all these reasons and given the uncertainty that continues to linger both in the internal macroeconomic environment and abroad, strengthening the Bank's capital base and reducing reliance on euro area funding are primary and necessary actions.

Undoubtedly the capital increase will strengthen the Bank's capital adequacy and will improve its liquidity position. The capital increase will raise the Common Equity Tier 1 ratio to 15,1% which compares very favourably with other European banks.

This increase in the Bank's capital adequacy is extremely important because it will provide it with significant additional buffers against the benchmark of a Common Equity Tier 1 ratio of 8% that the European Central Bank will be using in its baseline scenario for the October stress tests.

This significant and necessary increase of the Bank's capital adequacy that will result from the capital increase and the consequent improvement in its liquidity will instil more confidence to our depositor base and can potentially allow the Bank to draw funding from international debt markets on satisfactory terms.

We therefore assess, in all honesty, that the net result of the capital increase will be an extremely positive event for our Bank and also for the stability of the broader banking system. It comes at an opportune time when conditions in international debt markets are still favourable and before the European Central Bank's stress tests. The successful completion of the capital increase will strengthen the bank and allow it to continue with the restructuring of its balance sheet, the deleveraging of its loan book and the repositioning of its operations with a primary focus on the domestic economy.

The capital increase comprises three phases. The first phase of the private placement had been completed successfully. The second phase of the so called claw back, which placed the private placement of the first phase to an open offer of up to 20% of the new capital to existing shareholders, has also been completed. The third phase is a public offering to existing shareholders for an additional €100 million shares made available at the same price of the private placement and without the restriction of a minimum amount of €100 thousand of the second phase.

Investor participation in the first phase of the capital increase was very encouraging. The mix of investors that resulted from the private placement was no different than the investor mix that participated in the recent capital increases of Greek banks. It reflects the particular phase of restructuring the Bank is undergoing at present. In the case of Bank of Cyprus I note the participation of the European Bank for Reconstruction and Development as an especially positive development. The substantial participation of international investors like Wilbur Ross constitutes a vote of confidence for Bank of Cyprus and the Cyprus economy.

The final decision to proceed with a new capital increase was taken by the Board of Directors. It was not an easy decision. But after weighing all relevant factors, taking into account the challenges ahead, the risks to the economy and the uncertainties in the external environment, I have no doubt that we took the right decision.

Ladies and gentlemen

Just one year ago, the bank's future looked so uncertain, the problem of non-performing loans was mounting and funding was heavily dependent on euro area assistance. Today, one year later, the situation is a lot different. The situation we find ourselves in is still far from what can be considered normal and we continue to face difficult challenges. However, with the new capital issue complete the Bank will be one of the best capitalised in Europe. The liquidity position of the Bank will further improve and will allow us to reduce our dependence from the Eurosystem. Deposits are stabilising and whilst our non-performing loans are still excessively high, they are levelling off.

Ladies and gentlemen

The strength of the bank and its ability to perform its main role, which is the funding of the Cyprus economy, depends on the health of its balance sheet, the adequacy of its capital base and the extent of its liquidity and funding availabilities.

We have come a long way and we still have more to go. But today we can say with satisfaction that we look forward to the future with more optimism and conviction.