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Subject: State Aid SA.35334 (2018/N-2) – Cyprus – Liquidation aid for the orderly market exit of Cyprus Cooperative Bank Ltd

Sir,

1. PROCEDURE

- (1) On 24 February 2014 the European Commission (the "Commission") approved a EUR 1.5 billion recapitalisation of the Cyprus Cooperative Bank ("CCB" or "the Bank"; formerly known as "Cooperative Central Bank Ltd") as restructuring aid compatible with the internal market on the basis of Article 107(3)(b) of the Treaty on the Functioning of the European Union ("TFEU") (the "2014 decision").¹
- (2) On 18 December 2015, the Commission approved a second recapitalisation of EUR 175 million of the Bank by the Recapitalisation Fund² as restructuring aid

¹ Commission Decision of 24.2.2014; SA.35334 (2014/N); OJ C233, 18.7.2014, p. 2.

² The Recapitalisation Fund is a fund financed from the special levy imposed on credit institutions by Cypriot law, see recital 28 of the 2015 Decision

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compatible with the internal market on the basis of Article 107(3)(b) TFEU (the "2015 decision").³

- (3) On 27 April 2016, the Commission approved the amended restructuring plan resulting from the ex-post definitive valuation and ensuing re-allocation of CCB's shares (the "2016 decision").⁴
- (4) By letter dated 12 February 2018, the Cypriot authorities informed the Commission and the ECB of a potential support measure to allow for the carve-out of CCB's non-performing loans ("NPLs") to a state-supported asset management company, which in the view of the Cypriot authorities was free of State aid under Article 107(1) TFEU. However, this option was not pursued.
- (5) On 19 March 2018, a process aiming at selling all or parts of the Bank's assets and liabilities on market terms was launched by public announcement⁵(the "Sale Process").
- (6) On 2 April 2018, the Cypriot government issued nine bonds with maturities ranging from 15 to 20 years in a total nominal amount of approximately EUR 2.35 billion. These government bonds were purchased by CCB the following day. Subsequently the government deposited an equivalent cash amount of EUR 2.35 billion and additionally EUR 171 million in cash in CCB.
- (7) By letter dated 14 June 2018, the Central Bank of Cyprus informed the Commission that the Bank was in a difficult situation such that without state support in the context of the on-going Sale Process, financial stability in Cyprus would be at risk.
- (8) By letter submitted with the notification of 17 June 2018⁶, Cyprus agreed to waive its rights deriving from Article 342 TFEU in conjunction with Article 3 of Regulation 1/1958⁷ and to have the present decision adopted and notified in English.

2. BACKGROUND

2.1. The Bank and its difficulties

- (9) CCB is one of Cyprus' largest banks.⁸ It only has local residents as clients and focuses on collecting domestic deposits and lending to residents in Cyprus.
- (10) Prior to its restructuring in 2014, CCB was 100% owned by its affiliated Cooperative Credit Institutions ("CCIs") and other cooperative non-credit institutions. In line with their cooperative status, the CCIs were owned by their members who were usually also their customers.

³ Commission Decision of 18.12.2015; SA.43367 (2015/N); OJ C46, 5.2.2016, p. 13.

⁴ Commission Decision of 27.4.2016; SA.45051 (2016/N); OJ C241, 1.7.2016

⁵ See the press release of CCB, available at <http://www.ccb.coop/userfiles/93df4f45-33a6-4e45-9c09-c01795656b98/news-19032018-en.pdf>

⁶ See Annex II of the notification

⁷ Council Regulation No 1 determining the languages to be used by the European Economic Community, OJ 17, 6.10.1958, p. 385.

⁸ It has a market share of around 26% in domestic deposits and is the second largest local bank in terms of assets. See Annex I of the notification

- (11) Following the deep recession in 2012, unemployment rates in Cyprus increased and real estate demand and prices came under pressure. Consequently, a high proportion of the CCB's loan book became non-performing. The Bank needed capital injections of EUR 1.5 billion from the State to cover its losses.⁹
- (12) By the 2014 decision, the Commission approved the recapitalisation on the basis of a restructuring plan and commitments.
- (13) The recapitalisation was granted in the context of the Economic Adjustment Programme agreed in May 2013 between the Commission, the ECB, the International Monetary Fund ("IMF") and the Cypriot authorities and approved by the Council (in its Euro-area Member States composition).¹⁰
- (14) As a result of the recapitalisation, the State became the 99% shareholder of CCB, which in turn obtained control over the previously independent CCIs. In the end, as part of the burden sharing requirements, the CCIs and their individual owners were therefore diluted and only left with 1% of the shareholding. The restructuring plan also included commitments to sell or wind-down its non-core commercial operations and participations in non-core businesses,¹¹ as well as other rationalising and cost-cutting measures.¹²
- (15) In November 2015, following an on-site inspection, the ECB identified a provisioning shortfall of EUR 470 million and required CCB to submit a capital raising plan. As part of this plan, Cyprus notified an additional recapitalisation measure in the form of a capital injection of EUR 175 million.
- (16) By the 2015 decision, the Commission approved this additional recapitalisation of EUR 175 million injected by the Recapitalisation Fund.
- (17) By the 2016 decision, the Commission approved the amended restructuring plan resulting from the ex-post definitive valuation and ensuing re-allocation of CCB's shares.
- (18) As a result of the recapitalisation by the Recapitalisation Fund, the State's shareholding in CCB decreased from 99% to a level of around 77.8%, with the (state-controlled) Recapitalisation Fund holding around 21.2% of CCB. The previous CCB minority shareholders had their shareholding further diluted from 1% to around 0.8%.
- (19) As part of the restructuring plan, additional significant rationalising measures were put in place. If these measures could not be promptly implemented, Cyprus committed to complete a full legal merger of the existing 19 standalone legal entities (consisting of CCB and the CCIs) into a single entity at the latest by September 2018.¹³ In addition, Cyprus committed to either list at least 25% of the total CCB's shares on the stock exchange by September 2018, followed by

⁹ See recital (11) of the 2015 decision

¹⁰ The corresponding Memorandum of Understanding ("MoU"), setting out the underlying policy conditionality of the Programme, provided for a State-supported recapitalisation and restructuring of the Cooperative Credit Institutions and their central body, the CCB.

¹¹ See recital (59) of the 2014 decision.

¹² See recitals (68) and (69) of the 2014 decision.

¹³ See recital (26) and (27) of the 2015 decision.

subsequent listings¹⁴ or alternatively sell an equivalent part of CCB's capital to investors.¹⁵

- (20) Following the two recapitalisation measures, CCB has completed a number of elements of the restructuring plan. In particular, the operational restructuring of the group continued, notably the reduction of the number of branches, of staff and the development of a specialised internal unit in charge of managing non-performing loans. To simplify the structure of the group, to make it more efficient and to increase the chance of attracting new investors, the 19 legal entities were merged into one single legal entity on 1 July 2017.
- (21) However, CCB continued to face major difficulties. It did not succeed in reducing the extremely high ratio of NPLs that stood at 58.8% as of end-September 2017.¹⁶ In addition, the Bank did not manage to extract value from the NPLs: despite the strong economic recovery in the Cypriot economy, the very high NPL ratio shows the vast majority of the defaulted borrowers did not resume paying their loans. In addition, the Bank did not seize and sell the collateral of the defaulted loans in a short time frame. In other words, despite the fact that on paper a significant part of NPLs of the Bank are households and SME loans collateralised with real estate assets or guarantees, the Bank was unable to recover cash from that collateral in a reasonable timeframe. Despite this inability to recover cash from the NPLs, the Bank was provisioning these assets at less than 50% of their gross book value ("GBV") - the provisions booked by the Bank are reflected in a coverage ratio of 45.3%, which is below its private peers on the Cypriot market.¹⁷ In other words, in its accounts, the Bank was attributing to the NPLs a value in excess of 50% of their GBV, despite a very poor track record in terms of extracting cash from those loans.
- (22) Its failure to reduce its NPL ratio in a substantial manner despite the injection of fresh capital in 2014 and 2015 led the Bank to develop in Q3 2017 a strategy named "Agenda 2022".¹⁸ This plan notably envisaged an ambitious NPLs reduction by 76% within 5 years for the stock and a dramatic fall of the NPL ratio to 16.4%.¹⁹ However, the Bank realized that the implementation of such strategy would require non-negligible additional amount of capital. In Q3 2017, the Bank thus appointed Citigroup²⁰ as their global coordinator for a capital increase that would either have taken the form of a private placement to strategic and institutional investors or an IPO.

¹⁴ Another 25% by June 2019 and a next tranche by June 2020 until the residual combined shareholding of the Republic and the Recapitalisation Fund would not exceed 25%. See Commitment 22 of the 2015 decision

¹⁵ See Commitment 24 of the 2015 decision

¹⁶ See the latest available consolidated financial statements released by CCB (<http://www.ccb.coop/userfiles/f8ce1af3-1709-4976-a785-1a5a8d552da1/Financial-Statements-nine-months-ended-30092017.pdf>)

¹⁷ See the latest available consolidated financial statements released by CCB (<http://www.ccb.coop/userfiles/f8ce1af3-1709-4976-a785-1a5a8d552da1/Financial-Statements-nine-months-ended-30092017.pdf>)

¹⁸ See the Sept-2017 KPI reporting (https://www.ccb.coop/userfiles/f8ce1af3-1709-4976-a785-1a5a8d552da1/kyrioi_deiktes-30092017-en.pdf)

¹⁹ Information provided by the Cypriot authorities to the Commission services on November 8th, 2017

²⁰ See the Sept-2017 KPI reporting by CCB (https://www.ccb.coop/userfiles/f8ce1af3-1709-4976-a785-1a5a8d552da1/kyrioi_deiktes-30092017-en.pdf)

- (23) The ECB launched an on-site inspection in January 2018, whose results have not been finalised but seem to point to significant additional losses. According to the current estimation, this would lead to a material deterioration of CCB's capital ratios.
- (24) After the announcement of the Sale Process on 19 March 2018, CCB experienced a worsening of its funding situation. Combined with uncertainty regarding imminent supervisory action, this led to increasing deposit outflows and a decline in investor confidence in CCB. Until 2 April 2018, CCB witnessed deposit outflows of up to EUR 120 million per day.
- (25) As of February 2018, CCB had assets with a book value of EUR 12.21 billion. It had deposits of EUR 10.76 billion and gross loans in the amount of EUR 10.95 billion (out of which approx. EUR 4.69 billion were performing and EUR 6.26 billion were non-performing). As of 31 May 2018, CCB had 2,649 employees and a network comprising 172 branches in Cyprus. CCB does not have international presence. In terms of capital, as of February 2018, CCB had a total regulatory capital of EUR 1.14 billion and a CET1 ratio of 14.9%. The capital of CCB has gradually deteriorated due to the losses recorded over time, mainly driven by provisions for impairments.²¹

2.2. The Sale Process

- (26) In the 2015 decision, as part of the commitments for the restoration of market access and divestment of the stake of the state, Cyprus committed to launch the sale of its shareholding in the Bank as an alternative to its listing.
- (27) On 19 March 2018 the Sale Process for CCB was opened by public announcement.²² Citigroup, which was engaged by the Bank in 2017Q3, was appointed as its financial adviser for this operation.
- (28) Upon request from potential investors, a more detailed invitation for expressions of interest was shared, *inter alia*, explaining that potential investors could bid for either:
- (a) the fully licensed Bank entity effected through a control transfer by way of acquisition of all, or majority of, or increase of share capital; or
 - (b) all or parts of CCB's assets and liabilities – through an orderly transfer of such assets and liabilities and network (including branches and employees) in the case of the purchaser being a licensed credit institution in the European Union (the "Transaction").²³
- (29) By 29 March 2018, 16 expressions of interest were received, of which eight did not qualify for the next stage of the process.²⁴ One further potential investor

²¹ See Annex I of the notification

²² See the press release of CCB, available at <http://www.ccb.coop/userfiles/93df4f45-33a6-4e45-9c09-c01795656b98/news-19032018-en.pdf>

²³ See presentation prepared by Citi Investment Banking on *Project Coral: Process Update* dated 11 May 2018, attached as Annex 1.2 of the notification.

²⁴ These 8 expressions of interest did not qualify as they i) were interested only in certain limited assets that were not within the defined transaction perimeter, ii) were submitted post the deadline for submission or iii) failed to provide the required information.

withdrew from the process by revoking its non-disclosure Agreement. As a result, seven potential investors were granted access to CCB's Virtual Data Room ("VDR") and were provided with a process letter (the "Process Letter")²⁵ on 4 April 2018. The Process Letter set a deadline of 11 April 2018 for prospective investors to submit a reaffirmation of interest as well as explanatory notes on certain key topics, and 30 April 2018 as the deadline for submitting binding offers.

- (30) Following the deadline for reaffirmations of interest and explanatory notes, four parties were disqualified, two of which having not submitted explanatory notes, and the other two as they were interested only in certain limited assets that were not within the defined target perimeter.
- (31) The remaining investors were invited for a management presentation and expert sessions in Cyprus, with additional expert sessions with management taking place through to the deadline for binding offers.
- (32) An updated process letter was sent to potential investors on 18 April 2018,²⁶ *inter alia*, informing them that i) completion of the sales process was intended to take place on or about 7 May 2018 and that ii) potential investors were required to submit a detailed business plan covering a period of five years which would be subject to a viability and sustainability assessment by the authorities.
- (33) In the meantime, bidders were informed via an updated process letter on 25 April 2018²⁷ that the deadline for binding offers was now 14 May 2018. Consistent with the fact that the announcement of 19 March 2018 did not contain a minimum purchase price (or a requirement against a negative purchase price), the communication of 25 April 2018 further clarified that potential investors were free to make their binding offers conditional on additional state support to the acquired business. Bidders were also notified that, in line with the terms of the Government Bonds as issued, the Republic of Cyprus holds a unilateral call option to repay the Government Bonds (as defined in section 3.1) at their nominal value of EUR 2.35 billion (the "Call Option") and may exercise the Call Option within 18 months of the closing of the Transaction.
- (34) On 14 May 2018, two investors (Hellenic Bank and one US-based investment fund – "Bidder 2") presented offers ("Initial Offer"). The Initial Offer of Hellenic Bank related to the purchase of parts of the assets and liabilities it will acquire under the Transaction.
- (35) On 31 May 2018, Bidder 2 dropped out of the negotiation process, leaving Hellenic Bank as the sole remaining bidder.
- (36) After a period of negotiations, the Cypriot government reached an agreement in principle with Hellenic Bank.

²⁵ See example Process Letter attached as Annex 1.3 of the notification. One potential investor was ruled out on the basis that it revoked its Non-Disclosure Agreement to access the VDR.

²⁶ See update process letter dated 18 April 2018 attached as Annex 1.4. of the notification.

²⁷ See update process letter dated 25 April 2018 attached as Annex 1.5. of the notification.

- (37) On 17 June 2018, Cyprus notified to the Commission, among other things, (i) the agreed Business Transfer Agreement (the "BTA")²⁸; (ii) the agreed Transitional Services Agreement (the "TSA")²⁹; (iii) the agreed Asset Protection Scheme Agreement (the "APS Agreement")³⁰; (iv) the agreed form of the agreement that sets out the government guarantee (the "Government Guarantee Agreement").³¹ and (v) a draft integration plan that Hellenic Bank had submitted previously to the ECB's Single Supervisory Mechanism (the "SSM").

2.3. Description of the Buyer

- (38) Hellenic Bank ("the Buyer") is a Cypriot banking group which provides banking services to retail and corporate clients. As of December 2017, Hellenic Bank had a network of over 60 branches and employed 1,400 people. At the end of 2017, the total assets of Hellenic Bank amounted to around EUR 6.85 billion.³² It registered a net income of EUR 234 million in 2017 but a loss (after tax) of EUR 45 million. In Cyprus, Hellenic Bank had a market share of around 8% in terms of loans and 12% in terms of deposits at the end of 2017.
- (39) As of 1 June 2018, Hellenic Bank had a long-term deposit rating of Caa1 from Moody's and B from Fitch.³³

2.4. Perimeter of the transferred assets and liabilities

- (40) In the notified BTA, the Buyer has agreed to take over a specific perimeter of the assets and liabilities of CCB (the "Transferred Activities"), different from the proposed perimeter in the Initial Offer. On the assets side, the Transaction covers cash (approximately EUR 1.6 billion), government bonds, real estate assets, as well as other financial assets, performing loans, and money market placements, with a total value of approx. EUR 10.3 billion.³⁴ The transferred liabilities comprises CCB's non-governmental deposit base amounting to a total value of approximately EUR 9.7 billion, as well as EUR 66 million of other liabilities. The Transferred Activities will be acquired by the Buyer for a cash consideration of EUR 74 million (representing a multiple of around 0.3x over the target net asset value of around EUR 0.3 billion).³⁵
- (41) The acquisition of the Transferred Activities by the Buyer increases its risk-weighted assets ("RWA") which in turn results in the increase of its regulatory capital requirements by the supervisor to a CET1 ratio of 14.9%.³⁶ In order to

²⁸ See the copy of the agreement attached as Annex 1.6. of the notification.

²⁹ See the copy of the agreement attached as Annex 1.7. of the notification.

³⁰ See the copy of the agreement attached as Annex 1.11 of the notification

³¹ See the copy of the agreement provided as Annex 1.12. of the notification.

³² Source: Hellenic Bank – Presentation of 2017 results, 30 Mars 2018. See <https://www.hellenicbank.com/portalservlet/content/atom/ba122ca0-b615-4054-878e-cf272e6e3254/content/Results%202017/Report%202017/FY2017%20Audited%20Results%20Presentation%20Final.pdf?id=4a6bd774-6ff5-40a2-a6f6-a224be29fea5>

³³ Source: Hellenic Bank – Presentation of 2017 results, 30 March 2018. See <https://www.hellenicbank.com/portalservlet/content/atom/ba122ca0-b615-4054-878e-cf272e6e3254/content/Results%202017/Report%202017/FY2017%20Audited%20Results%20Presentation%20Final.pdf?id=4a6bd774-6ff5-40a2-a6f6-a224be29fea5>.

³⁴ Pre-fair value adjustment of EUR 336 million. See Annex I to the notification

³⁵ As per the BTA, the final consideration to be paid at the closing will be adjusted depending on the final net asset value of the Transferred Activities compared to the target of around EUR 0.3 billion.

³⁶ See the integration plan of Hellenic Bank submitted to the Commission.

meet this new target stemming from the acquisition of the Transferred Activities, the Buyer needs to raise EUR 150 million of CET1 capital (the "Capital Raise").

- (42) In total, the GBV of assets left in the Bank after the Transaction is completed ("Residual Entity") will amount to EUR 8.3 billion and include NPLs (EUR 7.0 billion of GBV and EUR 3.1 billion of NBV³⁷), as well as performing loans and real estate assets both amounting to a total value of ca. EUR 1.1 billion. The liabilities of CCB left in the Residual Entity will include around EUR 1.1 billion of equity and EUR 3.3 billion of government deposits.
- (43) The transfer of assets and liabilities of CCB to the Buyer will take place after the next Extraordinary General Meeting convened by Hellenic Bank on 1 August 2018 during which its shareholders are expected to approve the Capital Raise.

3. DESCRIPTION OF THE AID MEASURES

3.1. Measure A

- (44) On 2 April 2018, the Cypriot government issued nine bonds with a total nominal amount of approx. EUR 2.35 billion (the "Government Bonds issued on 2 April"). The nine bonds have a tenor ranging from 15 years to 20 years, and a coupon rate ranging respectively from 2.45% to 3.05%.
- (45) All of the Government Bonds were issued with the Call Option at par in favour of the Cypriot government.
- (46) The following day, on 3 April 2018, the Government Bonds were purchased by CCB (the "Subscription of 3 April") at par. Subsequently the Cypriot government deposited an equivalent cash amount of EUR 2.35 billion and additionally EUR 171 million in cash in CCB, hence in total approx. EUR 2.52 billion (the "Government Deposit of 3 April" or "Measure A").
- (47) The Cypriot government requested that the Bank pledged its NPL portfolio to the Government Deposit as well as other non-core assets with a total GBV of approximately EUR 7.0 billion and approximately EUR 3.1 billion of NBV with a trigger in the event of liquidation ("Pledge").
- (48) The intention of Measure A was to restore the confidence of the depositors and decrease the outflows to the normal level.³⁸

Additional public support to address the Asset-Liability Gap: Measures B to D

³⁷ Net Book Value.

³⁸ See *inter alia* Announcement by the Ministry of Finance's Press Office: "Κατάθεση εκ μέρους της Κυπριακής Δημοκρατίας, στη Συνεργατική Κυπριακή Τράπεζα" (04.04.2018), available at: <http://mof.gov.cy/en/press-office/announcements/400/?ctype=ar>; Business News: "Μην ανησυχείτε» αξίας €2,5 δις. από την Κυβέρνηση – VIDEO" (04.04.2018), available at: <http://businessnews.tothemaonline.com/economy/cyprus/2018/04/04/%C2%ABmin-anisyxeite%C2%BB-aksias-%E2%82%AC2,5-dis.-apo-tin-kybernisi-video/>; CyprusMail Online: "State's € 2.5bn for co-op 'allays depositor fears'" (04.04.2018), available at <https://cyprus-mail.com/2018/04/04/states-e2-5bn-co-op-allays-depositor-fears/>

- (49) The Buyer's Initial Offer, of 14 May 2018, identified a difference between the value of transferred liabilities and the value of transferred assets in the amount of around EUR 1.1 billion ("Asset-Liability Gap"). The difference in valuation of the transferred assets by CCB and the valuation conducted by the Buyer's independent advisors gave rise to a further increase of the Asset-Liability Gap (fair value adjustment of ca. EUR 0.3 billion). This Asset-Liability Gap would have led to a capital shortfall in CCB at the moment of transfer which would have had to be covered by the government in form of a direct cash injection.³⁹ In order to address this situation and eliminate the Asset-Liability Gap while enabling the Buyer to take onboard a significant amount of additional deposits, Cyprus will take the following range of measures.

3.2. Measure B

- (50) The Cypriot government will deposit EUR 1,020 million with CCB (the "Additional Government Deposit" or "Measure B").
- (51) The Additional Government Deposit will be secured by the Pledge which will be widened to cover also performing loans and real estate assets amounting to a total value of approx. EUR 1.1 billion.
- (52) This deposit is financed through the issuance of new government bonds in favour of CCB (described in "Measure C") for EUR 840 million and an additional cash transfer to CCB of EUR 180 million.

3.3. Measure C

- (53) The Cypriot government has accepted to improve the economic terms of existing assets held by CCB ("Improved Economic Terms" or "Measure C").
- (54) Following the signature of a Deed of Covenant,⁴⁰ the Cypriot government will issue five bonds ("the New Government Bonds"), which have a total nominal value of approximately EUR 3.19 billion and will be acquired by CCB. The Deed of Covenant also foresees that CCB may request to exchange the two longest bonds, amounting to around EUR 1.2 billion, for bonds with the same commercial terms issued under the Euro medium Term Note Programme. The New Government Bonds replace the Government Bonds issued in April 2018 for their nominal value of EUR 2.35 billion and provide an additional nominal value of EUR 840 million. The New Government Bonds have a tenor ranging from 6 months to 4.5 years and a coupon rate ranging from 1.90% to 3.50%. In comparison with the Government Bonds issued in April 2018, the new Government bonds imply a reduction in the weighted average maturity from around 17 years to around 2.5 years and an increase in the average coupon from 2.66% to 2.80%. This represents a significant improvement in the risk-reward profile of the bonds, and hence in their mark-to-market value.
- (55) The Cypriot government has accepted to amend the terms of an existing EUR [200-400] million loan granted to the Republic of Cyprus by CCB which is

³⁹ Furthermore, on the basis of guidance provided by the supervisor, the Transferred Activities required capitalisation in the amount of around EUR 0.25 billion.

⁴⁰ See the copy of the Deed of Covenant attached as Annex 1.10 of the notification.

transferred to the Buyer. The interest rate will be increased to [0-5]%. The intention of the Cypriot government is to repay the loan in cash by [...]. These amendments imply an improvement in the fair value of the loan.

3.4. Measure D

- (56) The Transaction is underpinned by 4 contracts in total:
- (a) the BTA, signed by the Bank and the Buyer, lays out the modalities of the sale of the Transferred Activities.
 - (b) the TSA, signed by the Bank and the Buyer, lays out the various services that the Bank agrees to provide the Buyer with on a transitional basis following completion of the sale.
 - (c) the APS Agreement, signed by the Bank and the Buyer, outlines the conditions of a guarantee provided by CCB against credit risk losses that will apply to a subset of the transferred assets for the benefit of the Buyer;
 - (d) the Government Guarantee Agreement, signed by the Buyer and the Cypriot Government, outlines the guarantees provided by the latter to the former so that CCB fulfils the obligations that derive from the three above contracts ("Measure D").
- (57) Measure D consists of all guarantees provided under the Government Guarantee Agreement by the Cypriot government to cover the following obligations which would fall on the Bank:
- (a) Under the BTA, any obligations to the Buyer related to CCB's representations, warranties and indemnities. These include :
 - cash needs resulting from the right for the Buyer to transfer back to the Bank (through a repurchase at fair value) any asset which was transferred to the Buyer but was an asset excluded from the perimeter of the Transferred Activities;
 - liabilities/losses related to, among others, the validity/integrity of the Transaction, the conduct of CCB prior to its completion, specific financial liabilities due by the Bank (which notably include contributions to the national Deposit Guarantee Scheme ("DGS") and Single Resolution Fund) and employee-related matters.
 - (b) Under the TSA:
 - any indemnity to the Buyer against all losses which the latter could suffer or incur from any claim brought against it by a third party which results from a breach by the Bank of the provisions related to data protection;
 - any indemnity to the Buyer against any liabilities arising from staff-related issues such as transfer, employment, termination and strikes;

- any indemnity to the Buyer against any liabilities arising from intellectual property rights of third-parties providing services to the Bank;
 - any indemnity to the Buyer against loss incurred on payments made by the Bank or through its systems to the Buyer.
- (c) Under the APS Agreement, quarterly payments to be made to the Buyer by the Bank to compensate the former for all losses incurred quarterly on the assets covered by this agreement.
- (58) As per the APS Agreement and the Government Guarantee Agreement, the Cypriot Government, CCB and Hellenic Bank will enter into an agreement for the set-up of two asset protection schemes (APS) covering risky performing and non-performing loans (the "APS Assets" - around EUR 2.8 billion of GBV or ca. 20% of CCB's total assets) which are part of the perimeter transferred to the Buyer.
- (a) APS 1: Loans with a GBV of approximately EUR 1.6 billion (consisting of NPLs and performing loans, mainly "Foreas" (loans which are subject to an unclaimed government guarantee). The fair value of these loans is ca. EUR 1.4 billion;
 - (b) APS 2: Performing loans (ca. EUR 1.1 billion of GBV and fair value of ca. EUR 1.1 billion) deemed to be of higher risk.
- (59) According to the APS Agreement, the following further key elements apply in relation to both APS 1 and APS 2:
- (a) These APS will feature a vertical loss sharing mechanism in which the Cypriot government would provide compensation for 90% of the credit risk losses that could be incurred on the assets while the Buyer would be exposed to 10 %.
 - (b) The reference portfolio value against which future claims for losses are to be made will be the fair value of the APS Assets which means that the APS will cover unexpected losses (the "APS Losses"). The potential APS Losses are not expected to exceed EUR [150-200] million in the view of the Cypriot authorities.⁴¹
 - (c) The Buyer will be entitled to include in the APS coverage any asset which was transferred to the Buyer but was an asset excluded from the Transferred Activities.
 - (d) APS 1 will have a duration of 12 years (extendable once by two years at the request of the Bank or the Buyer, subject to approval by the Cypriot government) and the cumulative losses to be paid by the Cypriot government are capped at 70% of the relevant starting reference value⁴² as determined in the APS Agreement.

⁴¹ See Annex I of the notification

⁴² Starting Reference Value for each APS Asset means the fair value of that APS Asset as finalised in the BTA.

- (e) APS 2 can only last 10 years (extendable by two years, subject to approval by the Cypriot government). The liability for the Bank, hence the State, will be capped at 60% of the relevant starting reference value as determined in the APS Agreement. Moreover, any asset covered by APS 2 that has become non-performing between 31 December 2017 and the date of closing of the Transaction will be moved to APS 1 and subject to the guarantee conditions of this APS.
- (f) The maximum outstanding liability of CCB, and hence the Cypriot government, for APS Losses after the periods below in respect of APS 2 shall be capped as follows:
- 1st to 4th anniversary of the closing : EUR [600-700] million
 - 4th to 10th anniversary of the closing : EUR [400-500] million
- or, in either case, if lower, [60-70]% of the relevant starting reference values less aggregate APS Losses for APS 2 at the relevant anniversary of closing.

4. POSITION OF CYPRUS

4.1. Position of Cyprus on the existence of aid to the Bank and on its compatibility

- (60) By letter from the Central Bank of Cyprus, the Cypriot authorities submit that the Bank's situation in terms of solvency and liquidity has been under pressure over the past few months and confirm the substantial capital needs (which has also been assessed by the ECB's on-site inspection). In this context, Cyprus argues that the failure of the Sale Process will have "serious spill-over effects to the rest of the banking system jeopardizing the country's financial stability". Thus, Cyprus argues that "the provision of state support is justified since there is a risk of a serious disturbance in the economy of Cyprus".
- (61) With regards to Measure A, Cyprus submits that it does not involve aid in favour of CCB as the Government Deposit of 3 April does not confer any advantage to the Bank. Given that the deposit is in the same amount as the Government Bonds issued on 2 April (i.e. CCB receives an equal amount of assets and liabilities), the net balance sheet effect of the Government Deposit is neutral and the coupon is at market level. The Cypriot authorities put forward that "the cash element received by CCB is limited to EUR 171 million".
- (62) Instead, Cyprus submits that the only point in time at which Measure A might amount to aid is at the point of sale of the Transferred Activities. Only then will CCB – or, more precisely, the assets and liabilities acquired – benefit from the split of the Government Bonds which will remain with the assets and liabilities acquired from the Government Deposit. Cyprus accepts that at this point in time, Measure A constitutes State aid and therefore requests the Commission to verify its compatibility with the internal market on the basis of Article 107(3)(b) TFEU.
- (63) With regards to Measure B, C and D, Cyprus accepts that all those measures constitute State aid and requests the Commission to verify its compatibility with

the internal market on the basis of Article 107(3)(b) TFEU. In the view of the Cypriot authorities, these measures were justified by the effort to reduce the Asset-Liability Gap identified by the Buyer in its Initial Offer.

4.2. Position of Cyprus on the applicability of Directive 2014/59/EU⁴³ and Regulation 806/2014⁴⁴

- (64) Cyprus submits that the present aid measures are designed and carried out under the national framework in place in February 2014, prior to the adoption of Directive 2014/59/EU ("BRRD") and of Regulation No 806/2014 ("SRMR"). According to the Cypriot authorities, since the recapitalization and the restructuring of the Bank were initiated in 2014 under the Cypriot national law,⁴⁵ the sale of the Bank which is part of the same process, remains governed by that law, and not by the SRMR and the national law transposing the BRRD.
- (65) According to the Cypriot authorities, the restructuring process of CCB commenced in 2014 and was intended to last until 31 December 2018. In its notification, Cyprus argues that the process required a number of important changes to be implemented by the Bank such as "new ownership structures; sufficient own contribution i.e. burden sharing of eligible creditors, including dilution of historical shareholders; significant reorientation of the bank's business model through a restructuring plan which involved divestments of non-core activities so as to restore viability; radical reorganization of the corporate structure of CCB's group [...] and notably a fundamental change in corporate governance and control of the CCIs and in turn of CCB itself".
- (66) In particular, Cyprus submits in its notification that the restructuring plan approved in 2014 "already contemplated the sale of the State's stake in CCB" and notably "a sale of the participation of the State in CCB (in part or in whole) via an open, transparent, non-discriminatory and unconditional competitive tender on market terms". Therefore, according to the notification, the aid measures described in the present decision are designed and are necessary to enable the completion of the Transaction and achieve compliance with the existing commitments "in the most cost-efficient manner available to the State, i.e. through a partial sale combined with an orderly wind-down and eventual market exit of the remaining assets and liabilities including the State's shareholding in CCB". Therefore the notified measures "are to be considered a continuation of the process which was already envisaged and commenced in 2014".
- (67) Given these circumstances and given that the decision to initiate the restructuring process of CCB was taken under Cypriot national law and prior to the adoption of BRRD and SRMR, Cyprus claims that the Sale Process should continue to be governed by the law applicable at the time, i.e. pre-BRRD national legal

⁴³ Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012 (OJ L 173, 12.6.2014, p. 190).

⁴⁴ Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014, p. 1).

⁴⁵ See the 2014 decision and the national laws quoted in this section.

framework applicable to bank restructuring, in order to preserve the unity and implementation of the process initiated in 2014.

- (68) Moreover, the Cypriot authorities further claim that "the Cyprus national laws (*The Resolution of Credit Institutions and Investment Firms Law of 2016*) transposing the BRRD are not applicable either. The legislative package adopted in Cyprus in 2013, consisting of *The Restructuring of Financial Institutions Law* and *The Resolution of Credit and Other Institutions Law* pursued the same objective of "safeguarding the public benefit and serving the public interest" and ensuring the continuity in the provision of critical banking or financial services. Both laws were thus part of the resolution framework in Cyprus prior to enactment of the BRRD (the *pre-BRRD resolution framework*)".
- (69) In its notification, Cyprus submits that "at the time the process for the restructuring of CCB was initiated, the former was deemed the more appropriate legal basis given that an application of the *Resolution of Credit and Other Institutions Law of 2013* may have had more serious repercussions on the stability of the financial system and/or may have resulted in higher public spending than the application of support measures pursuant to the *Restructuring of Financial Institutions Law of 2013*. In line with the scope and objectives of both laws⁴⁶, the process was hence commenced under the *Restructuring of Financial Institutions Law of 2013*, albeit within the pre-BRRD resolution framework. On that basis, the notified aid measures, whilst being part of the pre-BRRD resolution framework under Cyprus national law, do not lead to an application of *The Resolution of Credit Institutions and Investment Firms Law of 2016* as the process relating to CCB was not initiated under the *Resolution of Credit and Other Institutions Law*, but instead under *the Restructuring of Financial Institutions Law of 2013*."
- (70) Finally, Cyprus stresses that the aid measures, while being governed by the applicable national law, remain subject to the relevant EU State aid rules, especially the 2013 Banking Communication.⁴⁷

4.3. Position of Cyprus on the absence of aid to the Buyer

- (71) The Cypriot authorities submit that the sales process resulting in the Transaction was conducted in an open, transparent, non-discriminatory and competitive manner. Cyprus notably stresses in its notification that the Sale Process was visible in the market given that a public announcement was made in the national press as well as international media in order to maximise the number of potential investors.
- (72) With regard to the availability of state support, Cyprus submits that "the initial public announcement and the process letters did not include a requirement for a minimum price nor a requirement that the purchase price should not be a negative amount, which implies that all potential investors who took part in the process had the opportunity to submit bids with a negative price i.e. enter into negotiations with Cyprus on additional aid measures that could accompany the

⁴⁶ See, in particular, Art. 3(1) of *The Restructuring of Financial Institutions Law of 2013*.

⁴⁷ Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ("2013 Banking Communication") OJ C 216, 30.07.2013, p.1.

sale". In that respect, the Cypriot authorities note that all offers which were submitted contained additional state support measures.

- (73) In the Initial Offer, the Asset-Liability Gap identified by the Buyer amounted to ca. EUR 1.1 billion. Cyprus submits that Measure B, C and D would allow for the elimination of the Asset-Liability Gap. The Cypriot authorities notably argue that these aid measures are necessarily lower than the amount of aid that would have otherwise had to be provided directly in order to bridge the Asset-Liability Gap identified by the Buyer in its Initial Offer (through a cash injection by the Cypriot government).
- (74) Based on the elements above, Cyprus is of the view that the selected bid was the most economically advantageous offer which resulted from the open, transparent, non-discriminatory and competitive process.

4.4. Commitments by Cyprus

- (75) In order to substantiate a speedy and fully-fledged integration of CCB into Hellenic Bank, the compliance with State aid rules and the return of the viability of the entity resulting from the sale, Cyprus has provided a series of commitments summarized below and presented in detail in the Annex to the present decision.
- (76) Cyprus commits to ensure that the Buyer will fully integrate the Transferred Activities into its business including the migration to its own IT systems as well as full compliance with risk management policies and management systems.
- (77) Within a maximum period of 15 months after the Transaction's closing, the brand name of CCB will disappear. During this timeframe, a maximum of 75 branches of CCB (approx. 40% of the Bank's current branch network) will be rented out with an option to acquire them. Cyprus also commits that all remaining branches that will stay within CCB's Residual Entity will be shut down within these 15 months. Employees of the Residual Entity will be onboarded by the Buyer within the same timeframe after the closing and the maximum number of employees of the Residual Entity retained by the Buyer at the end of the 15-month period after the closing will not exceed 1,200.
- (78) All claims of shareholders in CCB remain in the Residual Entity. There will be no later transfer of any such claims to the Buyer, whether separately or as part of the Transferred Activities. In return for all the aid measures, the Cypriot government will receive a claim on the Residual Entity.
- (79) The Residual Entity will give up its banking authorisation or reduce the scope of such authorisation to the minimum necessary for any necessary activity during the course of the TSA between CCB and the Buyer. In any case, the banking authorisation will be withdrawn within 15 months of closing.
- (80) The Residual Entity's sole and single activity will be to manage the assets that remain in its perimeter, with the objective of divesting, liquidating or winding down the assets in an orderly manner but with a view to maximising the value to repay the State as much and as swiftly as possible. Besides fulfilling these objectives, the Residual Entity will not conduct any other economic activity, nor will it acquire clients or sell and buy products. This entails, among other things, that it will not carry out any banking business or asset management business

(including NPL management of third parties' NPLs) except if this is in favour of Hellenic Bank and covered by the terms of the TSA. Regarding real estate assets, this entails, among other things, that the Residual Entity will not carry out any economic activities in neither the residential nor commercial real estate development market.

- (81) The Residual Entity will not acquire any stake in any undertaking (except potentially in the framework of the management of its existing NPLs), be it an asset or share transfer. That ban on acquisitions covers undertakings which have the legal form of a company as well as any package of assets which form a business.
- (82) The charter/status of the Residual Entity will explicitly state that its sole objective is to maximize the proceeds from the management and disposal of its assets. The governance of the Residual Entity will be set so that the Residual Entity will be chaired and managed by highly-specialized experts with several years of international experience in the management of NPLs. Cyprus will ensure that all the board and management members are independent from the State and cannot receive any instruction from the State. Staff and management will be granted performance-based remuneration, i.e. based on the success of the workout of the assets.
- (83) The servicing of the assets will not be done in-house by the Residual Entity, but by a fully private servicing company with no financial link to the Residual Entity or to the State. This servicer will be selected through an open, transparent and unconditional tender within 15 months. The compensation of the servicer will be based on its performance to work out the assets.
- (84) The Residual Entity has the right to transfer the entire asset portfolio to any other state-owned asset management company ("AMC"), as long as the economic conditions of such a transfer do not in any way put in question the full burden sharing of the shareholders of the Bank. The conditions that define the operating conditions of the Residual Entity will also apply to a state-owned AMC that could take over the asset portfolio of the Residual Entity.
- (85) In order to eliminate the major impediments to the workout of NPLs in the country, Cyprus commits to enact far-reaching reforms that will allow an effective workout of NPLs by banks, asset managers and asset servicers, while continuing to protect the most vulnerable borrowers. The scope of these reforms will include, among other things, the legislation covering foreclosure to allow for the effective enforcement of claims, the setup of an electronic auction system for properties subject to foreclosure proceedings, a better access to the financial information of borrowers by financial institutions and a reform of the judicial process, in order to greatly increase the efficiency of handling of NPL cases by the judicial system. The latter will notably include addressing the abuse of the right to appeal court decisions, improving the court administration and functioning as well as to enhancing the use of an alternative dispute resolution processes in consumer disputes.
- (86) Cyprus commits that a Monitoring Trustee is appointed to report to the Commission on the compliance with all the commitments as listed in the Annex to the present decision.

5. ASSESSMENT OF THE MEASURES

5.1. Existence of aid

- (87) According to Article 107(1) TFEU, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.
- (88) The qualification of a measure as State aid therefore presupposes that all the following conditions are met: it must be imputable to the State and financed by a Member State or through State resources, it must grant a selective advantage susceptible to favour certain undertakings or the production of certain goods and it must distort or threaten to distort competition and have the potential to affect trade between Member States.

5.1.1. Subscription of 3 April 2018

- (89) The Government Bonds were purchased by CCB as part of private issuances by the Cypriot government. The Commission notes that the Cypriot government calibrated the pricing conditions based on a linear extrapolation of the Cypriot government yield curve. The extrapolation was based on a constant credit spread over the Portuguese yield curve. The extrapolation was needed because there are no traded Cypriot government bonds which have a maturity as long as 15 years. However, the Government Bonds issued on 2 April are private-placement illiquid securities while their coupon rates are based on the yield of tradeable liquid securities. As a consequence, CCB acquired these bonds at par with a coupon rate not higher than what a market economy investor would have required for less liquid Cypriot private Government Bonds. Hence, the Commission considers that CCB acquired an asset with a yield that is certainly not higher than market terms and therefore the Subscription of 3 April does not provide any advantage to the Bank.
- (90) As a conclusion, the Subscription of 3 April 2018 does not constitute State aid.

5.1.2. Absence of aid to the Buyer

- (91) As to whether the sale of CCB's activities supported by Measures A to D entails State aid to the Buyer, in line with points 79, 80 and 81 of the 2013 Banking Communication, the Commission has to verify that the sales process has been fair, open, competitive and transparent, that the sale happened on market terms and that the offer chosen maximises the value of the assets and liabilities sold. The assets and liabilities have been offered through the sales procedure as described in section 2.2 above.
- (92) Cyprus puts forward that the process was entirely transparent and visible in the market. In order to maximise the number of potential investors, a public announcement was made in the national press as well as international publications. The Commission observes that a wide range of international investors across Europe and the world initially expressed interest.
- (93) The Commission notes that the Process Letter specified the subject of the sale as assets and liabilities, and not only the shares of the Bank. The Process Letters

(initial and updated) did not include a requirement for a minimum price, which implies that all potential investors who took part in the process had the opportunity to submit bids with a negative price i.e. enter into negotiations with Cyprus on additional aid measures that could accompany the sale. The updated process letter of 25 April 2018 even stated explicitly that potential investors were free to make their binding offers conditional on additional state support to the acquired business.

- (94) Taking into account the above elements and circumstances, the Commission considers that the process was open, fair and transparent.
- (95) The Commission notes that there was only one fully-fledged bid for the perimeter put for sale. Regarding the minimisation of costs, the Commission takes into account that in the negotiations subsequent to receiving the binding offer, the Cypriot authorities have negotiated with the bidder to reduce the demands for State support made in the binding offer as demonstrated by the difference between the formal bid of 14 May 2018 (see recital (34)) and the BTA. For instance, new types of state support measures were introduced after the date of the formal bid of 14 May 2018, like the APS 1 and 2, but they were introduced with the goal and effect of reducing the size of state support measures requested by the Buyer in its formal bid of 14 May 2018 or with the goal and effect of convincing the Buyer to acquire more assets from CCB. There was therefore no increase of the net aid to the Transaction in the framework of the bilateral negotiations with the Buyer which took place after 14 May 2018.
- (96) On that basis, the Commission considers that the bid chosen was the best available and concludes that the Buyer is not a beneficiary of aid.

5.1.3. *Measures A to D*

5.1.3.1. State resources and imputability to the State

- (97) Measures A and B consist of deposits of State money in CCB. Therefore, Measures A and B entail the use of State resources and are imputable to the Cypriot government.
- (98) Measure C constitutes amendments of conditions that were previously agreed between the Cypriot government and CCB. The amended conditions become more favourable for CCB and, conversely, less favourable for the Cypriot government. They entail higher debt refinancing costs and risks for the State. As a result, Measure C is imputable to the Cypriot government and entails a burden on the State resources.
- (99) Measure D constitutes a direct claim against the Cypriot government budget. These are granted by the government. Thus, these measures entail the use of State resources and are imputable to the Cypriot government.

5.1.3.2. Selectivity

- (100) As the Cypriot government makes two deposits (EUR 2.52 billion and EUR 1.02 billion) in CCB, the Commission is of the view that Measures A and B are selective in nature as they were made available only to that Bank.

- (101) Measure C implies more favourable terms on assets, being them either bonds or loans, exclusively held by CCB. Thus, Measure C is selective in nature as it was made available only to the Bank.
- (102) Measure D will cover losses stemming from a selection of CCB's assets. It also protects the Bank from a range of liabilities/losses that could materialize in the course of the integration into the Buyer. Hence, the Commission considers Measure D to be selective in nature as it will only apply to CCB.

5.1.3.3. Presence of an advantage

- (103) As regards the existence of an advantage in favour of CCB, a number of elements indicate that Measures A and B have not been implemented on market terms.
- (104) First, the Commission notes that the Cypriot government took the decision to deposit money in the Bank precisely when other depositors were withdrawing their funds. The Cypriot government also publicly stated that the government deposit was made in order to "guarantee [depositors] from any theoretical risk".⁴⁸ This strongly suggests that the State did not act as a market economy operator when granting Measure A. The same reasoning applies to Measure B.
- (105) Second, the Commission observes that the Government Deposit of 3 April was made only a few days after Moody's Investors downgraded the baseline credit assessment of CCB to 'ca' from 'caa2' as well as placed the Bank's deposit ratings under review. The Additional Government Deposit was granted only a few weeks after the previous one. This means that in both instances the State deposited its money in a very risky bank, having a high probability of default according to the rating agencies.
- (106) Thirdly, the Commission also notes that the Government Deposits are of large size in both absolute terms and in relation to the Bank's total assets (EUR 12.21 billion at the end of February 2018), i.e. around 20% of the balance sheet for the first deposit and an additional 8% for the second deposit. In the Commission's view, it is unlikely that a market economy investor would make a deposit of such size to a bank of that size, even more since this bank is very risky.
- (107) Regarding the riskiness of both deposits made by the State, it can also be observed that the Bank had no senior debt, no subordinated debt, and an amount of capital which could be eroded by the findings of the on-site inspection of the supervisor, which are expected to identify significant under provisioning in the Bank. It means that, in case of insolvency, the deposits were not protected by a significant buffer of more junior liabilities. It is true that the government deposit of Measure A and Measure B are secured with the Pledge which initially covered a total of GBV EUR 7.0 billion of mostly NPL (estimated NBV of EUR 3.1 billion), and was subsequently widened with respect to Measure B, covering additional loans and real estate assets for a total value of approximately EUR 1.1 billion. However, those assets, and especially the NPL, cannot be sold rapidly due to their illiquidity and their market value is expected to be well below the nominal amount of deposits. It means that, in case of insolvency of the Bank, the State

⁴⁸ See the Announcement by the Ministry of Finance's Press Office: "Κατάθεση εκ μέρους της Κυπριακής Δημοκρατίας, στη Συνεργατική Κυπριακή Τράπεζα" (04.04.2018), available at: <http://mof.gov.cy/en/press-office/announcements/400/?ctype=ar>

would have a collateral it could not rapidly sell to recover the money. Monetizing these assets would require to start a lengthy process trying to workout or sell the NPLs, which, based on historical experience, is extremely slow, uncertain and costly in Cyprus. The Pledge therefore offers little protection to the State as depositor as it would be unable to rapidly recover the money deposited.

- (108) Based on the considerations above, the Commission concludes that the State did not behave as a market economy operator when granting Measures A and B, thereby granting an advantage to the Bank.
- (109) Measure C implies economic benefits for CCB, for example in terms of higher income and/or decreased maturities (and thus concentration risk). Such advantages have been granted by the state without any contractual obligation to do so and without any premium in exchange. The State has therefore not acted as a market economy operator with respect to Measure C, thereby granting an advantage to the Bank.
- (110) In relation to Measure D, no market economy operator would grant such a large and risky guarantee without an appropriate remuneration. Under the terms of Measure D, the State will not be remunerated. Given that no market operator provides gratuitous advantages in the market, the market operator principle does not seem applicable to this measure. In any event, even if it were applicable, the absence of remuneration shows that such guarantee would not have been provided by a market operator, and thus the market operator principle is anyway not complied with as regards Measure D. Therefore, Measure D also grants an advantage to the Bank.
- (111) With respect to Measures A, B, C and D, the Commission notes that a market economy operator owning CCB would have preferred to let the Bank fail (and thus avoid further losses) than to incur the additional significant expenses entailed by those Measures.
- (112) The Commission notes that Measure A was effective in immediately restoring confidence among depositors which were, until then, withdrawing their money at an increasing speed. In its absence, deposit outflows could have continued, potentially leading the Bank to become illiquid and thus to fail.
- (113) In addition, Measures A, B, C and D allow the Transferred Activities to be sold to a buyer. Indeed, first, Measure A covered the initial shortfall of the performing assets compared to the non-government deposits. Second, Measures B, C and D contributed to cover the residual Asset-Liability Gap identified by the Buyer in its Initial Offer. In addition, Measure D is going to decrease substantially the credit risk of the assets covered by the APS. Without Measures A, B, C, D and because of the excess of deposits compared to the performing assets which entails that the package offered would have had a negative value, it would not have been possible to find a buyer for all the deposits with matching good assets. Therefore, Measures A, B, C and D render possible that, despite its difficulty, the Transferred Activities could be sold to a buyer. In other words, without Measures A, B, C, and D, the package of assets/liabilities would not have constituted an economically interesting proposal. By extension, the Sale Process would have failed to find a suitable buyer. In such scenario, all assets and liabilities would have been left in the Bank which would then have been wound down under Cypriot national insolvency proceedings. Measures A, B, C and D therefore

provide an advantage to the Transferred Activities, which, in the absence of the sale supported by the five Measures, would have been discontinued under national insolvency proceedings.

5.1.3.4. Distortion of competition

- (114) As just concluded, Measures A, B, C and D allow some banking activities to continue, which would have otherwise been discontinued under national insolvency proceedings. The Commission therefore considers that Measures A, B, C and D distort competition.

5.1.3.5. Effect on trade

- (115) By avoiding the discontinuation of banking activities, Measures A, B, C and D are also likely to affect trade between Member States as the financial services market is open to competition from banks of other Member States and, by its nature, affects trade between Member States. Some of the direct competitors of CCB in Cyprus are subsidiaries or branches of banks established in other EU Member States.

5.1.4. Conclusion on the existence of aid

- (116) In light of all the foregoing considerations, the Commission concludes that Measures A, B, C and D constitute State aid to the Transferred Activities of the Bank within the meaning of Article 107 (1) TFEU.

5.2. Compatibility of the aid

5.2.1. Legal basis

- (117) Article 107(3)(b) TFEU enables the Commission to find aid compatible with the internal market if it is "to remedy a serious disturbance in the economy of a Member State."
- (118) The Commission has acknowledged that the global financial crisis may create a serious disturbance in the economy of a Member State, which can be addressed through State measures supporting financial institutions. This has been successively detailed and developed in the six Crisis Communications,⁴⁹ and then reconfirmed in the 2013 Banking Communication.

⁴⁹ Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis ("*2008 Banking Communication*"), OJ C 270, 25.10.2008, p. 8; Communication on the recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition ("*Recapitalisation Communication*"), OJ C 10, 15.1.2009, p. 2; Communication from the Commission on the treatment of impaired assets in the Community financial sector ("*Impaired Assets Communication*"), OJ C 72, 26.3.2009, p. 1; Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules ("*Restructuring Communication*"), OJ C 195, 19.8.2009, p. 9; Communication from the Commission on the application, from 1 January 2011, of State aid rules to support measures in favour of financial institutions in the context of the financial crisis ("*2010 Prolongation Communication*"), OJ C 329, 7.12.2010, p. 7 and Communication from the Commission on the application, from 1 January 2012, of State aid rules to support measures in favour of financial institutions in the context of the financial crisis ("*2011 Prolongation Communication*"), OJ C 356, 6.12.2011, p. 7.

- (119) By letter of the Governor of the Central Bank of Cyprus dated 14 June 2018, the Cypriot authorities submit that the failure of the Sale Process could jeopardize the country's financial stability. This provides an important indication that the provision of state support is necessary to avoid a serious disturbance in the economy of Cyprus.
- (120) In the 2013 Banking Communication, the Commission acknowledged that Member States should encourage the exit of non-viable players, while allowing for the exit process to take place in an orderly manner so as to preserve financial stability.⁵⁰
- (121) In view of the above, the Commission considers that the compatibility of the aid included in Measures A to D has to be assessed under Article 107(3)(b) TFEU. The Commission recalls that, since the beginning of the financial crisis, it has systematically used Article 107(3)(b) TFEU as legal basis to assess any restructuring or liquidation aid to banks in difficulty. Assessing the present measures under Article 107(3)(b) TFEU is therefore fully consistent with previous case practice.
- (122) The 2013 Banking Communication contains compatibility requirements for liquidation aid (section 6) but also separate compatibility requirements for liquidity support (section 4). Since Measure A is considered to be equivalent to a deposit and was granted before there was an agreement on the partial sale of the Bank to a buyer, it is necessary first to identify which of the two sections applies.
- (123) The Commission observes that, in the present case, CCB expected to face large capital needs. That is why the Sale Process was started in March 2018. The Sale Process offered not only a standard sale of the existing legal entity but also a partial sale, i.e. splitting the assets and liabilities of the Bank, partly selling them and partly letting them in the existing entity, the latter of which would then not constitute a viable entity anymore. This demonstrates that the deposits were made in an entity which was about to face huge additional capital needs and more fundamentally whose long term viability was highly uncertain. Those doubts were further amplified by increasing and unsustainable deposits outflows (see recital (24)).
- (124) Section 4 of the 2013 Banking Communication lays down compatibility requirements for "banks which have no capital shortfall". Conversely, Measure A was granted to a bank which was likely to have large capital needs and whose viability was doubtful. When granting Measure A in early April 2018, the authorities knew or should have known that there was a high likelihood that after a partial sale of CCB their new deposit could be left in a Residual Entity of CCB and that Measure A could therefore not be withdrawn anymore since the Residual Entity would have no cash to repay it. This means that the State repayment would depend on the workout of the assets left in the CCB post sale, i.e. illiquid risky and non-performing assets. Therefore, Measure A should not be assessed as a liquidity support for a going-concern under Section 4 of the 2013 Banking Communication but as liquidation aid under section 6 of the same Communication. The same reasoning applies even more to Measure B, which was granted later than Measure A, at the moment when there was an agreement on the

⁵⁰ See point 65 of the 2013 Banking Communication.

sale and liquidation of the Bank. It is therefore not a liquidity support to a bank with no capital shortfall but aid supporting the liquidation of the Bank through a partial sale and wind down of the Residual Entity.

5.2.2. *Compatibility assessment*

- (125) Section 6 of the 2013 Banking Communication sets out the State aid rules applicable to the orderly winding down of financial institutions in difficulty.
- (126) Points 71 to 78 of the 2013 Banking Communication set forth the compatibility conditions for aid measures in the context of an orderly winding down. Point 70 states that the Commission will assess the compatibility of measures aimed at resolving credit institutions on the same lines *mutatis mutandis* as set out in sections 2, 3 and 4 of the Restructuring Communication. Point 78 states that sections 3.1.2 and 3.1.3 must be complied with *mutatis mutandis*.
- (127) Therefore, the Commission will assess the compatibility of the aid measures with Article 107(3)(b) TFEU, according to the following criteria:
- (a) *Limitation of costs of winding down*: aid amounts should enable the credit institution to be wound down in an orderly fashion, while limiting the amount of aid to the minimum necessary;
 - (b) *Limitation of distortions of competition*: aid should not result in longer-term damage to the level playing field and competitive markets and measures to limit distortions of competition due to State aid have to be taken as long as the beneficiary credit institution continues to operate;
 - (c) *Own contribution (burden-sharing)*: appropriate own contribution to the costs of winding down should be provided by the aid beneficiary, particularly by preventing additional aid from being provided to the benefit of the shareholders and subordinated debt holders. Therefore, the claims of shareholders and subordinated debt holders must not be transferred to any continuing economic activity;
 - (d) *Viability of the entity resulting from the sale*: since the liquidation process entails the sale of an economic activity which holds a significant market share, viability of the entity resulting from the sale has to be verified.
- (128) Measure D consists of two asset protection schemes covering a portfolio of impaired assets of around EUR 2.8 billion of GBV. Therefore, the compatibility of Measure D must also be assessed under the Impaired Assets Communication. In the context of the present procedure, it is appropriate to examine the compatibility of Measure D with the 2013 Banking Communication and the Restructuring Communication before examining its compatibility with the Impaired Assets Communication.

5.3. Compatibility of Measures A to D under the 2013 Banking Communication and the Restructuring Communication

5.3.1. *Limitation of costs of winding down*

- (129) As described in Section 2.2, the amount of aid needed to sell the assets and liabilities of CCB has been determined by the outcome of a competitive Sale

Process with the aim of minimising the support needed for the sale. In that context, the offer that was selected minimised the charges to be borne by the Cypriot government.

- (130) The counterfactual scenario consists of the liquidation of CCB under normal insolvency proceedings under national law without any State support. Under that scenario, the liquidator would have overseen the termination of the activities, the seizure of the pledged performing assets by the secured creditors, the administration of the unencumbered assets and the activation of the DGS to protect covered depositors.
- (131) The Commission notes the substantial size of the CCB customer deposit base (more than EUR 9 billion), the vast majority of which would be covered by the DGS in case of insolvency of the CCB. However, the current funds owned by the Cypriot DGS for cooperative institutions are very limited (ca. EUR 30 million). This implies that the latter would not have been able to pay out immediately covered depositors in an insolvency scenario without resorting to additional funding from the State. Notwithstanding the risk of financial instability that might ensue following the start of insolvency proceedings, the scale of such disbursement means that the Cypriot government would have borne costs amounting to ca. 40% of GDP (stemming from the immediate reimbursement of covered depositors in liquidation). It is highly doubtful that the State could have borrowed such a large amount in a very short time on the market. In conclusion, the Commission points out that the counterfactual scenario, namely national insolvency without any State aid measures, would not have allowed the attain the same policy objectives at a lower cost for the State.
- (132) Regarding Measure D, the Commission takes positive note of the risk sharing mechanism with the Buyer (through a 10% vertical loss tranche) included in the APS which ensures that covered assets are managed with diligence by the Buyer. Moreover, the well-defined asset perimeter guaranteed by the State through the APS as well as the hard caps put a well-defined limit to the contingent exposure of the State. The Commission considers that those safeguards contribute to limit the future potential payment to be made by the Cypriot government.
- (133) In addition, the Commission positively notes the far-reaching reforms Cyprus committed to implement in its legal framework. These changes will improve the capacity of creditors to recovery money from defaulted borrowers and therefore contribute to maximize the proceeds the State will recover from the NPLs of the Residual Entity. Doing so will minimize the net costs of Measures A, B, C and D for the Cypriot government over the long term.
- (134) In light of the above, the Commission concludes that the costs for the State have been reduced to the minimum necessary to achieve its policy objectives.

5.3.2. *Limitation of distortions of competition*

- (135) The (non-contingent) State aid contained in Measure A and B amounts to roughly EUR 3.3 billion. This corresponds to around 45% of RWA of CCB as of end-June 2017.⁵¹
- (136) The Commission notes that CCB is the second largest bank in Cyprus (see recital (9)) with a substantial market share in deposits and loans. The sold activities were offered to competitors through an open Sale Process providing opportunity to any competitor to acquire the corresponding market share.
- (137) Following the sale of part of the assets and liabilities to the Buyer, CCB will cease to compete on the Cypriot banking market and will be wound down. Regarding the sale, the Commission observes that the Buyer will – over a period of a maximum of 15 months – take over less than 50% of the branches and staff of CCB. In addition, the Buyer is a bank having large activities in Cyprus and the purchased assets and liabilities will be fully integrated into the Buyer, including IT, and the brand of CCB will disappear. This means that the sale is not the continuation of the CCB activities under a new owner: the sale covers only a part of CCB and the part sold will fully disappear as a standalone competitor.
- (138) All assets, liabilities, branches and staff excluded from the acquisition will be left behind in CCB's Residual Entity. The Commitments provided by Cyprus will ensure that this entity will limit its activities exclusively to managing the assets that remain in its perimeter, with the objective of divesting, liquidating or winding them down in an orderly manner and with a view to maximising the recovery value. In particular, the aid will not be used to allow CCB's Residual Entity to continue to offer products and acquire clients. It will not compete on the market with other banks. Overall, the liquidation aid will allow CCB to achieve an orderly exit from the market with the Residual Entity being wound down overtime.
- (139) Taking into account the preceding elements, in particular the Commitments submitted by Cyprus, the open Sale Process, the full integration of those parts of CCB's activities acquired by the Buyer, the strict limitation of the activities of CCB's Residual Entity after that sale, the Commission concludes that there are no undue distortions of competition, despite the very large amount of aid.

5.3.3. *Burden-sharing*

- (140) According to the section 3.1.2 of the 2013 Banking Communication, shareholders and subordinate debt holders have to contribute to a maximum to the cost of the intervention. In this case, the shareholders will remain in the Residual Entity and will not be transferred to the Buyer. There is no subordinated debtholder on the balance sheet of CCB.
- (141) The Commission recalls that the Cypriot government, as a consequence of the new aid it will provide to CCB, in particular the government deposits (Measures A and B), will have a large claim towards CCB. Post sale of the assets and

⁵¹ See the EBA 2017 Transparency Exercise for the total RWA of CCB. State aid measures approved in the 2014 decision amounted to 13% of RWA while measures granted under the 2015 decision reached 2% of RWA.

liability to the Buyer, the Residual Entity will hold NPLs as well as – in smaller amount – real estate assets and other assets. This means that the repayment of creditors' claims essentially rely on the realisation of the risky and illiquid non-performing assets. Shareholders of CCB will recover their investment only after the State and the other creditors have been repaid in full. Hence, the Commission considers that the Bank's shareholders will contribute to the maximum extent possible to the costs of the wind down.

5.3.4. *Viability of the entity resulting from the sale*

- (142) According to the 2013 Banking Communication, if the market exit of an aided entity is fully or partly achieved through a sale to a competitor, the Commission will have to ensure that the viability of the sold aided activity is ensured through the integration efforts of the buyer.
- (143) Regarding the risk factor, the Commission observes that the Buyer will take over a perimeter of assets and liabilities (more than EUR 9 billion) larger than its own balance sheet (slightly less than EUR 7 billion). An acquisition of that size, which will materially modify the size of the Buyer, represents a challenge if not well planned. Moreover, the Buyer's loan portfolio – which is rather small compared to the Buyer's size - is burdened with a high ratio of NPLs (more than 50% as of end-2017). Finally, the Buyer has been lossmaking over the past two years. Under these circumstances, the Commission analysed the envisaged integration plan and business plan of the merged entity,⁵² to verify whether the risks factors identified above have been sufficiently addressed.
- (144) Regarding the operational integration of the acquired perimeter, the Commission notes that the Buyer is already present in the market where CCB operates, namely the banking services for retail and SME customers in Cyprus. The Buyer has therefore a detailed knowledge of the market and of the activities of CCB and has on that basis prepared a detailed integration plan covering all the aspects of the activities.⁵³ This reduces the risk represented by the large size of the acquisition.
- (145) Since they are present in the same market, the acquisition will allow the Buyer to achieve cost and revenues synergies. Besides overlaps, there is also complementarity between the two business models: the activities taken over from CCB are geared towards retail clients while the Buyer is traditionally focused on corporates and SMEs. The combined entity will therefore have a diversified and balanced business model with ca. 1/3 of its exposures to corporates, ca. 1/3 to mortgages and ca. 1/3 to consumers as well as SMEs.
- (146) Regarding revenues, the Commission notes that the Buyer expects a slight interest income to increase over the projection horizon, i.e. until 2022. This assumption is mainly based on (i) the income generation capacity of CCB's acquired performing loan book; (ii) the build-up of a substantial portfolio of European sovereign bonds by using the important cash holdings and (iii) the expansion of its new loan book.

⁵² See the integration plan of Hellenic Bank submitted to the Commission.

⁵³ The integration plan spells out the various steps needed to achieve full integration by the end of the TSA. The Commission notes that the Buyer is planning to, among others, (i) consolidate the branch network, (ii) align products and services between the two entities and (iii) implement the migration of the core banking system of CCB into the Buyer as well as (iv) undertake specific training for a smooth integration of the onboarded CCB staff.

In addition, the Buyer envisages a downward repricing of the important deposit book post-acquisition. Thanks to the combination of increased interest income and lower interest costs, the Buyer projects an increase in the net interest margin of ca. 50 basis points. Due to the synergies and the expansion of its customer base, the Buyer projects higher fee and commission income in the next five years. The share of non-interest income in banking revenues for the combined entity will be more or less stable over the years (ca. 30%).

- (147) Regarding costs, the Buyer envisages to take over less than 50% of CCB's employees and branches. This limited size in fact reduces the overall increase of operating expenses for the Buyer post-acquisition. Due to cost synergies, total operating expenses are expected to decrease over the next 5 years. Given the limited transfer of staff and branches from CCB, the cost structure of the Buyer will be lighter, with a cost-to-income ratio post-acquisition at around 60%, which is projected to decrease substantially over the years.
- (148) With regards to asset quality, despite the very large size of the acquired assets, it should be recalled that the vast majority of the NPL of CCB will not be acquired; the Buyer will acquire mainly government bonds, performing loans, liquid assets and cash. In addition, it will benefit from Measure D to cover for losses that would stem from the riskier performing loans and NPLs acquired. The combined entity will have a much lower NPL ratio (less than 25%) compared to the Buyer pre acquisition (more than 50%). In the financial forecasts of the Buyer for the merged entity, loan impairments, as reflected in the cost of risk, will be significantly lower and go down further over the projection horizon. Moreover, the Commission positively notes the far-reaching reforms planned by Cyprus under the Commitments. These changes to the domestic framework are expected to improve the capacity of the Buyer (and the rest of the Cypriot banking sector) to recover money from defaulted borrowers, which will contribute positively to the viability of the combined entity (as well as of the other Cypriot banks) and underpin the forecast of reduced loan impairment made by the Buyer for the merged entity for the coming years.
- (149) All in all, according to the integration plan prepared by the Buyer, the Return on Equity will be significant from the first year, and will steadily improve over the years. At the same time, solvency is projected to strengthen.
- (150) The Commission is of the view, in particular given the fact that (i) the Buyer takes over only the less risky assets of CCB, (ii) the Buyer takes over only less than half of the branches and staff, (iii) the acquisition allows to achieve synergies and complementarities as well as given (iv) the far-reaching reforms committed by Cyprus, the Buyer will be on a strong footing at the end of the projection horizon.
- (151) On the basis of the preceding elements, the Commission concludes that the entity resulting from partial acquisition of the CCB activities by Hellenic Bank will be viable.
- (152) This conclusion is without prejudice to the assessment by the ECB in its capacity as the Buyer's supervisor based on the applicable prudential rules.

5.3.5. Conclusion

- (153) In light of the considerations above, and given the commitments issued by Cyprus, the Commission concludes that Measures A, B, C and D meet all the conditions and requirements of the 2013 Banking Communication and the Restructuring Communication.

5.4. Compatibility of Measure D under the Impaired Assets Communication

- (154) Measure D provides the Buyer with two APS covering risky performing loans and NPLs of around EUR 2.8 billion GBV that the Buyer will take over from the Bank (see detailed description in section 3.4). For the avoidance of doubt, the Commission notes that Measure D does not cover any assets that have been held by the Buyer prior to the transaction. Therefore, the Commission hereby assesses the compatibility of Measure D under the Impaired Assets Communication.
- (155) Section 5.1. of the Impaired Assets Communication requires full ex ante transparency and disclosure of the impairments *"in order to minimise the risk of a recurrent need for State interventions in favour of the same beneficiaries"*⁵⁴. The aim of this requirement is to avoid that the same beneficiary will require further aid in the future because its difficulties have not been clearly identified and tackled at the setup of the impaired asset measure. In this regard, the Commission notes that since the Bank will exit from the market (thanks also to the aid measures including Measure D), there is no risk of further request for State aid by CCB in the present case. In the end, all of CCB's assets will be either sold and integrated into the Buyer or wound down.
- (156) Section 5.2 of the Impaired Assets Communication requires adequate burden-sharing. As the Commission already concluded in section 5.3.3, the Bank's shareholders will contribute to the maximum extent possible to the costs of the wind down as they will remain in the Residual Entity and therefore will recover their investment only after the State and the other creditors have been repaid in full. In this regard, the Commission also notes that the Bank has no subordinated debtholder, therefore the Commission considers that the required burden-sharing is achieved.
- (157) With regards to section 5.3. of the Impaired Assets Communication, the Commission notes that the Bank has without question a substantially degraded asset quality given its high NPL ratio. Therefore, there were clear grounds for CCB to benefit from asset relief. Moreover, as the Bank will exit the market, the economic positive effects of the APS will not lead to any unsustainable and distortive competitive behaviours.
- (158) With regard to the eligibility of the assets pursuant to section 5.4 of the Impaired Assets Communication, the Commission notes that the APS covers (i) non-performing loans and (ii) performing loans that the Buyer deemed to be of higher risk. The Buyer excluded part of the APS Assets from its Initial Offer and proposed to take the other part with a substantial value adjustment. The APS under Measure D were thus required to include these assets into the Transferred Activities (thereby reducing the Asset-Liability Gap) as without the measure, the

⁵⁴ See point 20 of the Impaired Assets Communication

Buyer was not willing to take part of the APS Assets onboard and was only willing to take the other part of them at a lower price than in the final offer. This demonstrates that the APS Assets carry a significant risk and are therefore eligible for protection under the Impaired Assets Communication.

- (159) Under Section 5.5. of the Impaired Assets Communication, the objective of the valuation is to calculate the amount of aid and thus the level of competition distortions for the purposes of determining how far-reaching the restructuring should be.⁵⁵ Pursuant to point 41, a transfer value exceeding the real economic value of the assets can only be accepted if it is accompanied by far-reaching restructuring.
- (160) The Commission notes that the transfer value of the APS Assets under Measure D – based on its experience of its case practice – is probably above their real economic value (the "REV"). Indeed, the State guarantees the credit losses beyond the fair value of the APS Assets set by the Buyer which is lower than the NBV attributed by the Bank to the APS Assets but nevertheless most likely higher than the REV. The Commission notes that in the present case the competition distortion is limited because the beneficiary CCB will exit from the market and the Residual Entity will no longer carry out economic activities other than the workout of its NPL portfolio. The orderly market exit can be considered to represent an as far-reaching restructuring as possible. In light of this far-reaching restructuring achieved by the market exit of the Bank, the Commission accepts that there is no need for valuation as the objective of the valuation – which is to prevent undue distortions of competition pursuant to point 37 of the Impaired Assets Communication – is already achieved. As the APS only cover CCB's assets, their objective was *in fine* to facilitate the search of a buyer and thus the market exit of the Bank. In addition, the Buyer will take over the APS assets at a more prudent valuation on its balance sheet. The Commission notes that it has accepted deviations from valuation and the REV in other liquidation aid cases based on the same reasoning.⁵⁶
- (161) Finally, with regard to section 5.6 of the Impaired Assets Communication, the Commission notes positively that the Buyer, i.e. the entity managing the APS Assets, will retain 10% of the losses vertically, on a *pari passu* basis with the Cypriot government. Thanks to this risk-sharing mechanism, the Buyer will manage the APS Assets the same way as any other of its assets, which will limit moral hazard.
- (162) On the basis of the preceding considerations, the Commission considers that Measure D is compatible with the Impaired Assets Communication.

⁵⁵ See also recital (110) of Commission Decision of 28.10.2009; Case C14/2008 (ex NN 1/2008) *Restructuring of Northern Rock*, OJ L 112, 05.05.2010, p.38

⁵⁶ See *inter alia* Commission Decision of 28.10.2009; Case C14/2008 (ex NN 1/2008) *Restructuring of Northern Rock*, OJ L 112, 05.05.2010, p.38; Commission Decision of 25.01.2010; Case NN 19/2009 *Restructuring aid to Dunfermline Building Society*, OJ C 101, 20.4.2010, p. 8.; Commission Decision of 21.12.2015; SA. 43977 (2015/N) *Resolution of Banif – Banco Internacional do Funchal S.A.*, OJ C 183/4 20.5.2016;

5.5. Conclusion on compatibility

- (163) The Commission considers that Measures A, B, C and D are compatible with the internal market within the meaning of Article 107(3)(b) TFEU.

5.6. Monitoring

- (164) Point 88 of the 2013 Banking Communication notes that the Commission must be in a position to monitor the orderly liquidation process and its impact on competition. In that regard, the Commission takes positive note of the commitment undertaken by Cyprus to appoint a monitoring trustee to monitor the compliance with Commitments to be undertaken by the Cypriot authorities and the Buyer towards the Commission (as referenced in the Annex I to the present decision). The monitoring trustee will report to the Commission.

6. COMPLIANCE OF MEASURES A TO D WITH THE PROVISIONS OF DIRECTIVE 2014/59/EU AND REGULATION (EU) NO 806/2014

- (165) The Commission needs to assess whether the measure violates indissolubly linked provisions of Directive 2014/59/EU and Regulation (EU) No 806/2014.
- (166) That obligation is in line with the jurisprudence of the Union Courts, which have consistently held⁵⁷ “*that those aspects of aid which contravene specific provisions TFEU other than [Articles 107 and 108 TFEU] may be so indissolubly linked to the object of the aid that it is impossible to evaluate them separately to that their effect on the compatibility or incompatibility of the aid viewed as a whole must therefore of necessity be determined in the light of the procedure prescribed in [Article 108]*”.⁵⁸
- (167) To assess whether a violation of a provision of Union law is indissolubly linked to the measure, it has to be established whether the State aid measure necessarily breaches a specific provision of Union law which is relevant for the compatibility analysis under paragraphs 2 and 3 of Article 107 of the Treaty.
- (168) **Error! Reference source not found.**The Commission notes that, as claimed by the Cypriot authorities (see section **Error! Reference source not found.**), the resolution process of CCB started in 2014 on the basis of national law preceding the adoption of Directive 2014/59/EU and Regulation (EU) No 806/2014.
- (169) Namely, the restructuring plan approved by Commission decision of 24 February 2014 was based on the following laws of Cyprus: the "*Restructuring of Financial Institutions Law*, the *Law for the Establishment and Operation of a Management Unit for the Participation of the Republic of Cyprus in the Ownership Structure of Credit Institutions* and the *Directive to Cooperative Credit Institutions and the Central Body for the Affiliation of Cooperative Credit Institutions with the Central Body*, which were all adopted or amended in 2013. As observed by the ECB when it was consulted on these draft laws during the legislative process,

⁵⁷ See *inter alia* Joined Cases C-134/91 and C-135/91 *Keramina-Keramische v Greece* EU:C:1992:434, paragraph 20; Case T-184/97 *BP Chemicals v Commission* EU:T:2000:217, paragraph 55; and Case T-289/03 *BUPA and others v Commission* EU:T:2005:78, paragraphs 313 and 314.

⁵⁸ Case 74/76 *Ianelli v Meroni* EU:C:1977:51 paragraph 14.

these laws form a comprehensive legal framework for the recovery, restructuring and resolution of credit and other institutions, with a view to safeguarding the smooth operation of the financial system and serving the public interest.⁵⁹ The Commission concurs with this observation. These laws therefore constituted a separate resolution framework which, however, did not transpose Directive 2014/59/EU into national law, as at that time the Directive had not yet been adopted (adopted on 15 May 2014). Regulation (EU) No 806/2014 was also adopted later - on 15 July 2014.

- (170) When notifying the Measures, the Cypriot authorities have invoked the continuation of the initial resolution process (see recital (64)).
- (171) The Commission considers that, since the initial restructuring of CCB was based on national laws which pursued the same objectives as Directive 2014/59/EU and of Regulation (EU) 806/2014 of restoring the bank's solvency and viability and of preserving the critical functions for the economy, while ensuring, at the same time, that shareholders bear first losses, the restructuring of CCB constitutes an ongoing resolution process pursuant to national law applicable before the adoption of Directive 2014/59/EU and Regulation (EU) No 806/2014 and thus falls outside the temporal scope of the said Union legal acts.
- (172) In addition, the Commission notes that the sale of the Bank was already envisaged in the original restructuring plan of 2014 and that both the measures adopted by the Cypriot authorities in 2015 and the current Measures, are aimed at facilitating and executing such sale. This confirms that all these measures form one whole process.
- (173) The notified Measures therefore constitute the final steps of the same resolution process initiated in 2014. Since the resolution process was commenced in 2014 under national law, it continues to be governed by the law applicable at the time, i.e. the national law of Cyprus preceding the adoption of the Union legal framework governing bank recovery and resolution.
- (174) In sum, the Commission considers that, although the 2015 Decision has authorised some adjustments to the resolution process as initially planned and approved further aid measures, and although further and more extensive changes would result from the notified measures, these changes have become necessary in light of factual developments in order to complete the resolution process commenced in 2014 and do not fundamentally alter its nature. As the resolution process providing the sale of the Bank was initiated in 2014, in order to preserve the unity and implementation of the envisaged resolution process, it should continue to be governed by the law applicable at the time, i.e. national law preceding changes introduced for the purpose of transposing Directive 2014/59/EU. The resolution process provided for by Regulation (EU) No 806/2014 is not applicable either, as the credit institution in question, CCB, was placed under resolution in February 2014 by the Cypriot authorities.
- (175) Any retroactive application of Directive 2014/59/EU and Regulation (EU) No 806/2014 to a resolution process already underway would undermine the principle

⁵⁹ See opinion of the ECB of 1 February 2013 on a resolution framework for credit and other institutions (CON/2013/10), paragraph 1.1, https://www.ecb.europa.eu/ecb/legal/pdf/en_con_2013_10_f_sign.pdf.

of legal certainty, non-retroactivity and the protection of the legitimate expectations of the affected creditors.

- (176) Therefore, in the present Decision, the Commission has not identified indissolubly linked provisions of Directive 2014/59/EU and Regulation (EU) No 806/2014.

The Commission has accordingly decided:

not to raise objections to the aid on the grounds that it is compatible with the internal market pursuant to Article 107(3)(b) of the Treaty on the Functioning of the European Union

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: <http://ec.europa.eu/competition/elojade/isef/index.cfm>.

Your request should be sent electronically to the following address:

European Commission,
Directorate-General Competition
State Aid Greffe
B-1049 Brussels
Stateaidgreffe@ec.europa.eu

Yours faithfully
For the Commission

Margrethe VESTAGER
Member of the Commission



Annex: Commitments of the Cypriot authorities attached to the notification.

ANNEX

List of Commitments

DEFINITIONS

For the purpose of these Commitments, the following definitions apply:

- the "Bank": Cyprus Cooperative Bank, i.e. the existing legal entity;
- the "Sold Assets and Liabilities": the parts (assets and liabilities) of the Bank which are included in the perimeter sold to the Purchaser;
- the "Purchaser": Hellenic Bank;
- the "Residual Entity": the Bank after the sale of the Sold Assets and Liabilities to the Purchaser;
- the "Commitments": all the commitments in the present document;
- the "Decision Date": the date of adoption of the Commission's present state-aid decision (18/06/2018)

OVERARCHING COMMITMENTS

Cyprus undertakes to implement the following Commitments:

1. Cyprus confirms to have informed the Purchaser of the Commitments regarding the Sold Assets and Liabilities, including the related monitoring and reporting obligations.
2. Within 3 months of the Decision Date, Cyprus will submit to the Commission for approval the draft plans for detailing how the Residual Entity / any Asset Management Company ("AMC") that could be envisaged to manage the remaining assets will be set up and run in accordance with Commitments 10 to 20;
3. Within 1 month of the Decision Date, Cyprus will:
 - a. submit to the Commission the draft plans for the changes to be made to the Cypriot legal framework that are conducive to allow an effective workout of non-performing loans ("NPLs") in accordance with Commitment 21.
 - b. ensure that the changes to its domestic legal framework will be enacted within the timeframes envisaged in Commitment 21 and remain in place for a duration of 5 years after the Decision Date.

COMMITMENTS REGARDING THE SOLD ASSETS AND LIABILITIES (TO ENSURE THAT THE MEASURE QUALIFIES AS "LIQUIDATION AID")

4. Within 15 months as of the closing of the acquisition of the Sold Assets and Liabilities by the Purchaser ("Closing"), the Purchaser will fully integrate the Sold Assets and Liabilities into its business including the migration of the Sold Assets and Liabilities to the Purchaser's target IT systems as well as full compliance with the Purchaser's risk management policies and management systems.

5. Within maximum 15 months as of Closing, the brand name (if any) of the Sold Assets and Liabilities will disappear.
6. Within 1 day as of Closing, the Residual Entity will enter into a transitional service agreement (TSA) with the Purchaser which will last no longer than 15 months. The Residual Entity will provide the Purchaser with the relevant services to service the Sold Assets and Liabilities.
7. Under the framework of the TSA, employees of the Residual Entity will be onboarded by the Purchaser. This onboarding process will take no longer than 15 months after the Closing. The maximum number of employees of the Residual Entity retained by the Purchaser at the end of the 15-month period after Closing will not exceed 1,200.
8. A maximum of 72 branches will be rented out to the Purchaser which will have the option to take them over within 15 months after the Closing.
9. All remaining branches in the Residual Entity will be shut down 15 months after the Closing.

COMMITMENTS REGARDING THE RESIDUAL ENTITY/AMC

10. All claims of shareholders in the Bank remain in the Residual Entity. There will be no later transfer of any such claims to the Purchaser, whether separately or as part of the Sold Assets and Liabilities.
11. In return for all aid measures that Cyprus provides in the process of selling the Sold Assets and Liabilities, it must receive a claim on the Residual Entity, equivalent in amount to the value of the aid measures provided in the sale of the Sold Assets and Liabilities as assessed in the present decision.
12. The Bank's shareholding in the joint venture Altamira Asset Management (Cyprus) Ltd (Altamira Cyprus) will remain in the Residual Entity and will be liquidated/sold to a private third party within 6 months in an open, transparent and unconditional tender. The Residual Entity will neither inject capital into nor grant any loans to Altamira Cyprus. It will also not impose any staff retention obligations on the buyer.
13. The Residual Entity will give up its banking license or reduce the scope of such licence to the minimum necessary for the activity described in Commitment 14. In any case, the banking license will be fully withdrawn within 15 months of Closing.
14. The Residual Entity's sole and single activity will be to manage the assets that remain in its perimeter, with the objective of divesting, liquidating or winding down the assets in an orderly manner but with a view to maximising the value to repay the State as much and as swiftly as possible. Besides fulfilling these objectives, the Residual Entity will not conduct any other economic activity, nor will it acquire clients or sell products. This entails among others that
 - a. it will not carry out any banking business or asset management business (including NPL management of third parties' NPLs) except if this is in favour of the Purchaser and covered by the terms of the TSA for a maximum period of 15 months after the Closing.

- b. Regarding real estate assets, this entails, among other things, that the Residual Entity will not purchase raw land, construct new residential/commercial properties, or purchase existing residential/commercial properties).

In line with Commitment 6, the Residual Entity will further provide the Purchaser with the relevant services under the TSA to service the Sold Assets and Liabilities for a period of 15 months after Closing.

15. The Residual Entity will not acquire any stake in any undertaking (except potentially in the framework of the management of its existing assets), be it an asset or share transfer. That ban on acquisitions covers both undertakings which have the legal form of a company and any package of assets which forms a business.
16. The charter/status of the Residual Entity will explicitly state that its sole objective is to maximize the proceeds from the management and disposal of its assets. The governance of the Residual Entity will be set so that the Residual Entity will be chaired and managed by highly-specialized experts with several years of international experience in the management of NPLs and real estate assets. This will be demonstrated by a report from an independent recruitment firm. Cyprus will ensure that all the board and management members are independent from the State and cannot receive any instruction from the State (except when it concerns the protection of taxpayers' money and the maximization of the recovery value of the assets remaining in the Residual Entity). The entity could under no circumstances receive instruction from the State on the treatment of single loans. If the independence criterion is not yet complied with, Cyprus will ensure the necessary changes are made within 15 months after Closing. Management will be granted performance-based remuneration, i.e. based on the success of the workout of the assets.
17. The success of the Residual Entity in the work out of assets will be assessed regularly, and, on that basis, the adequacy of the strategic and business plans will be adjusted.
18. The daily management (so-called "servicing") of the assets will not be done in-house by the Residual Entity, but by a fully private servicing company with no financial link to the Residual Entity or to the State. The servicing will therefore either be done by a new servicer selected through an open, transparent and unconditional tender within 15 months or by the current servicer, Altamira Cyprus. If the current servicer is retained, the existing servicing agreement will have to be reviewed by an independent third-party expert in loan servicing within 15 months after Closing to ensure market-conformity so that it doesn't entail State aid to the servicer. The compensation of the servicer will be based on its performance to work out the assets. The closing of the asset servicing contract will take place at the latest 15 months after the Decision Date.
19. The Residual Entity has the right to transfer the entire asset portfolio to any other state-owned AMC, as long as the economic conditions of such a transfer do not in any way put in question the full burden sharing of the shareholders of the Bank.
20. The conditions listed in Commitments 13 to 19 also apply to the state-owned AMC that could take over the asset portfolio of the Residual Entity.

COMMITMENTS ON FRAMEWORK CONDITIONS TO ALLOW EFFICIENT WORKOUT OF NON-PERFORMING LOANS

21. Cyprus will take actions that will allow an effective workout of NPLs by banks, asset managers and asset servicers, while continuing to protect the most vulnerable borrowers. The scope of these reforms will include, among other things, the following commitments:
- a. Within 4 months after the Decision Date, Cyprus will amend legislation, including legislation covering foreclosure, to allow for the effective enforcement of claims.
 - i. Introduce clarifications that cases, where a Court order has been issued under the previous foreclosure procedure and a foreclosure procedure has already begun, can proceed under the new foreclosure procedure;
 - ii. Amend legislation to allow for the electronic auction of property subject to foreclosure proceedings;
 - iii. Shorten the time period needed to foreclose and allow the bank to buy the property within a period of four months beginning, six months after the first auction, in comparison to the current arrangement which foresees that the bank can buy only after one year;
 - iv. Amend the notification requirements to allow alternative means of delivery when the delivery of notices cannot be achieved due to practical impediments
 - v. The minimum reserve price for auctions will be reduced from 80% of the property's market price, to 50% after 3 months from the first auction and to no reserve price applying after 6 months from the date of the first action and no further valuation will be required under the foreclosure law;
 - vi. The following protections will be amended as indicated below:
 1. The right of borrowers, who are in financial difficulties due to the financial crisis, to apply to the Court for a suspension of enforcement, foreclosure or bankruptcy proceedings for up to 6 months will be limited so that the total cumulative suspension period for any given borrower cannot exceed 12 months; and the definition of financial crisis will be amended to refer only to events occurred in 2012 and 2013;
 2. The right of borrowers to match the price of the highest bid at a foreclosure auction of his primary residence will be limited to primary residences with a value at current market price not exceeding EUR 350,000.
 - b. Within 12 months after the Decision Date, establish an electronic auction system for properties subject to foreclosure proceedings to be utilised by the AMC and banks.
 - c. Within 4 months after the Decision Date, Cyprus will amend legislation related to the sale of loans to clarify that loans considered terminated can be transferred.

- d. Within 12 months after the Decision Date, Cyprus will take measures, including where necessary to amend legislation, to improve the efficiency and effectiveness of the operation of the Insolvency Service of Cyprus and to regulate the profession of the insolvency practitioners. This will include redesigning the organisation structure to reallocate responsibilities along core and support functions to update the current action plan that aims to harmonise the procedures among the licensing authorities and all the stakeholders involved, and finally, to empower licensed insolvency practitioners through learning and development.
- e. Within 18 months after the Decision Date, Cyprus will undertake a reform of the judicial process, in order to greatly increase the efficiency of handling of NPL cases by the judicial system. This shall include:
 - i. The revision of the Rules of Civil Procedure, without infringing constitutional principles, by the end of 2019, so as to reduce the abuse of appealing Court decisions and the use of interim applications, and accelerating the execution of court judgments, thus removing impediments to the efficient handling of NPLs cases.
 - ii. accompanying measures to improve the court administration and functioning:
 1. Appoint, by the end of 2018, specific judges who will be responsible for the handling of financial disputes, inter alia, judicial procedures related to NPLs. To fulfil this task, these judges will undergo appropriate training.
 2. Updating case management procedures, starting from the clearance of backlog, including assigning case management judges to manage cases to trial, allocate cases to hearing and ensure consistency of the application of the rules of procedures.
 3. Carry out a study to examine the introduction of digital audio recording of Court proceedings. Upon completion of the study, the recommendations will be implemented, starting from the new Court buildings
 4. Introducing further measures to enhance the use of alternative dispute resolution (ADR) processes in consumer disputes through legislative measures and the revision of the Rules of Civil Procedure and providing training to judges and lawyers to encourage the use of ADR and to agree on the role of the ADR in the case management processes.
 5. Taking measures to ensure proper sizing and allocation of human resources, both in terms of judges and support capacity in the administration of the Courts.
 6. Establishing and introducing basic electronic systems by the end of 2018 to allow for a more efficient processing of applications, pending the full implementation of the e-justice system. Initiate in October 2018, the implementation of e-

justice system, provided the signing of the contract takes place as planned. By February 2019 the updated user requirements document, the Business re-engineering document, and the functional specification document to be completed and the pilot trial phase will be initiated.

- f. Within 6 months after the Decision Date, Cyprus will take steps to ensure that, in the context of NPLs, banks and the AMC will be able to access information on the financial position of the borrower, without relying solely on declarations by the borrower.

MONITORING

22. A Monitoring Trustee will be appointed to monitor the full compliance with the Commitments in accordance with the template agreement provided for as Annex hereto. The Monitoring Trustee will consist of one or more natural or legal person(s), with a significant international experience in assets' workout, independent from the Bank, the Cypriot State, the Sold Assets and Liabilities or the Residual Entity or the AMC, proposed by Cyprus and approved by the Commission. For the Commitments regarding the Sold Assets and Liabilities, the Monitoring Trustee will provide a report every 6 months and will cease to do so when these Commitments are complied with. For the Commitments regarding the Residual Entity/AMC, the Monitoring Trustee will provide an annual report on the performance of the Residual Entity/AMC in working out its NPL portfolio. The monitoring will stop when the nominal size of the loans held by the Residual Entity/AMC has been reduced by 80%. For the Commitments regarding the framework conditions, the Monitoring Trustee will provide a monthly report for the first six months, a quarterly report thereafter, and will cease to do so when every legal change envisaged in Commitment 21 is enacted by Cyprus.