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Subject: State Aid SA.49554 (2018/N) – Cyprus – Cypriot scheme for non-performing loans collateralized with primary residences (Estia)

Sir,

1. PROCEDURE

- (1) By letter dated 2 November 2018, Cyprus agreed to waive its rights deriving from Article 342 of the Treaty on the Functioning of the European Union ("TFEU") in conjunction with Article 3 of Regulation 1/1958¹ and to have the present decision adopted and notified in English.
- (2) On 7 November 2018, Cyprus notified the present primary residence protection scheme to the Commission.

2. BACKGROUND

2.1. Objective of the scheme

- (3) The main residence protection scheme (the "Scheme" or "Estia") aims to support vulnerable borrowers that encounter difficulties in repaying their loans backed by main residences.

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

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- (4) The Scheme will be administered by a dedicated State body (the "State Body"). The State Body will provide a grant to eligible borrowers to cover part of the instalments for repayment of loans and credit facilities² which are collateralised with the main residence of the borrower (or the main residence of another owner who offers it as collateral for the borrower's loan).³
- (5) The Scheme is open to all banking institutions licensed by the Central Bank of Cyprus that provided credit to eligible borrowers. It is also open to specialised NPE management companies holding eligible loans (together the "Financial Institutions").
- (6) The Financial Institutions that want to participate in the Scheme (the "Participating Institutions") shall sign a Memorandum of Understanding with the State Body.
- (7) The grant will be disbursed by the State Body in the form of annual cash payments to the Participating Institutions which have underwritten the respective loans for eligible borrowers.
- (8) Cyprus estimates that non-performing loans with a total gross value of up to EUR 3.4 billion as of 30 September 2017 are eligible under the Scheme.
- (9) Cyprus estimates that the maximum total cost for the State in the case of full participation and compliance of the borrowers will amount to approximately EUR 815 million over 25 years (approx. EUR 33 million annually) or 4% of GDP over 25 years (0.2% annually).

3. ELIGIBILITY CRITERIA

3.1. Eligible loans

- (10) Loans, issued in any currency, will be eligible if, and only if, they fulfil all the following objective criteria (the "NPE Criteria"):
 - (a) the loan is secured with a first-lien mortgage on the borrower's main residence (this is the residence used for accommodation of its owner or lessee under a financial leasing agreement as foreseen in Cypriot law for more than 6 months per year as of 30 September 2017);
 - (b) the current market value ("MV") of the main residence does not exceed EUR 350,000. This will be determined by reference to the average of two assessments, one on behalf of the Financial Institution and one on behalf of the borrower, which will be carried out by independent experts within the period of submission of applications;
 - (c) at least 20% of the total outstanding balance of the borrower's credit exposures towards the Financial Institution, in whose benefit the first rank

² Hereafter, all references to 'loans' in connection with the Scheme mean loans as well as all other credit facilities collateralised with the main residence of the borrower.

³ Hereafter all references to 'borrower(s)' in connection with the Scheme, shall include borrowers as well as owners of collateralised main residences, unless specified otherwise.

mortgage had been agreed, were over 90 days past due as of 30 September 2017. Loans that have been restructured after that date are not eligible.

3.2. Eligible borrowers

- (11) Eligible borrowers under Estia are either individuals who contracted a mortgage loan or micro businesses and small businesses which received a business loan. The Scheme has common eligibility criteria for both types of borrowers.
- (12) In addition to the NPE Criteria, borrowers will have to fulfil a set of cumulative means-based criteria to verify their income and debt-servicing capacity (the "Means Criteria").
- (a) the total gross annual household income⁴ of the borrower does not exceed
- EUR 60,000 for an applicant and his/her spouse that have at least 4 dependent family members;
 - EUR 55,000 for an applicant and his/her spouse that have 3 dependent family members;
 - EUR 50,000 for an applicant and his/her spouse that have 2 dependent family members;
 - EUR 45,000 for an applicant and his/her spouse that have 1 dependent family member;
 - EUR 35,000 for an applicant and his/her spouse without dependent family members;
 - EUR 20,000 for single applicants.
- (b) the remaining household net wealth of the borrower excluding the main residence (i.e. the household's wealth, other than the main residence, less current borrowings) should not exceed 80% of the MV of the main residence, and in any case not exceed EUR 250,000; and
- (c) the borrower has been resident in the European Union since 2013. Borrowers will still be deemed to have fulfilled this requirement in the case of (a) one month's absence abroad, (b) absence for medical reasons, and/or (c) temporary absence for educational purposes.
- (13) In the case of micro businesses and small businesses, the Means Criteria will be applied both to the small business owner as well as to the legal owner of the main residence, who will assume the responsibility to repay the restructured loan (to the extent that he/she is different from the owner of the small business). The value

⁴ A "household", for the purposes of calculating income and wealth, means the income of the borrower (and in the case of the borrower being a legal entity, of its main shareholder), his/her spouse/civil union partner and their children who have not completed 18 years of age if they were living in the same residence as the borrower as of 30 September 2017. A main shareholder means someone controlling more than 50% of a legal entity's shares.

of the business will be taken into account for calculating the wealth of the borrower.

- (14) In practice, the combination of these eligibility conditions entails that, de facto, only businesses with small size, turnover and balance sheet could be eligible to the Scheme, thus excluding large companies. Loans granted to micro & small businesses would concern either i) natural persons securing business loans with their main residence (“micro/small businessmen”); or ii) legal entities securing business loans with the main residence of their main shareholder (“micro/small businesses”). Owners/shareholders of larger businesses would not fulfil the Means Criteria, such as the maximum value of the main residence and the maximum household income/wealth of the borrower.
- (15) The NPE Criteria and the Means Criteria constitute together the "Eligibility Criteria".
- (16) Borrowers fulfilling the Eligibility Criteria (the "Eligible Borrowers") will benefit from the subsidy, provided that (i) they have submitted an application and (ii) the Financial Institution which has underwritten the respective loans is a Participating Institution in the Scheme.

4. RESTRUCTURING TERMS AND PAYMENT OF THE GRANT BY THE STATE BODY

4.1. Loan restructuring

- (17) Eligible Borrowers shall declare to the relevant Participating Institution their intention to participate in the Scheme.
- (18) The relevant Participating Institutions will be obliged to restructure the eligible loans at a total loan amount (the "Restructured Nominal Amount") equal to the lower between (i) the outstanding contractual amount of the eligible loan at the time of restructuring (the "Outstanding Nominal Amount"), and (ii) the MV of the main residence (the "Collateral's MV").⁵⁶ Consequently, under this mechanism, Participating Institutions will contribute to the Scheme through a reduction of the outstanding loan amount in cases where the MV of the main residence is lower than the outstanding amount of the loan. According to the estimation contained in the notification made by the Cypriot authorities, this reduction would amount to 32 % on average for the eligible loans.

⁵ In case the borrower’s loans are secured by further collateral securities, the relevant Participating Institution will offer an additional restructured loan at a total loan amount equal to the lower of either (i) the outstanding contractual amount of the loan at the time of restructuring (after the restructured loan which is secured by the main residence), or (ii) the market value of the collateral securities less a reduction percentage.

⁶ In case there is an outstanding amount of the loan at the date of restructuring which is not secured by other collateral securities, it will remain ‘frozen’ and will be payable to the bank in case of non-compliance with the restructured loan. If the restructured loan is fully repaid, the frozen amount will be finally deleted.

- (19) Any cash or deposits in excess of 20% of the borrower's net household wealth should be used to repay the loan before the restructuring.⁷
- (20) The interest rate of the restructured loan will be flexible throughout the repayment period, based on:
- a. For the first 7 years, Euribor plus a 2.5% margin, with a total cap of 3.5%;
 - b. Thereafter, Euribor plus a 2.0% margin (without any floor or cap).
- (21) Existing collateral/guarantees supporting the loans will be retained, but no additional collateral/guarantees will be requested from borrowers.
- (22) The above terms of the restructuring will be uniform for all borrowers except for the duration of repayment, which will take into account the age of the borrower, but will not exceed 25 years.⁸
- (23) The State Body will administer the Scheme and reserves the right to perform audit procedures, including sample audits, in order to verify the fulfilment of the Eligibility Criteria. This shall be supported by the appointment of independent external experts who will submit a relevant report to the State Body, after carrying out appropriate controls. On the basis of the expert's report, the State Body shall be entitled to take remedy measures such as the full recovery of the grant and pursuing legal means.
- (24) For the avoidance of doubt, prior to the restructuring, each Participating Institution, in line with the relevant framework of the Central Bank of Cyprus, will assess the borrower's ability to repay control the viability of the proposed restructuring and report its findings to the State Body.⁹
- (25) If the proposed restructuring is considered non-viable, the State Body will reject participation in the Scheme. The State Body will, at the end of every month within the application and evaluation period, submit to the Cypriot Ministry of Finance a full list of cases rejected on the grounds of non-viability, with the aim of assessing their potential inclusion in other complementary State plans/schemes.

4.2. Application and payment of the grant by the State Body

- (26) The initiation and the duration of the period of submission of applications to the Scheme will be publicly announced by the State Body. The period for submission of applications will be limited to three months and it will begin on the date after the public announcement of the Scheme. Application within that period shall be a condition to participation within the Scheme.

⁷ To this end, Participating Institutions can also access borrowers' accounts at other institutions.

⁸ In case a borrower is older than 65 years, a five-year repayment prolongation will be granted.

⁹ Only in cases where the viability of the restructured loan has to be ensured, the bank can take into account the ability to repay of first degree relatives of the borrower who have agreed to support the repayment of the loan as guarantors, or of the main residence owner who will become co-debtor for the loan.

- (27) A Participating Institution will collect all required information from the borrower wanting to apply for the Scheme (including payslips, tax returns, valuation reports etc. for household income and household net wealth) as well as the information required for the assessment of the borrower's financial position in accordance with the relevant directive of the Central Bank of Cyprus.
- (28) In a next step, the application and all collected information will be forwarded by the Participating Institution to the State Body on behalf of the borrower, along with (i) a recommendation by the Participating Institution on whether the borrower is eligible for the Scheme based on the Scheme's Eligibility Criteria, (ii) the results of the viability assessment performed by the Participating Institution, and (iii) in the case the borrower was assessed as viable, the restructuring solution to be offered.
- (29) The State Body will perform the necessary verifications in order to check the validity of the application and the supporting evidence submitted. This will include access, for example, to social insurance, tax authorities, or Land Registry records, other social schemes offered by other Ministries that Participating Banks do not have access to. This will also include verification of the evidence submitted as to the viability assessment of the borrower.
- (30) The State Body will evaluate the application and inform the borrower and the Participating Institution in writing of the approval or rejection of the application. The contract between the State Body and the borrower for provision of the grant will be signed promptly thereafter.
- (31) The Participating Institution shall pay a EUR 75 fee to cover the cost for the processing and evaluation of every application.
- (32) At the end of 2019, and at the end of every fiscal year thereafter until the maturity date of the restructured loan, the State Body will pay to the Participating Institution one third of the total monthly instalments (covering both principal and interest) due in a given year. This is subject to the borrower continuing to pay the remaining two thirds of the due total monthly instalments under the restructured loan.
- (33) The State Body will pay the grant at the end of every year. Before payment, the Participating Institutions will confirm in writing that two thirds of the total monthly instalments due in a given year have been paid by the borrower.
- (34) In addition, the contract signed between the State Body and the borrower will explicitly provide for a claim for the recovery of any grant payments, ranking *pari passu* along with the Bank's claims towards the borrower, in case the borrower stops paying the two thirds of the loan repayment (i.e. upon re-default).
- (35) If a borrower that benefits from the grant re-defaults under the Scheme, the Participating Institution will revert the restructured loan back to its original terms, notably reinstating the initial outstanding amount, interest rates and maturity. Borrowers and the main residence will be subject to the foreclosure process, which will be initiated promptly.

5. POSITION OF CYPRUS

- (36) Cyprus submits in its notification that the grant available under Estia does not constitute State aid within the meaning of Art.107(1) TFEU to either the Eligible Borrowers which have received a loan or the Participating Institutions that provide or hold the respective loans.
- (37) With respect to individual borrowers, Cyprus argues that only natural persons who have loans secured by their protected main residence are eligible to receive the State grant. Therefore, they cannot be regarded as undertakings within the meaning of Art. 107(1) TFEU.
- (38) With respect to micro- and small-businesses, Cyprus submits that the amount of the subsidy is restricted to one third of the borrower's repayment obligation which cannot be higher than EUR 350,000 following the mandatory restructuring described in recital (18), therefore the maximum amount of the grant cannot exceed EUR 116,666 per eligible borrower, thus the State support would qualify as *de minimis* aid under Regulation (EU) 1407/2013 ("De Minimis Regulation"). The Cypriot authorities will ensure the compliance of the Scheme insofar undertakings are concerned with the requirements of the De Minimis Regulation. In particular, they will establish a monitoring mechanism to ensure that each undertaking benefitting from the Scheme does not receive aid in excess of the *de minimis* ceiling and that the provisions on cumulation are complied with.
- (39) With respect to Financial Institutions, the Cypriot authorities submit that Estia does not entail any direct or indirect aid. Their assertion is based on the fact that the ultimate beneficiary of the grant is the Eligible Borrowers as Financial Institutions only serve as pass-through entities. In addition, the Participating Institutions will continue to bear the full risk of the restructured loans as the latter are not transferred. Finally, Cyprus submits that the grant is not selective as the Scheme will be available to all banks and NPE management companies with retail eligible loans.

6. ASSESSMENT

6.1. Existence of aid

- (40) 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.
- (41) The Scheme has been drawn up and adopted by the Cypriot government. The grant under Estia is to be disbursed by a public organisation to the Participating Institutions which thereby will receive partial reimbursement of Eligible Borrowers' loans (interest and outstanding amount). Therefore, the notified aid Scheme is created by the State and funded from the budget of the Republic of Cyprus. It follows that the measure is imputable to the State and that State resources are involved.
- (42) In the case of Estia, there are three possible groups of beneficiaries, namely individual mortgage borrowers, micro and small businesses which have received

a business loan and the Participating Institutions which underwrote and/or are holding the loans on their balance sheet.

Individual mortgage borrowers

- (43) With regard to the individual mortgage borrowers, only natural persons who reside in the property underlying the mortgage contract are eligible to participate. Therefore, they cannot be regarded as undertakings within the meaning of Article 107(1) TFEU and, thus, assistance to them falls outside the scope of State aid rules.

Micro- and small-businesses

- (44) With respect to micro and small-businesses, the support constitutes *de minimis* aid under the De Minimis Regulation. According to Article 4(1) of the De Minimis Regulation, it applies only to "transparent aid" which is defined as aid in respect of which it is possible to calculate precisely the gross grant equivalent *ex ante* without any need to undertake a risk assessment. Under the Scheme, the subsidy covers 1/3 of the outstanding amount plus 1/3 of the interests due under the restructured loans. This is economically equivalent to the repayment by the State of 1/3 of the restructured loan, subject to the borrower continuing to repay the other 2/3. As the present economic value of the restructured loans can not exceed EUR 350,000, the value of the 1/3 part that is repaid by the State can not exceed EUR 116,666. Article 3(2) of the De Minimis Regulation provides that "*the total amount of de minimis aid granted per Member State to a single undertaking shall not exceed EUR 200,000 over any period of three fiscal years*". In this context, the subsidy to micro and small businesses is within *de minimis* ceiling. Moreover, Cyprus will ensure that all requirements of the De Minimis Regulation, including cumulation, are complied with.
- (45) Therefore, as regards micro and small businesses, the Commission observes that the conditions of the De Minimis Regulation are met and, as a result, the measure at stake is deemed not to have any effect on trade between Member States and not to distort or threaten to distort competition. As the measure does not meet all the criteria laid down in Article 107(1) TFEU, it is not subject to the notification requirement under Article 108(2) TFEU.

Participating Institutions

- (46) The Scheme provides for the grant to be channelled to the eligible beneficiaries via Financial Institutions, which are considered undertakings and thus fall within the scope of State aid rules.
- (47) In assessing the economic effect of the Scheme on the Participating Institutions, the Commission observes that:
- (a) If the loans do not turn performing as a result of the Scheme, the situation for the Participating Institutions would not change as compared to the current situation; the institutions would have recourse to the loans' collateral up to their Outstanding Nominal Amount, including through the foreclosure process.
 - (b) If the loans turn performing as a result of the Scheme, the Participating Institutions will be able to restart collecting cash-flows, as long as the borrowers do not re-default, up to the loans' Restructured Nominal Amount.

This amount may be lower than the Outstanding Nominal Amount, if the latter is higher than the Collateral's MV, i.e. if the loan's equity is negative.

- (48) The Scheme would then have two opposite effects on the Participating Institutions:
- (a) On the one hand, the State subsidy will help the defaulted borrower to restart paying the restructured loans to the Participating Institutions. This entails a positive economic effect for the Participating Institutions as long as the loans' Restructured Nominal Amount is higher than the potential proceeds from the banks' recourse to the loans' collateral, including through the foreclosure process, under the current loans' terms.
 - (b) On the other hand, the Participating Institutions may give up some potential economic upside as long as the Restructured Nominal Amount is lower than the Outstanding Nominal Amount.
- (49) To the extent that the Scheme is effective in improving the perspectives of the Participating Institutions to turn the NPLs into performing loans, the positive effect (of recovering a value higher than the proceeds from the recourse to the loans' collateral and up to the Restructured Nominal Amount) would tend to prevail over the negative effect (of giving up a potential upside above the Restructured Nominal Amount and up to the Outstanding Nominal Amount). Since participation to the Scheme by Financial Institutions is voluntary, the group of Participating Institutions will reasonably encompass those Financial Institutions that have studied those two types of effects on their NPLs and expect an overall profitable outcome in their favour.
- (50) In conclusion, the Participating Institutions indirectly benefit from the Scheme and its embedded subsidies.
- (51) The advantage is selective because it is only available to Financial Institutions, as opposed to other businesses that supply goods and services, and amongst these, it is only open to those which hold loans that are secured against the borrower's main residence.
- (52) As the Scheme gives an economic advantage to the Participating Institutions who are competing on the banking market, the Commission notes that the Scheme potentially distorts competition.
- (53) Regarding trade between Member States, the Commission notes that intra-Union trade should be considered affected once a national measure reinforces the position of an undertaking as regards its competitors. It is not necessary that the beneficiary undertaking takes part itself in intra-Union trade. The circumstance that an economic sector, such as that of financial services, has been the object of a significant process of liberalisation at the level of the Union, which has accentuated competition, gives rise by its nature to a real or potential effect of aid, such as the Scheme, on trade between Member States.
- (54) Therefore, as the measure is imputable to the State, involves State resources, provides a selective advantage to certain beneficiaries engaged in an economic activity, affects trade between Member States and distorts or threatens to distort

competition in internal market, the Commission concludes that the Scheme constitutes State aid within the meaning of Article 107(1) TFEU.

7. COMPATIBILITY OF THE SCHEME

7.1. Legal basis for the compatibility assessment

- (55) It is necessary to examine the Scheme's compatibility with respect to the indirect aid to the Participating Institutions in the light of Article 107 TFEU.
- (56) With respect to the different groups of eligible beneficiaries, the compatibility of the indirect aid to the Participating Institutions will be assessed under two distinct legal bases. More specifically, with regard to individual borrowers as final beneficiaries, Article 107(2)(a) TFEU constitutes the compatibility basis. However, with regard to micro and small businesses as final beneficiaries, Article 107(3)(c) TFEU serves as the applicable compatibility basis. For the avoidance of doubt, the indirect aid to the Participating Institutions will not be assessed under Article 107(3)(b) TFEU, which is the legal basis under which the Commission has been consistently assessing any restructuring or liquidation aid to financial institutions since the beginning of the financial crisis. Therefore, the Crisis Communications¹⁰, detailing the compatibility assessment under Article 107(3)(b) TFEU are not applicable.

7.2. Compatibility of the indirect aid to the banks flowing from the support to individuals: assessment under Article 107(2)(a) TFEU

- (57) With respect to the indirect aid to Participating Institutions flowing from the support to individuals, it can benefit from the exception on aid having a social character as laid down on Article 107(2)(a) TFEU.
- (58) Article 107(2)(a) TFEU provides that *"aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned"* shall be compatible with the internal market.

¹⁰ 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; 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 and 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.

- (59) The proposed Scheme primarily intends to safeguard the main residence of borrowers from the risk of repossession. As a consequence of the crisis that Cyprus has suffered, mainly since 2012, the unemployment rate has increased while at the same time wages have decreased and house prices have fallen substantially from their pre-crisis peak. As a result, the amount of defaults on the repayment of loans has dramatically increased and the threat of repossession has emerged for a significant part of the population. To the extent that the Scheme aims at securing that households are protected from the risk of foreclosure, it reflects both short-term and long-term social concerns.
- (60) The Commission, therefore, accepts that the Scheme is predominantly of a social nature. For instance, the eligibility criteria take into account the income and wealth of the borrower's household.
- (61) The Commission also concludes that the Scheme fulfils the condition under Article 107(2)(a) TFEU that the aid must be “granted without discrimination related to the origin of the products concerned” since all mortgage lenders established in Cyprus are able to access the Scheme.
- (62) In the light of all the foregoing, the Commission concludes that the indirect aid to the financial intermediaries channelling the support to individual borrowers is deemed to be compatible pursuant to Article 107(2)(a) TFEU.

7.3. Compatibility of the indirect aid to the banks flowing from the support to micro and small businesses: assessment under Article 107(3)(c) TFEU

- (63) Article 107(3)(c) TFEU provides that "*aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest*" may be considered compatible with the internal market.
- (64) The Commission assesses the measure directly under Article 107(3)(c) TFEU following the common assessment principles. In particular, it has to analyse whether the measure contributes to a well-defined objective of common interest, whether it is appropriate with respect to the aim it desires to achieve, whether the measure is necessary and whether it is proportionate.
- (65) With regard to the objective of common interest, the Scheme aims at avoiding the foreclosure of small entrepreneurs from the house in which they live. Without it, the activation of foreclosure proceedings would likely involve serious hardships as these entrepreneurs would be evicted from their homes. Thus, the aid pursues an objective of common interest which consists in addressing the social hardships particular to the vulnerabilities faced by owners of micro and small businesses.
- (66) With regard to the appropriateness of the Scheme, the measure is suitably designed to achieve the objective of common interest, since the State will pay part of the monthly instalment due by the entrepreneurs to the Participating Institution, such that the institution does not proceed with foreclosure and seize up the residence of the entrepreneurs. Hence, the Scheme seems well-targeted and appropriate to the intended objective. The Scheme is designed in such a way so as to alleviate the current risks of foreclosure faced by entrepreneurs operating micro and small businesses.

- (67) With regard to the necessity of the Scheme, its criteria are designed so as to target vulnerable owners of those micro and small businesses only and, thus, it avoids targeting the entire stock of existing NPLs held by Cypriot Financial Institutions. In addition, the Scheme is limited to payments of part of the monthly instalment; the Participating Institutions will continue to bear the credit risk vis-à-vis such loans, for the amount of the loan still outstanding post-restructuring. This means that the risk of default is not eliminated by the Scheme.
- (68) With regard to the proportionality of the Scheme, the measure seems to be limited to what is necessary to achieve the objective pursued. The aid cannot generate unnecessary advantages to the Participating Institutions and hence cannot generate undue distortion of competition. Cyprus has estimated a budget for the grant available under the Scheme of 33 million EUR per year for a maximum of 25 years. The Eligible Loans would amount to a total of up to ca. EUR 3.4 billion, i.e. ca. 16% of Cypriot banks' total NPLs (amounting to ca. EUR 21.5 billion), or ca. 5% of total assets (amounting to ca. EUR 67.2 billion) as of end of September 2017 (i.e. the cut-off date for the eligibility of the NPLs). The amount of NPLs eventually subject to the subsidy can get reduced by the Financial Institutions' participation and the application of the Means Criteria.
- (69) In view of the above, with respect to micro and small businesses, the indirect aid to the financial intermediaries which channels the de minimis aid to those firms is compatible under Article 107(3)(c) TFEU.

8. ASSESSMENT OF THE EXISTENCE OF INTRINSICALLY LINKED PROVISION OF UNION LAW

- (70) It has been established that the Scheme provides indirectly aid to the Participating Institutions. To the extent that some Participating Institutions, notably the banks, fall into the scope of Directive 2014/59/EU¹¹, as defined in Article 1, it needs to be assessed whether such aid qualifies as "extraordinary public financial support", as defined pursuant to Article 2(28).
- (71) This is necessary because the Commission cannot approve aid as compatible with the internal market if it breaches another intrinsically linked provision of Union law.
- (72) Article 2(28) of the Directive defines extraordinary public financial support as: *"State aid within the meaning of Article 107(1) TFEU, or any other public financial support at supra-national level, which, if provided for at national level, would constitute State aid, that is provided in order to preserve or restore the viability, liquidity or solvency of an institution or entity referred to in point (b), (c) or (d) of Article 1(1) or of a group of which such an institution or entity forms part."*
- (73) That definition does not encompass any type of aid, but only aid whose objective is *"to preserve or restore the viability, liquidity or solvency"* of a bank. The Scheme's objective is two-fold depending on whether the direct beneficiary is a

¹¹ 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, OJ L 173 of 12.06.2014, p. 190.

natural person or a micro/small enterprise. In the first case, the aid objectively pursues the social goal of Article 107(2)(a) TFEU. In the second case, the aid objectively pursues the goal of addressing the social hardships particular to the vulnerabilities faced by owners of micro and small businesses under Article 107(3)(c) TFEU. Nevertheless, in both cases, the predominantly social objective indicates that the Scheme's objective is not to preserve or restore the viability, liquidity or solvency of a bank. The Participating Institutions benefit only indirectly by channelling the aid to those two categories of direct beneficiaries. This is corroborated by the fact that the aid does not qualify as one of the types of aid contemplated by the Crisis Communications, as indicated in recital (56).

- (74) Furthermore, it is expected that the size of the support to each Participating Institution would anyway not be sufficiently large to have a material effect on the viability, liquidity or solvency of the bank. As discussed in recital (66), the total budget of the Scheme is small compared to the stock of NPLs and to the size of the banks active in Cyprus. In addition, compared to the potential maximum benefit implied by the total budget, the actual benefit will be reduced by certain factors – including the number of applicants as resulting from the eligibility filters and the take-up, the actual ability of the Scheme in turning the NPLs into performing loans, the re-default rates.
- (75) In conclusion, the Scheme's objective is not to preserve or restore the viability, liquidity or solvency of a bank and it is also unlikely that it would result in any material effect on any of the financial institutions' viability, liquidity or solvency.
- (76) Therefore, the criteria for the aid to be considered as "extraordinary public financial support" are not fulfilled and the Scheme does not fall under the scope of Directive 2014/59/EU.
- (77) This assessment is without prejudice to the prerogative of the Commission to initiate infringement procedures against a Member State for breach of Union law, including breach of the provisions of Directive 2014/59/EU.

9. CONCLUSION

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(2)(a) and 107(3)(c) 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

