EUROPEAN COMMISSION

Brussels, 22.01.2013
C(2013) 313 final

Subject: State Aid SA.35852 (2012/N) - Cyprus
First prolongation of Cypriot guarantee scheme for banks H1 2013

Madam,

1. PROCEDURE

(1) On 6 November 2012 the Commission approved until 31 December 2012 the Cyprus Guarantee Scheme for banks (hereinafter "the scheme") by its decision in State aid case SA.35499 (2012/N) (hereinafter "the original decision")[1].

(2) On 6 December 2012, Cyprus notified a first prolongation of the scheme until 30 June 2013. Further information was provided on 21 and 31 December 2012.

(3) For reasons of urgency, Cyprus accepts that the present decision exceptionally is adopted in the English language.

2. FACTS

2.1. Description of the scheme

Legal basis and budget

(4) The legal basis of the scheme comprised, first, the *Law that Governs the Granting of Government Guarantees for the Conclusions of Loans and/or the Issue of Bonds by Credit Institutions* ("the Law") and, secondly, the Ministerial *Decree pursuant to section*

[1] Not yet published.

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8 of the *Law that Governs the Granting of Government Guarantees for the Conclusions of Loans and/or the Issue of Bonds by Credit Institutions* ("the Decree"), both adopted on 9 November 2012.

(5) The total budget of the scheme as adopted on 9 November 2012 amounted to only EUR 3 billion and not to EUR 6 billion as foreseen in the draft law on which the original decision was based[2]. That reduction was, according to Cyprus, the result of parliamentary discussions as a result of which it was considered that an amount of EUR 3 billion was sufficient to cover the liquidity need of credit institutions. However, additional liquidity needs arose subsequently, and an amendment of the law – providing for an additional amount of EUR 3 billion became necessary. Consequently, on 23 November 2012 an amending law (Law Amending the *Law that Governs the Granting of Government Guarantees for the Conclusions of Loans and/or the Issue of Bonds by Credit Institutions* hereinafter "the amended Law") and related Decree (*Additional Decree pursuant to section 8* of the *Law that Governs the Granting of Government Guarantees for the Conclusions of Loans and/or the Issue of Bonds by Credit Institutions* hereinafter "the additional decree") were adopted. The content of all other provisions remained unchanged in comparison with the measure approved in the original decision.[3]

(6) Thus, the total budget of the scheme is EUR 6 billion.[4]

The objective of the scheme

(7) The objective of the scheme is "to remedy the serious disturbance on the Cyprus economy"[5]. As described in the original decision, the measure should enable credit institutions to raise funding.[6] The disturbance of the Cyprus economy is ongoing. Since the original scheme came only into effect on 9 November 2012 eligible credit institutions could only make limited use of it before 31 December 2012. A prolongation beyond that date is therefore considered to be necessary by the Cyprus government.

Description of the scheme

(8) The terms and conditions of the scheme remain the same. Eligible beneficiaries are banks and cooperative credit institutions that are incorporated in the Republic of Cyprus and have been licensed by the Central Bank of Cyprus or the Commissioner[7] ("beneficiaries").

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2 See recital 9 of the original decision.

3 In that context it should be noted that pursuant to the amended law, any guarantee amount exceeding EUR 1 billion requires the prior approval of the Financial and Budgetary Committee of the House of Parliament. In the law of 9 November 2012, prior approval of that Committee was required for any guarantee amount exceeding EUR 0.5 billion.

4 Notification letter of the Governor of the Central Bank of Cyprus of 6 December 2012.

5 Notification letter of the Governor of the Central Bank of Cyprus of 6 December 2012.

6 See recital 5 of the original decision.

7 Section 3 of the Law and section 3 of the Decree.

(9) The remuneration for the guarantees will be calculated in accordance with the formula set out in the 2011 Prolongation Communication[8] and described in the original decision[9]. Since credit default swap ("CDS") data are unavailable for any of the domestic credit institutions, the Cyprus authorities will continue to determine the guarantee fee on the basis of the CDS of the sample of banks in the lowest rating buckets ("BBB and below").

(10) A detailed description of the scheme is provided in the original decision, in particular recitals 5 and 6 concerning the objective of the scheme, recital 7 concerning the legal basis and recitals 8 to 19 on the general description of the scheme.

Operation of the scheme up to 31 December 2012

(11) According to the report on the operation of the scheme until 31 December 2012 submitted by Cyprus on 31 December 2012, a total guarantee amount of EUR 1 billion has been granted so far.

3. POSITION OF CYPRUS

(12) Cyprus requests a prolongation of the scheme for a further period of six months until 30 June 2013.

(13) Cyprus submits that the scheme constitutes State aid within the meaning of Article 107(1) of the Treaty on the Functioning of the European Union ("TFEU"), but is of the view that the proposed prolongation is compatible with the internal market on the basis of Article 107(3)(b) TFEU as it is necessary in order to remedy a serious disturbance in the economy of Cyprus.

(14) Cyprus submitted a letter by the Central Bank of Cyprus further supporting the need for the proposed prolongation to safeguard the stability of the financial system in Cyprus because prevailing market conditions do not allow for a termination of the scheme.

(15) In line with the requirements of the 2011 Prolongation Communication, Cyprus provided an indicative fee (estimation) for each financial institution eligible to benefit from those guarantees. The estimation was based on an application of the scheme's remuneration formula and recent market data. The indicative guarantee fee, as submitted by Cyprus, is 81 basis points as of 6 December 2012 for all the eligible credit institutions.

(16) Cyprus submitted commitments that concern, inter alia, reporting obligations, the submission of individual restructuring or liquidation plans for banks which cause the guarantee to be called upon and the imposition of a ban on advertisement referring to the State support as well as on any aggressive commercial strategies that would not take place without State support. In addition, Cyprus committed itself to grant aid measures under the scheme only to solvent financial institutions meeting capital requirements, to

[8] Communication from the Commission on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis, OJ C 356, 6.12.2011, p. 7.

[9] Recitals 15 to 17 of the original decision.

grant the guarantees under the support scheme only for new issuance of commercial bank senior debt (subordinated debt is excluded), to provide guarantees only on debt instruments with maturities from three months up to five years (or a maximum of seven years in the case of covered bonds) and to limit the guarantees with a maturity of more than three years to one-third of the scheme's overall budget. Details of those commitments are set out in the Annex (entitled 'Commitments') to this decision.

4. ASSESSMENT

4.1. Existence of State Aid

(17) 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.

(18) For the reasons indicated in the original decision, the Commission considers that the scheme constitutes State aid within the meaning of Article 107(1) TFEU, because it concerns the provision of State resources to a certain sector, i.e. financial sector, which is open to intense international competition. Under the scheme, participating financial institutions obtain guarantees under conditions which would not be available to them under market conditions, and so receive an advantage. Given the characteristics of the financial sector, any advantage from State resources to a financial institution affects intra-Union trade and therefore threatens to distort competition. The measure therefore constitutes State aid within the meaning of Article 107(1) TFEU.

4.2. Compatibility

(19) Under the scheme Cyprus intends to provide aid in the form of guarantees in favour of credit institutions.

(20) Given the exacerbation of tensions in sovereign debt markets that has taken place since 2011, the Commission considers it appropriate to examine the measure under Article 107(3)(b) TFEU.

(21) Article 107(3)(b) TFEU empowers the Commission to find that aid is compatible with the internal market if it is intended "to remedy a serious disturbance in the economy of a Member State". The Commission has acknowledged that the global financial crisis can create a serious disturbance in the economy of a Member State and that measures supporting banks are apt to remedy that disturbance. That assessment has been confirmed in the Recapitalisation Communication[10] and the Restructuring Communication.[11] The

[10] Commission Communication - Recapitalisation of financial institutions in the current financial crisis: limitation of the aid to the minimum necessary and safeguards against undue distortions of competition, OJ C 10, 15.1.2009, p. 2.

[11] Commission Communication on the return to viability and the assessment of the restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.8.2009, p. 9.

Commission still considers that requirements for State aid to be approved pursuant to Article 107(3)(b) TFEU are fulfilled in view of the reappearance of stress in financial markets. The Commission confirmed that view by adopting the 2010 Prolongation Communication[12], which prolonged until 31 December 2011 the application of State aid rules to support measures in favour of banks in the context of the financial crisis. The Commission has since extended the application of those rules beyond 31 December 2011 under the 2011 Prolongation Communication.

(22) The Commission does not dispute the position of the Cypriot authorities that Cypriot credit institutions need to improve their funding situation to reinforce the overall financial stability of the Cypriot banking system. Hence, the Commission finds that the scheme aims at remedying a serious disturbance in the Cypriot economy.

(23) Therefore, the Commission continues to base its assessment of State aid measures in the banking sector on Article 107(3)(b) TFEU.

Appropriateness

(24) The objective of the scheme is to temporarily offer appropriate measures to establish backstops for the financial system in a timely and efficient manner, where financial institutions face difficulties in obtaining sufficient funding. The Commission observes that the continuing crisis has eroded confidence in the creditworthiness of the banks, which results in difficulties in obtaining necessary funding on the financial markets. Hence, a backstop mechanism by the Member State, which in case of urgency ensures that the banks would have access to funding, is an appropriate means to strengthen financial institutions and thus to restore market confidence.

Necessity

(25) With regard to the scope of the measure, the Commission notes positively that Cyprus has limited the size of the scheme by determining its maximum budget at EUR 6 billion and that the scheme applies until 30 June 2013.

(26) The Commission notes that Cyprus has committed to follow the pricing and other conditions for State guarantees as laid down in the 2011 Prolongation Communication which requires, in particular, the application of a new pricing method based largely on market data.

(27) The original decision observed that the Cypriot banks do not have representative CDS. In the on-going absence of any representative data, the Commission does not object to Cyprus's intention to continue determining the guarantee fee for banks on the basis of the CDS of the sample of Union banks in the "BBB- and lower" rating category. The Commission will review its assessment on the absence of representative CDS whenever a further prolongation/extension of the scheme is notified.

[12] Communication from the Commission on the application, from 1 January 2011, of State aid rules to support measures in favour of bank's in the context of the financial crisis, OJ C 329, 7.12.2010, p. 7.

(28) Therefore, the Commission considers the measure as limited to the minimum necessary.

Proportionality

(29) As regards proportionality, Cyprus committed to present a viability review for any bank that requests new guarantees under a scheme which take or keep the total amount of the bank's outstanding guaranteed liabilities above 5% of the bank's total liabilities and above the absolute amount of EUR 500 million. That commitment ensures that the use of guarantee scheme will not enable banks with structural weaknesses in their business models to postpone or avoid the necessary adjustments.

(30) Second, the Commission notes that Cyprus committed to a number of behavioural safeguards such as a ban on advertisements referring to the State support and a ban on any aggressive commercial strategies which would not take place without the State support. Such safeguards help ensure that the participating institutions do not misuse the received State support to expand their activities.

(31) Finally, the Commission welcomes that Cyprus undertakes to submit individual restructuring or liquidation plans, within six months, for banks which cause the guarantee to be called upon.

(32) As regards the combination of the scheme with other aid measures, the Commission recalls that, as indicated in the Annex to the Restructuring Communication, the restructuring plans to be submitted should contain all State aid received as individual aid or under a scheme during the restructuring period.

(33) Furthermore, based on point 16 of the Restructuring Communication, the Commission recalls that, should further aid not initially foreseen in a notified restructuring plan be necessary for the restoration of viability, such additional aid cannot be granted under an approved scheme but needs to be subject to individual ex ante notification. All State aid measures received by a bank as individual aid or under the scheme during the restructuring period will be taken into account in the Commission's final decision on that bank.

Monitoring

(34) The Commission welcomes that Cyprus undertakes to present every three months a report on the operation of the scheme and on guaranteed issuances and to complement it with updated available data on the cost of comparable (nature, volume, rating, currency) non-guaranteed debt issuances.

Conclusions on the compatibility of the aid measure

(35) The Cypriot guarantee scheme for banks remains an appropriate, necessary and proportionate measure to remedy a serious distortion of the Cypriot economy and does not alter the Commission's previous assessment in the original decision. The notified prolongation therefore complies with the requirements set out above and is compatible with the internal market pursuant to Article 107(3)(b) TFEU.

(36) In line with the Commission's decisional practice Cyprus may prolong the guarantee scheme for banks until 30 June 2013. Any further prolongation or extension will require the Commission's approval and will have to be based on a review of the developments in financial markets and the scheme's effectiveness.

5. DECISION

The Commission has accordingly decided not to raise any objections to the measure on the basis that it considers the aid to be compatible with the internal market.

Cyprus exceptionally accepts that the present decision be adopted in the English language, for reasons of urgency.

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 by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Greffe
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Fax No: +32 2 296 12 42

Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President

Annex

Commitments

Cyprus commits:

- to grant aid measures under the support scheme only to solvent financial institutions which meet capital requirements;
- to grant the guarantees under the support scheme only for new issuance of commercial bank senior debt (subordinated debt is excluded);
- to provide guarantees only on debt instruments with maturities from three months up to five years (max. seven years in the case of covered bonds) and to limit the guarantees with a maturity of more than three years to one-third of the scheme's overall budget;
- to impose a ban on advertisements referring to the State support on the beneficiaries of the scheme and to prevent them from employing any aggressive commercial strategies, which would not take place without the State support;
- to submit an individual notification if a restructuring plan has already been submitted that did not foresee the envisaged guarantee or liquidity measure;
- to submit individual restructuring or liquidation plans, within six month, for banks which cause the guarantee to be called upon;
- to determine the minimum level of State guarantee remuneration according to the formula set out in the Commission's Communication on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis[13];
- to communicate to the Commission, within three months following each issuance of guaranteed bonds, the actual fee charged;
- to report on the operation of the scheme and on guaranteed issuance by 15 April 2013 (for the period 1 January 2013 to 31 March 2013) and by 15 July 2013 (for the period 1 January to 30 June 2013) at the latest;

[13] OJ C 356, 6.12.2011, p. 7.

- to complement reports on the operation of the scheme with updated available data on the cost of comparable (nature, volume, rating, currency) non-guaranteed debt issuances;
- to present a viability review for every financial institution that is granted guarantees on new liabilities or renewed liabilities for which at the time of the granting of new guarantee, the total outstanding guaranteed liabilities (including guarantees accorded before the date of this decision) exceed both a ratio of 5% of total liabilities and the total amount of EUR 500 million. The viability review should be presented on the basis of the parameters established in the Restructuring Communication[14] within three months of the granting of the guarantees.

[14] Commission communication on the return to viability and the assessment of the restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195 of 19.8.2009, p. 9.