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Subject: State Aid SA.35334 (2018/N-3) – Cyprus – Amendment to the liquidation aid for the orderly market exit of Cyprus Cooperative Bank Ltd

Sir,

1. PROCEDURE

- (1) On 17 June 2018, Cyprus notified a number of State aid measures to facilitate the sale of Cyprus Cooperative Bank Ltd ("CCB" or the "Bank") to Hellenic Bank (the "Buyer") (the "Initial Notification").
- (2) By decision of 19 June 2018 (the "2018 Decision")¹, the Commission approved the notified measures (which were presented under 4 categories as "Measures A, B, C, D")² as liquidation aid needed for the orderly market exit of CCB.
- (3) The Initial Notification was based on draft agreements between Hellenic Bank, CCB and the Republic of Cyprus ("the parties"), the latter being also the shareholder of CCB. After the 2018 Decision, the parties continued to finetune their agreement and on 25 June 2018, the Bank and the Buyer signed a final business transfer agreement (the "BTA") with all the details on the Buyer's acquisition of certain assets and liabilities of CCB (the "Transaction"). The parties also agreed on the final form of the Asset Protection Scheme (the "APS")

¹ State Aid SA.35334 (2018/N-2) – Liquidation aid for the orderly market exit of Cyprus Cooperative Bank Ltd, not yet published

² Recitals (44) to (59) of the 2018 Decision contain a detailed description of Measures A, B, C and D.

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covering part of the transferred assets. The BTA requires, – as a condition precedent for closing – that all State aid in the Transaction is notified to the Commission and approved. The signed BTA provides that – subject to regulatory approvals – the Transaction should close on 3 September 2018 (the "Closing").

- (4) On 9 August 2018, Cyprus notified the final agreements between the parties to the Commission (the "Addendum Notification").
- (5) By letter dated 10 August 2018, Cyprus agreed to waive its rights deriving from Article 342 TFEU in conjunction with Article 3 of Regulation 1/1958³ and to have the present amendment decision adopted and notified in English.
- (6) On 22 August 2018, the Buyer's Extraordinary General Meeting approved a capital raise of EUR 150 million, which was needed to bring the Buyer's capital ratio's post-acquisition in line with regulatory requirements.

2. BACKGROUND

2.1. The Bank and its difficulties

- (7) CCB is the second largest bank of Cyprus with a market share of 25% in terms of deposits, focusing on retail deposits and lending. CCB has only local residents as clients.
- (8) In spite of two consecutive State recapitalisations –respectively in 2014 and 2015 – CCB did not succeed in returning to viability. In particular, CCB did not manage to reduce its very high ratio of non-performing loans ("NPLs"), which at the end-September 2017 still stood at 58.8% of total loans.⁴ The Bank also did not manage to extract value from its NPLs and was in particular unable to recover –in a reasonable timeframe – cash from its collateral.
- (9) The Bank and its difficulties are described in more detail in recitals (9) to (25) of the 2018 Decision.

2.2. The sale process

- (10) The difficulties of CCB eventually led to the announcement⁵ – on 19 March 2018 – of a process aiming at selling all or parts of the Bank's assets and liabilities on market terms (the "Sale Process"). The various steps of the Sale Process are described in detail in recitals (26) to (37) of the 2018 Decision.
- (11) On 14 May 2018 – the deadline by which binding bids had to be submitted –, only two investors (Hellenic Bank and "Bidder 2") presented offers. The Initial Offer of Hellenic Bank (the "Initial Offer") related to the purchase of parts of the assets and liabilities of CCB. On 31 May 2018, Bidder 2 dropped out of the negotiation process, leaving Hellenic Bank as the sole remaining bidder.

³ Council Regulation No 1 determining the languages to be used by the European Economic Community, OJ 17, 6.10.1958, p. 385.

⁴ 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>)

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

- (12) In its Initial Offer, the Buyer offered to take over a pool of assets and liabilities with the value of liabilities exceeding the value of assets by around EUR 1.1 billion. This created a so-called "Asset-Liability Gap".⁶ The Cypriot authorities were expected to close this Asset-Liability Gap by means of a direct cash injection.
- (13) The Cypriot authorities however intended to avoid or at least reduce the amount of cash to be injected and started discussions with the Buyer for alternative solutions. An APS reducing the risk related to the transferred assets, was meant to encourage the Buyer to acquire a higher amount of assets (including NPLs) and liabilities.⁷ The APS was supposed to increase the value of the transferred assets covered by its protection and to reduced the risk weights and capital requirements related to them. After intense negotiations, the Cypriot government reached an in-principle agreement with the Buyer which allowed transferring significantly more assets and liabilities compared to the Buyer's Initial Offer, without a direct cash injection. The Commission approved the APS and other measures underpinning this agreement by means of the 2018 Decision.⁸ However, at the 2018 Decision adoption date, only an agreement in principle was reached. The draft contracts were not yet signed and any of the parties, in particular the Buyer, could still withdraw from the Transaction.
- (14) Concretely, the Initial Notification and the 2018 Decision were based on :
- (i) an agreed form of the BTA ;
 - (ii) an agreed form of the Transitional Services Agreement (the "TSA");
 - (iii) an agreed form of the Asset Protection Scheme Agreement ("APS Agreement") and;
 - (iv) an agreed form of the government guarantee term (the "Government Guarantee Agreement").
- (15) Following the adoption of the 2018 Decision, the Bank, the Cypriot authorities and Hellenic Bank further finetuned their agreement and the State aid measures which were approved in the 2018 Decision. Therefore, on 9 August 2018, Cyprus notified to the Commission, amongst other, the following documents:
- (i) the amended BTA⁹;
 - (ii) the amended Transitional Services Agreement¹⁰;
 - (iii) the amended APS Term Sheet (the "Amended APS Agreement" or the "Amended APS")¹¹;

⁶ This gap was due to:

- (i) the negative difference of EUR 0.4 billion between the assets/liabilities targeted by the Buyer;
- (ii) a fair value adjustment of ca. EUR 0.3 billion; and
- (iii) a net asset value target of EUR 0.3 billion to cover the capital needs stemming from the transferred assets.

⁷ See recitals (40) and (49) of the 2018 Decision

⁸ See recitals (44) to (59) of the 2018 Decision

⁹ See the copy of the agreement attached as Annex 2 of the Addendum Notification.

¹⁰ See the copy of the agreement attached as Annex 7 of the Addendum Notification.

- (iv) the amended Deed of Guarantee (the " Amended Government Guarantee Agreement")¹²;
 - (v) two financial analyses on the losses to be covered by the APS¹³; and
 - (vi) a financial analysis on the regulatory effect of the APS.¹⁴
- (16) At the end, based on the final 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. The TSA also specifies that, within a maximum period of 15 months after the Closing, a maximum of 72 branches¹⁵ of CCB (approx. 40% of the Bank's current branch network) will be rented out to Hellenic Bank with Hellenic Bank having an option to acquire them.
- (17) In the Addendum Notification, Cyprus also informed the Commission that it will repay the government loan of Measure C by the end of 2018, while keeping the interest rate of the loan unchanged. In the Initial Notification, Cyprus had notified the amendment of the terms of an existing EUR 349 million loan granted to the Cypriot government by the Bank and included in the perimeter of assets transferred to the Buyer, which the Commission approved by the 2018 Decision as Measure C.¹⁶ An option foreseen at the time was that the interest rate would increase to 3.5%, while another option was for the Cypriot government to repay the loan in cash by the end of 2018, thereby *de facto* reducing the loan's maturity. Cyprus preferred the latter option. During the finalisation of the agreements governing the Transaction, the Buyer and the Cypriot government have agreed that the Cypriot government will repay the loan in full by the end of 2018, without amending the interest rate (i.e. from the two alternatives, the second option has been chosen).

3. AMENDMENTS TO MEASURE D

- (18) Measure D of the 2018 Decision consists of a guarantee from the Cypriot government to cover for any obligations that fall on the Bank under the BTA, the TSA and the APS Agreement.¹⁷
- (19) As regards the Government Guarantee Agreement, its final version states that payments by the Cypriot government in case of activation of the guarantee are made within 30 days (instead of within 10 days stated in the initial version). Also, Cyprus' interest obligations are calculated on the basis of the rate set pursuant to the Uniform Government Debt Interest Rate Law of 2006 (167(I)/2006)¹⁸, instead

¹¹ See the copy of the agreement attached as Annex 4 of the Addendum Notification.

¹² See the copy of the agreement provided as Annex 5 of the Addendum Notification.

¹³ See the copy of the document provided as Annex 9 and 10 to the Addendum Notification.

¹⁴ See the copy of the document provided as Annex 3 to the Addendum Notification.

¹⁵ The 2018 Decision mistakenly referred to 75 branches due to typographical error made in the urgency of the adoption process. The present Decision clarifies that the correct number of branches is 72 – as stated in Commitment 8 in the Annex of the 2018 Decision. Similarly, by typographical error, the definition of “Decision Date” in the List of Commitments annexed to the 2018 Decision refers to 18 June 2018, which however should be understood as the actual adoption date of 19 June 2018.

¹⁶ See recital (55) of the 2018 Decision

¹⁷ See recitals (56) to (59) of the 2018 Decision.

¹⁸ The abovementioned law provides for a uniform interest rate for late payment applicable to public payment obligations stemming from legislative acts. The interest rate applicable in 2018, as

of being fixed at 5% as under the initial Government Guarantee Agreement submitted in the Initial Notification.

- (20) The initial BTA, among others, provided for the compensation of the increase of contributions to the Cypriot Deposit Guarantee Scheme (the "DGS") and the Single Resolution Fund (the "SRF") to be made by the Buyer in the future. The increase of the contributions (the "DGS Payments" and the "SRF Payments") stem from the take-over of the Bank's covered deposits which are being transferred to the Buyer as part of the Transaction. The final BTA clarifies that the Bank will make a one-off payment of approximately EUR 8.6 million to the Buyer so as to indemnify the latter for the increase of the contributions it will need to pay to the the DGS. The BTA now also specifies that the SRF Payments are not covered through this one-off payment. In the end, this one-off payment replaces the series of payments¹⁹ that were featured in the agreed form of the contracts notified in the Initial Notification. The DGS Payments are covered by the (Amended) Government Guarantee Agreement, i.e. the Cypriot government will cover this payment obligation – alongside other payment obligations of CCB stemming from the three contracts – in case CCB itself is not able to honor it.
- (21) The BTA of the Initial Notification contained a condition precedent (the "APS CP") which made completion of the Transaction conditional upon the ECB (or the relevant supervisory authority) confirming that 90% of the covered transferred performing and non-performing loans (the "APS Assets") will be risk-weighted against the Republic of Cyprus, as a result of the application of the Government Guarantee Agreement and its recognition as a guarantee or credit derivative under the relevant capital requirement regulation rules^{20,21} (the "APS Regulatory Effect"). Hellenic Bank had factored in the APS Regulatory Effect in its Initial Offer of 14 May 2018.
- (22) The APS Agreement – which was part of the Initial Notification – initially covered APS Assets" with a gross book value ("GBV") of around EUR 2.8 billion (representing ca. 20% of CCB's total assets). For a more detailed description of the APS Agreement, see recitals (57) to (59) of the 2018 Decision.
- (23) The APS Assets were split in two pools:
- (a) APS 1: Loans with a GBV of ca. EUR 1.6 billion consisting of NPLs (in majority forborne) and performing loans, mainly "Foreas" (loans subject to an unclaimed government guarantee).

determined by Decree of 21 December 2017, is 3.5%, available at <http://mof.gov.cy/en/legislation/single-public-default-rate/180/?ctype=ar>

¹⁹ Clause 6(c) of the agreed form of the BTA, which was submitted with the Initial Notification, required the Bank to pay to the Buyer from time to time up to 1% of CCB's covered deposits for contributions to the DGS as well as the SRF. Under the Amended BTA this has been limited to a one-off payment of a maximum of 0.4% of CCB's covered deposits (amounting to approximately EUR 8.6 million) for contributions to the DGS (and not the SRF).

²⁰ In particular Part 3, Title 1, Chapter 4 of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L 176, 27.6.2013, p. 1–337

²¹ See Clause 4.1(n) of the amended and signed BTA provided in Annex 2 to the Addendum Notification.

- (b) APS 2: Performing loans with a GBV of ca. EUR 1.1 billion of GBV deemed to present a higher credit risk.
- (24) The initial draft APS Agreement underlying the 2018 Decision explained that the cumulative exposures of the Cypriot government under APS 1 and APS 2 were capped at respectively 70% and 60% of the respective starting reference values²² as determined in the APS Agreement.
- (25) However, following the adoption of the 2018 Decision and after further internal analysis by the Buyer, it became clear that the initial design of the APS would not achieve the required APS Regulatory Effect. Thus, the APS would have contributed to covering the Asset-Liability Gap in a lesser extent than foreseen under the Initial Notification.²³
- (26) Therefore, the initial APS Agreement had to be amended in the following manner:
- (a) the caps on both APS 1 and APS 2 were removed; but
 - (b) the parties agreed that:
 - the Buyer shall pay an admission fee of EUR 15 million to the Cypriot government following the first anniversary of Closing;
 - following the second anniversary of Closing, the Buyer may either
 - (i) remove EUR 250 million of APS Assets (by reference value) from the APS perimeter, or
 - (ii) pay a guarantee fee of EUR 17 million to the Cypriot government;
 - following the third anniversary of Closing, the Buyer may either
 - (i) remove EUR 350 million of APS Assets (by reference value) from the APS perimeter, or
 - (ii) pay a guarantee fee of EUR 23 million to the Cypriot government;
 - following each subsequent anniversary of Closing (after the third anniversary) until the 11th anniversary of Closing, Hellenic Bank shall pay to the Cypriot government a guarantee fee of EUR 1 million (i.e. maximum EUR 8 million in total) whatever the choice it made at the second and third anniversary.

4. POSITION OF CYPRUS

- (27) Cyprus accepts – as in its Initial Notification – that the measures also in their new form still constitute State aid in favour of CCB.

²² Starting Reference Value for each APS Asset means the fair value of that APS Asset as finalised in the BTA. The Reference Value of each APS Asset is based on the Starting Reference Value with further adjustments pursuant to the Amended APS Term Sheet as Annex 4 to the Addendum Notification.

²³ See the presentation *Hellenic Bank capital implications from APS* prepared by KPMG, external advisors of Hellenic Bank, dated June 2018 provided as Annex 3 to the Addendum Notification

- (28) Cyprus also repeats that aid measures in their new form are still designed and carried out under the national framework in place since February 2014, so prior to the BRRD²⁴ and SRMR²⁵.
- (29) The Cypriot authorities also maintain that the selected bid was economically the most advantageous offer in an open, transparent, non-discriminatory and competitive process, implying that none of the notified measures – also in their new form – constitute aid in favour of Hellenic Bank.
- (30) With regard to the Amended APS Agreement, Cyprus notes that it is meant to achieve the APS Regulatory Effect required by Hellenic Bank in its Initial Offer and required by the APS CP. In other words, the APS Regulatory Effect was an inherent part of the initial (negative) purchase price for the package of assets and liabilities of CCB. By removing the guarantee cap in the Amended APS Agreement, the APS Regulatory Effect can be achieved, while the other relevant terms of the Amended APS Agreement mean that this will take place without overall granting any benefits beyond the APS Regulatory Effect to Hellenic Bank or adding to the liabilities by Cyprus under the APS Agreement.
- (31) The Amended APS Agreement will produce the required APS Regulatory Effect whilst compensating Cyprus for additional costs potentially due to the caps removal.
- (32) As explained in recital (26)(b), the Amended APS Agreement implies that different options are possible. These can be summarised in the following two options²⁶:
- (a) a first option ("Option 1") in which the Buyer removes in total EUR 600 million of assets from the scope of the APS during the second and third year; under this option, the Buyer will pay a guarantee fee of EUR 15 million to the Cypriot government in the first year and EUR 1 million annually from the fourth to the 11th year, i.e. a total of EUR 23 million during of the life of the APS.
 - (b) a second option ("Option 2") in which the scope of the APS remains unchanged; under this option, the Buyer would pay an additional guarantee fee of up to EUR 17 million in the second year and of EUR 23 million in the third year, i.e. a total of EUR 63 million during of the life of the APS.

²⁴ 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, of the European Parliament and of the Council, OJ L 173, 12.6.2014, p. 190–348

²⁵ 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. 1–90

²⁶ The two options reflect the two extreme alternatives, where (1) APS assets are removed in both the second and the third year, (2) APS assets are not removed in either the second or the third year. Intermediate alternatives, such as the removal of APS assets in one year only, are also possible.

- (33) The Cypriot authorities explain that the fee structure incentivises the Buyer to choose Option 1 since, at that point in time, the cost of removing the relevant APS Assets from the APS perimeter is likely to be lower than the guarantee fee payable under Option 2 (where the APS Assets are not removed). The financial advisor of the Cypriot authorities submits that this in the end results in a lower contingent liability for Cyprus and lower pay-out by around EUR 29 million from the government.
- (34) In conclusion, Cyprus explains that the potential costs for which it may be liable under the Amended APS Agreement are expected to be lower than in the initial APS Agreement under the two scenarios of its financial advisor:²⁷
- (a) a base case scenario (the "Base Case Scenario"), where the probability of default ("PD") of the covered loans is 11%-19% and the loss-given-default ("LGD") is 17%-24%;²⁸
 - (b) a stressed scenario (the "Stressed Scenario"), where the PD is 30% and the LGD is 35%;²⁹
- (35) The financial advisor concludes that – under the the Base Case Scenario – the potential net cost for the State during the 12-year period is not expected to exceed EUR 155 million in the Amended APS compared to EUR 184 million in the initial APS Agreement; under the Stressed Scenario, the cost is not expected to exceed EUR 319 million in the Amended APS compared to EUR 447 million in the initial APS Agreement. In other words, in both scenarios, the payment of the guarantee fee exceeds Cyprus' extra potential cost from the removal of the APS cap.

5. ASSESSMENT

- (36) 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.
- (37) By means of the 2018 Decision, the Commission approved the measures that the Cypriot authorities had notified as compatible aid. Meanwhile certain parameters of Measure C were further specified and certain parameters of Measure D were amended or further specified. Therefore, the Cypriot authorities have notified those amendments and specifications with the Addendum Notification, asking the Commission to assess the compatibility of those amended measures. In the following sections, the Commission will assess whether the updated measures

²⁷ See Annex 9 to the Addendum Notification showing the initial financial analysis prepared by Grant Thornton dated 14 June 2018 in relation to the initial APS as well as Annex 10 to this Addendum showing the analysis in relation to the Amended APS.

²⁸ As for Annex 9 and 10, these compare to actual net default rates for the Bank in 2016 of 7%-10% and in 2017 of 6%-7%

²⁹ As for Annex 9 and 10, this scenario assumes PDs slightly higher than those observed during the financial crisis in 2013 and LGDs which include a 10% reduction in property values over the Base Case Scenario

still constitute State aid and, in the affirmative, whether they are still compatible with the internal market.

5.1. Aid to CCB

- (38) The specifications submitted by Cyprus on Measure C described in recital (17) do not modify the measure, as approved by the Commission in the 2018 Decision. In the Addendum Notification, Cyprus confirmed to the Commission that the early repayment of the loan has been eventually chosen from the two alternatives that had been approved by the 2018 Decision. The Commission had already assessed the amendment of the terms of the loan – including the early repayment by the Cypriot government – and had concluded that it was imputable to the State, entailed a burden on State resources, represented a selective advantage to CCB while distorting competition and affecting intra-EU trade as it made the terms more favourable for CCB (while entailing higher debt refinancing costs and risks for the State) and was part of the measures that allow the continuation of part of CCB banking activities by integration of the Transferred Activities by the Buyer.³⁰ This assessment and these conclusions remain valid and unaltered. As a result, the early repayment of the loan – the chosen form of Measure C – still entails aid to the Bank within the meaning of Article 107(1) TFEU.
- (39) The amended form of Measure D, which includes the changes to the payment conditions under the Government Guarantee Agreement as described in recital (19), the Amended APS as described in recital (26) as well as the guarantee over the updated DGS Payments, still entails aid to the Bank within the meaning of Article 107(1) TFEU.
- (40) Given the targeted nature of the amendments, recitals (99) and (102) of the 2018 Decision still apply: Measure D is imputable to the Cypriot State as it involves State resources and it remains selective. In the same vein, the assessment made in recitals (114) and (115) of the 2018 Decision remains valid: Measure D still threatens to distort competition and affects intra-EU trade.
- (41) Regarding the presence of an advantage, the assessment made in recitals (111) and (113) remains valid. The Commission is still of the view that – also taking into account the amendments – no market economy operator would have granted such a large and risky guarantee to the Bank. The Commission therefore concludes that Measure D – in its new form – still grants an advantage to the Bank.
- (42) Since all the cumulative criteria for State aid are still met, the Commission concludes that Measure C and the amended Measure D constitute State aid to CCB within the meaning of Article 107(1) TFEU. The assessment of the existence of aid in the two other aid measures of the 2018 Decision (Measures A, and B) is still entirely valid.

5.2. Compatibility of the aid to CCB

- (43) In the 2018 Decision, the Commission assessed the compatibility of Measures A to D with Article 107(3)(b) TFEU based on the 2013 Banking Communication and

³⁰ See recitals (98), (101), and (109) to (115) of the 2018 Decision

the 2009 Restructuring Communication. As Measure D contains an APS, the compatibility of that measure was also assessed, for the sake of completeness, under the Impaired Asset Communication.^{31 32}

- (44) The specifications submitted by Cyprus on Measure C do not modify the measure, as approved by the Commission in the 2018 Decision. As a result, they do not alter the conclusions of the compatibility assessment reached in the 2018 Decision. In particular, the Commission notes that the two alternatives – as presented by Cyprus in the Initial Notification – were economically broadly equivalent: they represented two different ways to reprice the loans to market terms. The choice of one alternative over the other – as specified by Cyprus in the Addendum Notification – cannot alter the assessment, as laid down in recitals (129) to (153) of the 2018 Decision.
- (45) The amendments submitted by Cyprus on Measure D do not modify the conclusions of the compatibility assessment, as laid down in recitals (135) to (139) of the 2018 Decision. The scale of the expected reduction of CCB's economic footprint through its integration into the Buyer is of the same size and the fact that the residual entity of the Bank will be wound down under the conditions set forth in the unchanged Commitments provided by Cyprus in the 2018 Decision substantially helps to limit the risk of undue distortions of competition resulting from the aid.
- (46) Also, the assessment with regard to burden-sharing – as developed in recitals (140) and (141) of the 2018 Decision – still applies.
- (47) As to the viability of the entity resulting from the sale, the Commission considers that the conclusions of its assessment in the 2018 Decision³³ remain unchanged. Though the lower DGS Payments and Amended APS under the new form of Measure D will entail additional expenses³⁴ for the Buyer post-sale, the Commission is of the view that, given the scale of its projected income and cost base,³⁵ the profitability of the resulting entity will only be marginally impacted over the projection horizon. Therefore, on that basis, the Commission still concludes that the entity resulting from partial acquisition of the CCB activities by Hellenic Bank will be viable.
- (48) Regarding the limitation of the costs of winding down the Bank, recitals (130), (131) and (133) of the 2018 Decision are still valid.

³¹ 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; 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 treatment of impaired assets in the Community financial sector ("*Impaired Assets Communication*"), OJ C 72, 26.3.2009, p. 1.

³² See recitals (129) to (163) of the 2018 Decision

³³ See recitals (142) to (152).

³⁴ For the DGS Payments, the Buyer will in the end receive neither the "from time to time" DGS contribution of up to 1% of CCB's covered deposits nor CCB's SRF contributions but instead a one-off payment of a maximum of 0.4% of CCB's covered deposits for the DGS contribution only (ca. EUR 8.6 million). For the Amended APS, the additional expense refers to the guarantee fee to be paid to the Cypriot government (ranging from an average of EUR 2 million to EUR 5.7 million per year).

³⁵ See recitals (145), (146) and (147) of the 2018 Decision.

- (49) With regards to the updated payment conditions set out in the Amended Government Guarantee Agreement under Measure D, the Commission takes note of the changes made to the terms. By granting more time to pay the Buyer, the Cypriot government will be in better position to smoothen its outlays and minimize costs related to its day-to-day liquidity management. The interest rate on any amount due under the Amended Government Guarantee Agreement is now set a lower level than before, thus reducing the potential penalties to be paid by Cyprus to the Buyer.
- (50) With regard to the DGS Payments under Measure D, the Commission takes note of the change of the terms of the indemnification for the increase of the contributions payable by the Buyer to the Cypriot DGS in the future with respect to the covered deposits taken over from the Bank, which are covered by the Amended Government Guarantee Agreement. The changed terms result in a more favourable outcome for the State (and definitely not less favourable), as they actually reduce the potential liability of the Cypriot government stemming from the BTA under the Amended Government Guarantee Agreement. This is because the changed terms now exclude SRF Payments and reduce the Bank's liability related to the DGS Payments.
- (51) With regard to the Amended APS under Measure D, part of recital (132) of the 2018 Decision remains relevant as the risk-sharing mechanism with the Buyer is still present and the asset perimeter remains the same as before. These two elements contribute to limit the risk of any future potential pay-out by the Cypriot Government.
- (52) Despite the absence of hard caps in the Amended APS, the Commission notes that the estimated pay-out by the State to cover the losses on the APS Assets as per the Amended APS Agreement does not reach the initial caps, under either the Base Case or the Stressed Scenarios. The removal of the caps might theoretically imply a higher potential pay-out by the Cypriot government but only in tail risk scenarios. Based on the simulations attached to the notifications, for both caps to be activated, the realised losses on the APS Assets would have to exceed ca. EUR 1.8 bn, i.e. approx. 9 times the expected losses under the Base Case Scenario.
- (53) Assuming that no assets are removed from the scope of the APS (i.e. the Buyer chooses Option 2), the caps would be activated only if the aggregate fair-value losses on the APS Assets were to exceed 78% or 67% (respectively for APS 1 and 2), i.e. if the loans' aggregate value would fall below ca. 20% and 30% of the loans' aggregate GBV (respectively for APS 1 and APS 2). Such outcome would require both a high number of defaulted loans and a high LGD. Given that the majority of the loans covered by the APS are performing loans and that the residual covered NPLs are in majority forborne, a payout by the State in excess of the initial cap levels would appear extremely unlikely at present.
- (54) Compared to the previous version of the APS, assuming that no assets are removed from the scope of the APS (i.e. the Buyer chooses Option 2), Cyprus is to receive a guarantee fee, which will amount to EUR 63 million (i.e. EUR 15 million in the first year, EUR 17 million in the second year, EUR 23 million in the third year, and EUR 1 million annually from the fourth to the 11th year).
- (55) In conclusion, the fees to be received by the State balance the theoretical higher risk due to the cap removal. Thus, despite the cap removal, the Commission still

considers that the new characteristics of the APS contribute to limit the future potential payment to be made by the Cypriot government.

- (56) With regard to the compatibility requirements of the Impaired Asset Communication, although the removal of the guarantee caps puts the transfer value of the APS Assets under Measure D further beyond their Real Economic Value (the "REV") as compared to the 2018 Decision, the Commission notes that competition distortions will continue to be limited thanks to the market exit of CCB. Pursuant to point 37 and point 41 of the Impaired Asset Communication, the Commission still accepts that there is no need for valuation and that the Amended APS is in line with the compatibility requirements of the Impaired Asset Communication.
- (57) In general, the Commission notes that the amendments of Measure D do not alter the overall balance of the aid measures to CCB's Transferred Activities and commitments provided by Cyprus. Therefore, the Commission's conclusions reached in the 2018 Decision – that
- (i) the aid does not exceed the minimum necessary to achieve the objective of remedying a serious disturbance in the Cypriot economy;
 - (ii) the limitations of distortions to competitions remain limited thanks to the market exit of CCB;
 - (iii) adequate burden-sharing is achieved since the shareholders of the Bank will maximally contribute to the costs of the wind down and;
 - (iv) the viability of the entity resulting from the Transaction – also after the amendment of the APS – is ensured.³⁶
- (58) In conclusion, the Commission considers that Measures A to D granted to CCB, and in particular the Measure D in its new form, are compatible with the internal market under Article 107(3)(b) TFEU.
- (59) The amendments do not affect the Commission's assessment on the indissolubly linked provisions of Directive 2014/59/EU and Regulation (EU) No 806/2014, as described in recitals (165) to (176) of the 2018 Decision. In particular, the Commission considers, unaltered, that the restructuring of CCB constitutes an ongoing resolution process pursuant to national law applicable before the adoption of the BRRD and the SRMR and thus falls outside the temporal scope of the said Union legal acts.

5.3. No aid to the Buyer

- (60) The Commission notes that the initial APS Agreement is only re-designed to produce the APS Regulatory Effect which it was supposed to generate (but in fact did not). Consequently, the changes in the APS parameters, including the removal of the guarantee caps which is offset by the introduction of a guarantee fee, do not improve the terms of the acquisition of CCB's Transferred Activities for the Buyer compared to what the APS in its form notified on 17 June was supposed to achieve. The amendments have only the effect of enabling the closing of the

³⁶ See recitals (129) to (153) of the 2018 Decision

Asset-Liability Gap present in the Buyer's Initial Offer. As indicated in the previous section, the changes had been made before any contract was signed and therefore do not represent an improvement of a signed contract in favour of the Buyer. The changes had been made to ensure that the contract to be signed by the parties was equivalent to the Buyer's Initial Offer.

- (61) As stated in its 2018 Decision, the Commission considered that the sale process was open, fair and transparent.
- (62) The Commission therefore concludes that the amendments do not constitute aid to the Buyer.

5.4. Conclusion

- (63) In light of all these considerations, the Commission concludes that Measures A, B, C and D (as amended) remain compatible with the internal market within the meaning of Article 107(3)(b) TFEU. They also do not constitute State aid to the Buyer within the meaning of Article 107 (1) TFEU.

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:

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Yours faithfully
For the Commission

Margrethe VESTAGER
Member of the Commission

