The "Estia" scheme in Cyprus: A social policy mirage?

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Emerging from the 2013 crisis, Cyprus is now faced with one of the highest rates of Non-Performing Loans in Europe. In an attempt to protect the first residence of distressed borrowers and contribute to financial stability, the government has proposed the Estia *scheme, as a solution based on social policy criteria. But is it quite so?*

Description

Inspired by the ancient goddess *Estia*, protector of home and family life in ancient Greece, the scheme aims to achieve a socially acceptable solution to the problem of debt-overburdened households, while at the same time contributing to the deleverage of Cypriot banks. *Estia* is a one-off scheme, whose implementation will start in the next couple of months, open to all Cypriot banks, as well as to other financial institutions that aspire to clean up their balance sheets.

According to the terms of the scheme, the Non-Performing Loans (NPLs) of borrowers who meet certain eligibility criteria will be restructured and, furthermore, 1/3 of the restructured loan instalments will be subsidised by the state. The participating banks will have to agree to offer all eligible borrowers the restructuring terms of the scheme, as a precondition for eligibility for the subsidy.

In order to allay some of the concerns raised by the stakeholders, the authorities revised the terms of the *Estia* scheme (which was initially approved by the Council of Ministers in July 2018) in November 2018, tightening some of the eligibility criteria.

Under the revised scheme, the income threshold for participating in the scheme ranges from €20,000 for single applicants to €60,000 per annum for couples with 4 or more dependent members. In addition, the wealth criterion has been lowered to a net wealth (excluding primary residence) of up to 80% of the market value of the primary residence, with a cap at €250,000. An additional new requirement is that any cash or deposits above 20% of the borrower's net household wealth must be used to pay down the outstanding loan before its restructuring. Finally, the borrower must have Cypriot citizenship (Ministry of Finance, 2018).

Outlook & commentary

The NPL ratio is expected to drop to around 31% of total loans by the end of 2018: a reduction of 13 percentage points compared to 2017. Still, the ratio remains one of the highest in the EU (European Commission, 2018), posing serious threats to financial stability (Michail and Savva, 2018). Yet, the high incidence of bad loans also has social repercussions. Particularly, though the percentage of Cypriot households with dependent children facing heavy financial burden due to housing costs fell from 81.9% to 71.4% between 2013 and 2017, it is still 2.5 times the EU-28 average (35.2% in 2017) (Eurostat Online Database). Therefore, it seems that the scheme comes at the right moment to deliver a much-needed solution.

Yet despite the recent tightening of the eligibility criteria, there are still concerns about encouraging strategic default and compromising fairness. Interestingly, these two issues are interrelated. For example, the gross annual income of an eligible couple with two dependent members must not exceed €50,000 (€4,166/month); admittedly, this is not the income of a deprived family in Cyprus. Furthermore, the eligibility criteria still allow households with substantial illiquid assets (that is, real estate other than primary residence) to participate in Estia. Thus, the introduction of the scheme may produce feelings of injustice in taxpayers who are paying off their loans (or even renters who wisely avoided loans during the halcyon days) concerning those benefiting from Estia, possibly alluring the former to stop paying their loans.

Stakeholders and parliamentary parties seem to have acknowledged these risks. The budget for the scheme was blocked by a majority vote of the opposition parties, their main argument being that the eligibility criteria should have been stricter. There is also a wider consensus that several shortcomings of the scheme must be eliminated in order to reduce NPLs while at the same time protecting truly vulnerable households.

To ease the tensions between economic and social goals, the government should more carefully monitor all the outstanding risks stemming from the scheme. Several ideas can be heard in the public debate. Possibly the more promising include measures to further and more effectively target deprived families, and to devise mechanisms allowing the state to recover part of the cost of the scheme in the future. The latter might reassure frustrated taxpayers.

Further reading

European Commission (2018), Post-Programme Surveillance Report Cyprus, Institutional Paper 092, November 2018.

Michail, A. N. and Savva, C. S. (2018), Determinants of Non-Performing Loans in Cyprus: A Bayesian VAR approach, Economic Policy Paper, 03-18, Economics Research Centre, University of Cyprus.

Ministry of Finance (2018), Overview of the Scheme, Project Estia, Republic of Cyprus, November 2018.

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