

April 2013 - Update in regards to the banking system in Cyprus

An unprecedented and controversial decision was taken by Eurogroup last week, in dealing with the recapitalization of the two largest banks in Cyprus. Having been unable to recapitalize the two banks directly, Cyprus sought the support of the EU for obtaining a loan.

As a result, the following resolution measures were taken in regards to the two banks, as of 30 March 2013

1. Laiki Bank

The resolution measures already adopted are:

- (a) The sale of Laiki Bank's branches in Greece to Piraeus Bank in Greece
- (b) The sale of Laiki Bank's business in Cyprus (excluding the bank's subsidiaries and branches abroad) to the Bank of Cyprus.

As a result of the above, all contracts are transferred to either the Bank of Cyprus or Piraeus Bank.

Furthermore, all branches of Laiki Bank resumed as normal on Tuesday, 2 April 2013 together with their staff, but under the ownership of the Bank of Cyprus.

Moreover, the following points are clarified:

- All insured deposits (individuals and legal entities) up to €100.000 have, as of 26 March 2013, been transferred from Laiki Bank to the Bank of Cyprus. In addition, the entire amount of deposits belonging to financial institutions, the government, municipalities, municipal councils and other public entities, insurance companies, charities, schools, educational institutions, and deposits belonging to JCC Payment Systems Ltd have been transferred to the Bank of Cyprus.
- All other deposits exceeding €100.000 remain in the 'bad' Laiki Bank.
- All loans and credit facilities to Laiki Bank customers are transferred to the Bank of Cyprus, apart from the amount which is attributed to the deposits that remained in the 'bad' Laiki Bank, as mentioned above. In other words, there will be a set off between loans and deposits.

2. Bank of Cyprus

The resolution measures are:

(a) The sale of Bank of Cyprus's branches in Greece to Piraeus Bank in Greece.

(b) Adopting a bail-in rescue plan.

- For the purposes of the above measure, if the aggregated deposits a customer (individual or entity) held on 26 March 2013 at the Bank of Cyprus exceed €100.000, then for the amount higher than €100.000 the following apply:

(a) Total loans and credit facilities of the customer on 26 March 2013 at the Bank of Cyprus are deducted from the deposits exceeding €100.000. If the sum of the balances of loans and credit facilities is greater than or equal to the amount of deposits exceeding €100.000, then the resolution measures are not applicable to this client. If the sum of the balances of loans and credit facilities is less than the deposits exceeding €100.000, then the following apply:

(b) 37,5% of this difference is automatically converted into Class A' shares of the Bank of Cyprus, with voting rights and dividends.

(c) 22,5% of this difference is temporarily 'frozen' and possibly part or the whole of it, will be converted into Class A' shares of the Bank of Cyprus with voting rights and dividends for the purposes of the bank's resolution. In that regard, an independent valuer will be appointed for the valuation purposes of the Bank of Cyprus. Not later than 90 days from the completion of the valuation, all or part of that percentage might be converted into shares and the remainder returned to the depositor. To the extent that the 22,5% will be re-deposited, the interest will be calculated retrospectively together with a small increment.

(d) The remaining 40% of the difference is temporarily 'frozen' for liquidity purposes. However, the interest continues to be calculated for this deposit based on the existing interest rate, plus an increment of 10 basis points. This amount will be 'unfrozen' in a short period of time and will not be used for resolution purposes.

- The current capital of the Bank of Cyprus (shares, securities convertible into shares, bonds) is converted into new shares as explained below:

- The existing ordinary shares are converted into new shares of Class D'.

- The existing securities which are convertible into shares are converted into new shares of Class C'.

- Existing bonds are converted into new shares of Class B'.

Voting rights and dividends for the above-mentioned new classes of shares (B', C', D') may be exercised only if the total dividends to be given to holders

of Class A' shares reach the original contribution plus interest at an annual rate of EURIBOR-3 months plus 10%. Class A' shares have full voting rights and dividends.

As a result of these resolution measures, the Bank of Cyprus has essentially absorbed the largest part of the operations of Laiki Bank in Cyprus and continues to provide services to the customers of both banks, through the branches of the Bank of Cyprus and the branches of the former Laiki Bank.

Customers are encouraged to continue using the branches with which they previously conducted their business until the extended network is able to serve all customers from all points.

It is important to note that the above resolution measures do not apply to the former customers of Laiki Bank and do not apply to any amounts deposited with the Bank of Cyprus, either by a client of the Bank of Cyprus or by a client of the former Laiki Bank, after 26 March 2013.

3. In relation to the implementation of resolution measures for Laiki Bank and the Bank of Cyprus, the following principles apply:

3.1. Treatment of joint accounts: According to the Regulations for the operation of the Deposit Protection Scheme and the *Resolution of Credit and Other Institutions Law, 2013*, each of the joint account holders is considered to have a separate deposit, and hence the total deposit is divided by the number of persons who are co-owners, unless there are specific contractual terms or elements which differentiate the above.

3.2. Treatment of multiple deposit accounts per customer: If a customer has more than one deposit account, then the deposit amount with respect to the measures referred to in points 1 and 2 above is considered to be the sum of all accounts up to €100.000.

3.3. Deposits (a) of persons acting as trustees or nominees, (b) persons who are beneficiaries in clients' accounts: Amounts relating to the above categories, are 'frozen' until the presentation of appropriate evidence to the respective banks for the beneficiaries of the account holder.

3.4. Series of Conversion deposits into equity per customer at the Bank of Cyprus:

In the case of multiple accounts per customer, the conversion of deposits into equity is in the following order of priority: (a) accounts with a longer period until maturity (longest maturity date), (b) accounts with larger account balances.

It is important to note that the relative Decrees may be modified by new Decrees issued by the resolution authority, if the need arises.

The restrictions on financial transactions which were imposed by the Central Bank are modified / relaxed based on Directives that it issues, so should you require the most recent information please refer to the following link: <http://www.centralbank.gov.cy>

Although affected , the financial services sector will continue to operate and even grow in the short to medium term, as there has been no mass exodus of clients as was anticipated by many. Cyprus remains a favorable jurisdiction offering important benefits in international business structures. The high quality of human resources in legal, tax and financial services, along with the business friendly legal system and infrastructure designed to support the establishment of international companies, will continue driving the sector upwards.

The decisions of the Eurogroup were strongly criticized by EU and third countries, financial publications, Nobel winning economists and business circles. It is expected that the local economy will be strongly affected due to the losses suffered by individual depositors and companies. An increase in unemployment is also inevitable.

The banks opened on 28th March after being closed for 7 working days. Some temporary capital movement restrictions have been implemented in order to control a possible fleeing of deposits. The remaining banks in Cyprus, almost 40 including branches of overseas banks remain unaffected, other than following the 7 days bank holiday.

According to information received by the banks there were no mass attempts to withdraw or transfer amounts.

Therefore, we can say that “business is as usual”, only change being that alternative banking arrangements had to be made. Cyprus companies are not required to operate a bank account in Cyprus and many clients were already performing bank transactions in multiple jurisdictions.

Our team at Pamboridis LLC is ready to assist with any issues arising due the recent developments.

Background

Cyprus economy was significantly exposed to the Greek market and the holding of Greek bonds led the two largest banks as mentioned above suffer significant losses, in otherwise profitable operations. The turning point was the 2011 Eurogroup's decision to implement an innovative approach in dealing with the Greek debt, this being the write-off of Greek debt.

The losses suffered by the two banks equal to almost 5 billion euros (the same amount that the above restructuring of the two banks will inflict on the depositors). In effect, the Eurogroup's controversial solution of the write-off of Greek debt, has led to the write-off of Cypriot deposits, in order to recover the losses created by the former.