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Experiences from the implementation of bail-in resolution measures in Cyprus

Central Bank of Cyprus

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CENTRAL BANK OF CYPRUS
EUROSYSTEM



Experiences from the implementation of bail-in resolution measures in Cyprus



**FinSAC Annual International Conference
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Overview

- Events that led to the assumption of resolution action in March 2013
- Resolution measures taken-open bank bail in
- Issues faced and lessons learned



Events that led to resolution

- Systemic financial crisis which affected the two largest banks (Bank of Cyprus and Laiki Bank)
- Deterioration of economic environment in Cyprus and Greece, the two banks' main markets, led to huge losses from NPLs and investments in Greek Government Bonds
- Solvency fell substantially below minimum supervisory requirements



Events that led to resolution (cont.)

- Banks requested state aid for recapitalisation
- Loss of deposits and bank run impacted liquidity
- Banks dependent on Central Bank Emergency Liquidity Assistance to cover liquidity needs
- June 2012: Cyprus requested financial assistance from the ESM - IMF (recapitalise banks + public finances). MoU agreed in April 2013



Resolution measures - March 2013

- Resolution Law enacted in March 2013 based on European Commission's proposal for BRRD of June 2012. Replaced in 2016 by full transposition of BRRD
- Central Bank of Cyprus (CBC) designated as National Resolution Authority
- Resolution decrees issued by CBC with the agreement of Ministry of Finance.



Bail in resolution measures- **March 2013 (cont)**

- Bank of Cyprus, the largest bank in Cyprus with 30 % market share, was recapitalized through open bank bail in
- Own funds (equity+AT1+T2) written down to zero to absorb accumulated losses. Existing shares were cancelled.



Bail in resolution measures- **March 2013 (cont)**

- Deposits in excess of the insured amount of 100.000euro converted into shares to recapitalize. Initially, 37.5% of the excess amount converted into shares on the basis of a provisional valuation carried out by the Resolution Unit.
- For the purposes of determining the final bail in, deposits in excess of 100.000 euro were blocked till the completion of the independent valuation (Valuation 2)
- After independent valuation of assets and liabilities at fair value by a professional valuer, the conversion amount increased to 47,5%.
- Bail in amount reached 3.8billion euro of deposits (around 25% of total deposits) and affected around 20.000 depositors



Bail in resolution measures- **March 2013 (cont.)**

- Independent valuer appointed after a procurement process. Valuation process lasted two months
- CBC appointed Special Manager. BoD and Senior Management of Bank of Cyprus were removed from their posts
- Resolution measures taken on 25 March 2013. Exit from resolution on 31 July 2013. Duration of resolution more than four months
- New shareholders appointed new BoD and CEO in early September 2013



Issues faced and lessons learned

- Resolution scheme not well prepared. No advanced resolution planning
- No MREL requirements at the time
- Losses imposed on depositors led to disruption of banking system, hit on the confidence of the banking system and financial stability
- Introduction of strict bank wide capital controls to address issues of liquidity outflows



Issues faced and lessons learned (cont.)

- Problems with cross border resolution (pre-BRRD). EU Member States' competent authorities where Bank of Cyprus had branches/subsidiaries took measures individually to ring-fence their banking systems.
- Operational impediments in implementation of bail in: Identifying insured depositors, client a/cs, trustee a/cs, minor a/cs, set – off of deposits against loans, etc.
- Issues with quality of data for conducting the independent valuation caused delay
- Problems with correspondents banks and counterparties affected smooth conduct of transactions



Issues faced and lessons learned (cont.)

- Perception of the term ‘**resolution**’ by different stakeholders as an event of default.
- New shareholders were dissatisfied and aggrieved former depositors. Became shareholders/investors by “force”.
- Bailed in deposits resulted in default in loan repayments. New NPLs created
- Impact on real economy. Economic activity slowed down. NPLs reached 50%



Issues faced and lessons learned **(cont.)**

- Litigation: Thousands of court actions against CBC / Bank of Cyprus / Government
- The Resolution Law imposed the burden on plaintiffs to prove breach of the “No Creditor Worse Off” principle.
- Resolution Law did not require at the time liquidation valuation (Valuation 3)



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Thank you

Questions?



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