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Financial assistance for Cyprus

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FAQ – Financial assistance for Cyprus

➤ **1 – What is the purpose of the programme?** The programme will address the exceptional financial, budgetary and structural challenges that Cyprus is facing. The programme aims to restore financial stability and reduce the size of the financial sector to a viable level, promote sustainable growth and sound public finances over the coming years.

➤ **2 – What is the size of the programme?**

The total amount of financial assistance, agreed by the Eurogroup, is up to €10 billion. Out of this amount, the ESM will provide approximately €9 billion, and the IMF will contribute around €1 billion. The programme is to cover Cyprus's financing needs over three years (from Q2 2013 to Q1 2016) after the inclusion of proceeds from burden-sharing measures adopted by the Cypriot government.

➤ **3 – What policy measures were taken by the Cypriot authorities with regard to the Bank of Cyprus (BoC) and the Cyprus Popular Bank (Laiki)?**

The BoC was capitalised through the full contribution (bail-in) of the shareholders and bondholders of the bank and through the conversion of 47.5% of uninsured deposits (over €100,000) into equity.

After exiting the resolution, the new BoC became adequately capitalised with a CT1 capital ratio of around 12%. This ensures that the CT1 capital ratio of the bank will stay above the regulatory minimum of 9% during the programme period.

The new BoC, with the assistance of its external advisors, will devise its restructuring plan, to be finalised by mid-October 2013.

The resolution of Laiki minimised the use of taxpayers' money with a full bail-in of equity shareholders and bondholders, and a partial bail-in of uninsured depositors. All deposits under €100,000 were fully protected.

As a result, Laiki was split in two units. While all uninsured deposits were kept in a legacy unit (Legacy Laiki), the insured deposits were transferred together with certain assets and liabilities to the BoC. In exchange for the positive net asset position transferred, the Legacy Laiki received shares of the BoC.

The uninsured depositors of Laiki will be compensated through the liquidation of the assets of Legacy Laiki which also include these shares in the BoC.

➤ **4 – Why were uninsured depositors part of the bail-in?**

Given the large banking recapitalisation needs, as well as the acute public finance problems, it became necessary to include uninsured depositors in the bail-in in order to ensure the sustainability of public debt. Imposing losses only on shareholders and bondholders was not sufficient to finance the restructuring of Cyprus's two largest banks (BoC and Laiki). Even after taking all these measures into account, the financial assistance of €10 billion provided by the ESM and IMF is among the largest in the euro area, in GDP terms.

- 5 – Will the bail-in of depositors be used to recapitalise other banks in the system, e.g. Hellenic Bank and cooperative credit institutions?

There will be no depositor bail-in beyond the one already completed at the BoC and Laiki. Hellenic Bank has announced that it aims to raise private capital in order to meet the capital requirements set under the programme by the end of September 2013. In case private sector funds do not cover in full the required capital increase, the bank will be recapitalised in line with state aid rules. No depositor bail-in will be requested.

Recapitalisation of the cooperative credit sector will occur through state aid, which will be financed by programme resources. To this end, €1.5 billion of the financial assistance has been reserved. Again, no bail-in of depositors will be requested.

- 6 - Will any uninsured deposits from public authorities be exempted? What about EU structural funds?

According to the resolution decrees, the bank deposits of the central government and local authorities will be exempt from the bail-in. Such deposits also include payments from the European Union for the co-funding of projects.

- 7 – What happened to the branches of Cypriot banks in Greece?

The branches of Laiki, BoC and Hellenic Bank in Greece have been acquired by Piraeus Bank. They reopened on 27 March 2013.

- 8 – Will any money from the programme go to the financial sector?

No programme money was used to recapitalise Laiki or BoC. However, other Cypriot banks and the cooperative credit sector are eligible for assistance from the programme envelope under state aid rules.

- 9 – What is the policy conditionality specified in the MoU?

The key objectives of the MoU programme are:

- to restore the soundness of the Cypriot banking sector and rebuild depositors' and market confidence by thoroughly restructuring and downsizing financial institutions,

strengthening supervision and addressing expected capital shortfalls;

- to continue the on-going process of fiscal consolidation in order to correct the excessive general government deficit by 2016, in particular through measures to reduce current primary expenditure, and maintain fiscal consolidation in the medium-term, in particular through measures to increase the efficiency of public spending within a medium-term budgetary framework, enhance revenue collection and improve the functioning of the public sector; and
 - to implement structural reforms to support competitiveness and sustainable and balanced growth, allowing for the unwinding of macroeconomic imbalances, in particular by reforming the wage indexation system and improving the functioning of services markets.
- 10 – Cyprus’s problems were partly due to the overexposure of Cypriot banks to Greek sovereign debt. Has anything been done to prevent this from happening in the future?

Yes. To avoid similar outcomes in the future, the Central Bank of Cyprus will update relevant liquidity regulations by December 2014, after consultation with the ECB, European Commission and the IMF.

- 11 – Are anti-money laundering measures included in the MoU?

Yes. The Cypriot authorities are committed to further enhancing the anti-money-laundering framework. To this end, an independent audit was carried out by Moneyval¹ and Deloitte which was finalised in early May 2013.² The recommendations of the independent audit will be implemented as part of a comprehensive action plan, which has been included as an annex to the MoU. The measures include the establishment of trust registers and a third-party assessment of the functioning of the Registrar of Companies. Cooperation with foreign financial intelligence units will be further strengthened.

- 12 – What is the timeline for restoring the sustainability of Cyprus’s public finances?

A good measure of the soundness of public finances is the budget balance before interest payment, i.e. the primary balance. Cyprus is expected to see this indicator stabilise at 4% of GDP from 2018 onwards. The debt to GDP ratio is expected to peak at around 126% of GDP in 2015 to decline to around 122% of GDP in 2016 and to around 105% in 2020.

- 13 - How much has already been disbursed and when is the next disbursement going to take place?

¹ MONEYVAL is the acronym of the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism, established by the Council of Europe in 1997.

² A summary of the findings is available at: http://www.centralbank.gov.cy/nqcontent.cfm?a_id=12806

The first tranche of ESM financial assistance was transferred to Cyprus in two separate disbursements. The first disbursement of €2 billion was made on 13 May 2013. The second disbursement of €1 billion was transferred on 26 June 2013.

The funds disbursed under the first tranche were used to finance fiscal needs and the redemption of maturing debt.

The second tranche of ESM financial assistance in the amount of €1.5 billion will be disbursed by the end of September, following the finalisation of the first review procedure. The proceeds of the second tranche will be used for the recapitalisation of cooperative credit institutions.

➤ **14 – What will be the maturity of loans granted to Cyprus?**

The average maturity of all loans will be 15 years, with a maximum maturity of 20 years.

➤ **154 – What will be the financing cost for Cyprus?**

In accordance with the ESM Pricing Guideline, the financing cost of an ESM loan is the sum of the following fees:

- i. Base rate – the cost of funding incurred by the ESM, derived by a daily computation of the actual interests accrued on all of the bonds, bills and other funding instruments issued by the ESM.
- ii. Commitment fee – the negative cost of carry³ and issuance costs, charged for the period from raising funds by the ESM until disbursement to the Beneficiary Member State or for the period from the refinancing of relevant funding instrument until its maturity. The commitment fee will be applied ex-post on the basis of the negative cost of carry actually incurred.
- iii. Service fee – the source of general revenues and resources to cover the ESM's operational costs. The service fee has two components: (i) up-front service fee (50 bps) deducted from the drawn amount, (ii) annual service fee (0.5 bp) paid on the interest payment date.
- iv. Margin – (10 bp) according to the ESM Pricing Guideline for a macro-economic adjustment programme, accruing day to day with effect from the first interest payment date of the relevant disbursement of the first tranche.

³ The negative cost of carry reflects the fact that the interest rate at which ESM raises funds would most likely be higher than the return obtained for shorter-term investments in high quality assets.

➤ 16 – How will the programme be monitored?

The European Commission, in liaison with the ECB and IMF, will verify at regular intervals that the policy conditions attached to the financial assistance are fulfilled, through missions and regular reporting by the Cypriot authorities, on a quarterly basis. The ESM is also involved in the programme monitoring.

➤ 17 – Why were capital controls introduced by the Cypriot authorities?

Restrictive measures had to be introduced so as to protect the financial stability of the Cypriot banking system. This refers in particular to preventing large deposit outflows and preserving the solvency and liquidity of credit institutions. These extraordinary measures should be dropped over time and significant changes have been introduced, especially since the entry into force of the 10th Decree (end of April).

➤ 18 - What measures are still in place?

Current restrictive measures mainly apply to the cashing of cheques, cross border transfers, domestic transfers above a certain amount, the withdrawal or export of cash and the opening of accounts. In other areas there are no restrictions, e.g. payment card transactions or incoming payments from abroad.

A complete list of decrees is available here:

Ministry of Finance:

http://www.mof.gov.cy/mof/mof.nsf/page01_en/page01_en?OpenDocument

Central Bank of Cyprus:

http://www.centralbank.gov.cy/nqcontent.cfm?a_id=12636&lang=en

➤ 19 - How long are restrictive measures going to stay in place and when will they be relaxed?

The Cypriot authorities have published (on 8 August) a roadmap which identifies a series of milestones for the gradual relaxation of the remaining measures. The roadmap foresees two major stages of relaxation: the first pertains to measures within Cyprus and the second relates to cross-border movements of capital.⁴

➤ 20 – Are these capital controls legal under EU treaties?

⁴ The roadmap is available at:

[http://www.mof.gov.cy/mof/mof.nsf/All/3766C4D62B9EDE71C2257BC2002E22E9/\\$file/Roadmap%20PresentationLHM07%2008%202012ENG%20\[Compatibility%20Model\].pdf](http://www.mof.gov.cy/mof/mof.nsf/All/3766C4D62B9EDE71C2257BC2002E22E9/$file/Roadmap%20PresentationLHM07%2008%202012ENG%20[Compatibility%20Model].pdf)

According to the Treaty on the Functioning of the European Union, Member States may introduce restrictions on capital movement, including capital controls, in exceptional circumstances and under strict conditions on the grounds of public policy or public security. In accordance with the case law of the European Court of Justice, measures may also be introduced for overriding reasons of general public interest.

Such exception to the principle of the free movement of capital must be interpreted very strictly and be non-discriminatory, suitable, proportionate and applied for the shortest possible period.

In current circumstances, the stability of financial markets and the banking system in Cyprus constitutes a matter of overriding public interest and public policy justifying the imposition of temporary restrictions on capital movements.

While the imposed restrictive measures were necessary in the current circumstances, the free movement of capital should be reinstated as soon as possible in the interests of the Cypriot economy and the European Union's single market as a whole.

➤ **21 – Has Cyprus stepped out as a guarantor of the EFSF?**

Yes. Under the EFSF Framework Agreement, a euro area Member State experiencing severe financial difficulties and requesting a stability support loan or benefit from financial support under a programme, can request to have its commitment to provide further guarantees suspended. Cyprus made such a request, which was approved by the Eurogroup Working Group (EWG) on 29 April 2013.⁵ The liability of Cyprus as a guarantor for notes issued prior to its stepping out is not affected.

➤ **22 – Is the programme for Cyprus a template for crisis management in the future?**

While it is clear that the Cyprus case does not represent a template *per se* for future financial assistance programmes, the issue of burden sharing in future bank restructuring is a topic under discussion. The EU finance ministers have reached an agreement in June 2013 on a general approach to establish a framework for the recovery and resolution of failing banks, which may see a final approval by the European Parliament before the end of this year. This approach aims to create a harmonised rulebook for the allocation of the costs of bank failure: it starts with the bail in of bank shareholders and creditors, and it is backed by financial support from resolution funds sourced from the banking sector instead of taxpayers.

⁵ For information concerning the changed EFSF contribution key following Cyprus's stepping out as a guarantor, please consult:
<http://www.efsf.europa.eu/attachments/EFSF%20supplement%20to%20the%2011%20February%202013%20prospectus.pdf>

