Rescue Programme for Laiki Bank

Saturday, 30 March 2013

In response to suggestions that Laiki Bank was kept active in the summer of 2012, rather than being liquidated and dissolved, the Central Bank of Cyprus (CBC) wishes to state the following:

1. The continuous downgrades in the creditworthiness of the Republic of Cyprus by international credit rating agencies, which were mainly due to the exposure of the three largest Cypriot banks in Greece, and their subsequent downgrades, had created a severe liquidity problem in Laiki Bank. As a result, from October 2011 onwards Laiki Bank requested Emergency Liquidity Assistance (ELA) from the CBC, with the consent of the European Central Bank (ECB). It should be noted that, until then, Laiki Bank was also able to conduct monetary policy operations directly with the ECB since it was able to provide adequate collateral.

2. At the same time, under the European Directive on Capital Requirements, and after supervisory review, the College of Supervisors set the shortfall in capital for Laiki Bank at €3,1 billion. The CBC asked Laiki Bank to cover this deficit and, to that end, Laiki Bank presented a recovery plan based on deleveraging and a capital increase of €1,8 billion from private investors.

3. The effort to attract private investors began in late 2011 and continued until June 2012 without any result. It should be noted that, in November 2011 Andreas Vgenopoulos resigned from Laiki's Board of Directors, followed by Efthimios Bouloutas in December of the same year. Michalis Sarris took over as President of the Board of Directors of Laiki Bank in December 2011. Given the failure to attract private investors, Laiki's Board of Directors asked the government to cover a capital deficit of €1,8 billion. The government agreed to this request after passing a relevant bill through Parliament and with the consent of the new CBC Governor, Panicos Demetriades, who took office in May 2012.

4. The capital shortfall was covered by the government through the issuing of an unfunded bond worth €1,8 billion, in order to acquire equity of equal value. With this procedure, Laiki Bank essentially became a state-owned bank, since the government acquired 84% of its share capital.

5. As a result of the political uncertainty in Greece and the two elections (May and June 2012) as well as the rumors of a possible exit from the euro, there were €2 billion of deposit outflows from the branches of Laiki Bank in Greece. As a consequence, there was a further increase in the amount that the bank channeled through the ELA mechanism.

6. In May 2012, the Greek covered bonds held by Laiki Bank, which were worth €1,2 billion, were downgraded. This development led to a corresponding increase in the liquidity absorbed through the ELA.

7. On 25 June 2012, the third and last downgrade of the Republic of Cyprus by the credit rating agency Fitch occurred (from BBB- to BB+ for long-term assessment and from F3 to B for short-term assessment). As a result of this, Cyprus government bonds ceased to be accepted as collateral by the ECB for monetary policy operations. Thus, all the debt of Laiki Bank to the ECB, which had reached €2,6 billion, was transferred to the ELA.

8. As a result of the three above-mentioned events - loss of deposits in Greece amounting to €2 billion, downgrading of Greek covered bonds worth €1,2 billion and downgrading of Cyprus bonds amounting to €2,6 billion- the ELA increased by €5,8 billion. The total debt to the ELA increased from €3,8 billion in May 2012 to €9,6 billion on 3 July 2012.Consequently,the government, following the CBC Governor’s suggestion and a decision by Parliament, applied to the EU Support Mechanism. Hence, negotiations with the Troika began in July 2012.

9. Throughout this period and thereafter, the CBC Governor warned through presentations, statements and interviews for the urgent need to design and implement a programme that would allow Cyprus to raise the necessary funds in order to accomplish the restructuring and recapitalisation of the country’s financial system. Only by reaching an agreement with the Troika could uncertainty, the lack of confidence and collapse of Cyprus’s financial system be dealt with.

10. On 18 November 2012, the CBC announced its own agreement with the Troika regarding the programme for the financial sector. Since no subsequent agreement with the government was reached regarding fiscal matters, the Troika left Cyprus and on 22 November 2012 Laiki Bank came under unprecedented pressure due to massive deposit outflows.

11. The prompt recommendation of the CBC Governor to the government to announce its intention to sign a Memorandum of Understanding (MoU) averted the risk of collapse of Laiki Bank, the second largest and systemic bank in Cyprus, which would have led to the collapse of the entire financial system. However, a final agreement on the MoU could not be signed before the completion of the independent diagnostic checks of Cypriot banks by PIMCO, which were aimed at identifying the capital needs of Cypriot banks, a condition stipulated in the MoU.

12. When the findings of PIMCO were submitted in January 2013, the country was already in a pre-election period. Hence, the Troika deliberately abstained from any action that could serve or be interpreted as a political intervention. Consequently, at the end of January 2013, the ECB’s Board of Directors extended the deadline of ELA to Laiki Bank until 21 March 2013. In making its decision, the ECB’s Board of Directors indicated that this decision was taken in accordance with the Terms of Reference of the Eurogroup, in order to urge the new government of the Republic of Cyprus to finalise the agreement for the support programme soon after the elections of February 2013. This decision was announced by the CBC Governor to the new president of the Republic of Cyprus in a letter dated 4 March 2013.

13. This was followed by the first Eurogroup decision on 16 March 2013 for a general ‘haircut’ on deposits of all banks operating in Cyprus. On 19 March 2013, Parliament rejected the government's bill to implement this decision.

14. On 21 March, the ECB’s Board of Directors implemented its decision to cease the provision of ELA to Laiki Bank, with a requirement to repay on 26 March 2013. The implementation of this decision would have led to a disorderly bankruptcy of Laiki Bank and to an immediate activation of the Deposit Protection Scheme, which had only €125 million in funds.This would have resulted in an obligation for the Republic of Cyprus to repay the €6,4 billion of insured deposits in Laiki Bank, which would have caused the bankruptcy of the country itself.

15. Faced with this disastrous outlook, the CBC Governor publically stated on the evening of 21 March 2013 the need for immediately passing a series of bills through Parliament, including the bill for the resolution of banks, so that Laiki Bank could be resolved immediately and avoid liquidation and dissolution.

16. The second Eurogroup decision followed on 25 March 2013, whereby a support programme for the Cyprus economy was agreed with the Troika, which included the immediate resolution of Laiki Bank and the subsequent absorption of its operations by the Bank of Cyprus.

17. Consequently, the simplistic and unsubstantiated allegation that the CBC Governor "allowed" the continuation of the provision of liquidity to Laiki Bank through the ELA is incorrect and is refuted by the above facts. On the contrary, it is clearly evident that the Governor, with his timely statements and actions (given the two political decisions taken at the Eurogroup) prevented a disorderly bankruptcy of Laiki Bank and consequently of the country itself.