Cyprus Banking Sector - Lessons From Restructuring And Current Challenges
A Banker / Economist Perspective
Presentation Structure

• Part I - The Pre Crisis Situation
• Part II - The Crisis & Current Situation
• Part III - The Challenges Ahead
• Part IV – Epilogue
The Pre Crisis Situation

The Bubble
Property Prices

- EU Entry
- Euro Introduction
- Rents Index

BuySell /MAP Platis Property Index
Over leveraged Private Sector
Household Loans/GDP (Eurozone 2013)
Over leveraged Private Sector
Business Loans/GDP (Eurozone 2013)
Oversized Banking System*

*Banking System Assets / GDP 2012
Aspects of the Crisis

Main Causes

• Greece
  • Greek Bonds
  • Greek Economy
    • Fraud?

• Cyprus
  • Property Bubble

Constrains

• Size of Banks
• Problematic CY Government Finances
The Crisis & Current Situation

Developments so far
March 2013 Eurogroup
Main Banking Terms

- Sale of Greek Operations of CY Banks
- Laiki split Good – Bad
- BoC got good Laiki and depositor bail-in
- Co-ops got State Aid and obligation to Restructure
- Hellenic Capitalized through share and bond conversion
- Capital Controls
- New Banking Rules

IBU activity severely disrupted.
The 2 Largest Sydronic Banks badly Hit. If Co-ops taken into bad and badly affected banking system.
March Eurogroup Impact

Depositor Confidence in Banks lost
Depositor Confidence

Currency in Circulation
Banking Impact
Banking System Prior to MoU

Banking System

Central Bank Controlled

Specialist Institutions
- 1 Unit
- 9 Locally Active
  - 4 Locally Owned
  - 5 Foreign
    - 4 Greek Subs
- 5 Foreign
- 4 Greek Subs

Deposit Money Banks
- Commercial Banks
- Co-op Central Bank

Superintendent of Co-ops

Co-op Credit Societies
- Limited Liability
- Unlimited Liability
- 26 IBUs
- 1 Rep. Offices
- 28 "Savings" Banks
- 65 Credit Societies
Banking Impact
After MoU

Central Bank Controlled

Specialist Institutions
- 1 Units
  - 11 Locally Active
    - 0 Local
    - 11 Foreign
      - 4 Greek Subs
  - 11 Foreign

Deposit Money Banks

Commercial Banks

Co-op Central Bank

Superintendent of Co-ops

Banking System

Co-op Credit Institutions

1) Logistics
2) “Interesting” Legal issues created
Resizing the Banking System*

*Banking System Assets/GDP 2013
The Crisis & Current Situation
Lessons from the Restructuring
Lessons from the Restructuring 1

• Legal Issues are in the Background
  • Bail-in
  • Bond Holders
  • Other Issues
    • Base Rates
    • Sale of Greek operations
    • Laiki Guarantees
    • Changes in the Rights / Obligations of Banks / Borrowers / Guarantors on “live” agreements

• Capital Controls are messy
  • No need to repatriate earnings facilitates strategic default and strain liquidity

• DG Competition Rules on State Aid Can Cause Instability if applied to Banks
Lessons from the Restructuring 2

- Bail-in and protection of non sophisticated investors
- Bail-in and wealth redistribution effects
- Bail in and business working capital
- Bail-in in the absence of capital mobility

A Better System is Needed one Resembling the Rules of Capital Markets
Lessons from the Restructuring 3

• Problem Loans take time to fix
  • Strategic defaults and asymmetric information
  • Re-contracting and free riders
  • Defaulter expectations
    • Politicians
    • Lawyers
The Challenges Ahead

Immediate Challenges
The Banking Challenge in a Nutshell

- Maximise Votes
- Cheap Finance
- Protect itself (and Taxpayers?)

- High Profit
- Quick Returns

- Cheaper Loans
- Protect “homes”
- Write-offs

- Safety
- Return
- Access
New Operating Environment

Cyprus

• Angry Frightened Customers
  • Haircuts
  • Bond Holders
  • NPL customers

• Hostile Political Environment
  • New Legislation
    • Customer Risk Margins
    • Fees
    • “Penalty” interest rates
    • “Unfair” contract terms

• Troika/Central Bank/ECB
  • NPLs
  • Loan Origination
  • Insolvency Regime

Europe/International

• SSM

• Bank insolvency regime

• “New” views on tax jurisdictions

• Laundering tightening worldwide
Challenges

- Problem Loans (NPL’s)
- New Lending
- Bank Profitability
- Turning into a Bad Bank
- Depositor Confidence
- GOVERNANCE
Problem Loans

- Can repay through restructuring
  - Prolongation

- Can partly repay
  - Interest Rate Reduction
  - Debt Haircut

- Bank will be repaid via Collateral
  - Sale of Collateral
    - How long does it take
    - At what price
    - By Calling in Guarantees

- Loss Expected
  - Adequacy of Provisions
NPL dynamics

Problem Loans

Collection through Collateral

Re-Defaults

Viable?

Restructured

Cured

New Defaults

NPLs

Stabilizing?
NPLs and Public Policy

• Changes introduced increased reported NPLs
• NPLs ratios are more likely to increase further
• People worry about Deposit Haircut
• NPLs are perceived as Bad
  • Provisions is the Keyword
• NPLs attract Media Attention which amplifies fear

Banks need to Manage NPLs but collectively we also need to Manage NPL expectations
New Lending

• Bank Capital
• Bank Liquidity
  • ELA
• Over - Leveraged Private Sector
  • Risk Premia?
  • Long term customer affordability

NEED EQUITY FINANCING
Turning into “Bad” Banks

• NPLs dynamics
• New Lending
• Private Sector Deleveraging
• Debt for Land Swaps
  - Property Management skill issues
Governance

• At Banks
  • Board Fusion
  • Strategy
• At Central Bank
The Challenges Ahead

Longer Term Challenges
Aspects of the Cypriot Banking Sector

Size issue

- Size / Growth of the non-bank “Offshore” Sector
- Few large Banks (Concentration)
- Co-ops (Merged)
- CY banks active in broadly same areas - markets, countries
- Greek Bank Subsidiaries
- Difficult Market Access
  - CY-Banks
  - Government
Cyprus Contagion Channels

- External Channels
  - Greece
    - Greek Bank Subs

- Intra-Cyprus Contagion Channels
  - Bank to Bank
    - Deposit Guarantee Scheme
    - Interbank Placements
  - Bank to Government
  - Government to Bank
Greek Subs

• ??????
Longer Term Challenges

• New Banking Model
  • BoC / Coops too big?
  • IBU?
  • Cyprus Government Bond Holdings
ECB, SSM & SRM

- New untested bodies
- “Eager” to show their worth
Epilogue
Aftermath 1

“The final and common feature of the speculative episode ...... is what happens after the inevitable crash. This, invariably, will be a time of anger and recrimination ...
Aftermath 2

The anger will fix upon the individuals who were previously most admired for their financial imagination and acuity.....
Aftermath 3

There will also be scrutiny of the previously much-praised financial instruments and practices...... implausible securities issues ...... that have facilitated and financed the speculation.
Aftermath 4

There will be talk of regulation and reform.
Aftermath 5

What will not be discussed is the speculation itself or the aberrant optimism that lay behind it. Nothing is more remarkable than this: in the aftermath of speculation, the reality will be all but ignored.”

J.K. Galbraith
A Brief History of Financial Euphoria 1993
Thank you