"Europe in Crisis "

The Cyprus Bail-out

1. Background

As you are no doubt aware, the last few days saw turmoil in Cyprus, due to a banking crisis brought about by the financial problems faced by the two largest banks in Cyprus, namely the Bank of Cyprus, and Laiki Bank. This in turn was a direct result of the wider economic problems brought on by Greece, and the Eurozone.

However, an agreement has now been reached with the so called "Troika" for a bailout, whereby the two banks will be re-structured and re-capitalised, bringing to an end the uncertainty of the past few days.

The roots of this problem lie in the fact that when the Greek economy collapsed, Cyprus was one of the first countries to help, in an act of solidarity directed towards Greece, and the Eurozone in general. Unfortunately, when the EU then imposed a haircut on all creditors of the Greek economy, as part of the bail-out plan, Cyprus lots many billions of Euro. Due to these huge losses, the Bank of Cyprus and Laiki were unable to raise the capital required to cover the losses on their own, resulting in the need for the Cyprus Government to seek European assistance, in order to re-capitalise these two banks.

2. Cyprus Bail-out

In a controversial move that shocked the international community, the European Finance Ministers agreed to an unprecedented tax on Cypriot bank deposits as officials unveiled a 10 billion-euro rescue plan. Under the initial plan, Cyprus would be called upon to impose a levy of 6.75% on deposits of less than 100,000 euros, and 9.9 percent above that.

This plan was met with shock and outrage both in Cyprus and in the international financial community, as for the first time, it broke the notion of trust, which forms the basis of the global banking system, and was also illegal, as it contravened one of the basic tenants of the International Convention of Human Rights, the right to enjoy unhindered access to one's own property, as well as one of the founding principles of the European Union. The result was that, in a unanimous move, the Parliament of Cyprus rejected this plan outright.

What then followed was a difficult week of negotiations and uncertainty, culminating in an agreement being reached in the early hours of Monday 25 March 2013.

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Under the provisions of the bail-out, the Bank of Cyprus and Laiki will be re-structured and re-capitalised, but this will also result in the partial liquidation of Laiki Bank. The remaining healthy part of Laiki's business will be amalgamated in the operations of the Bank of Cyprus. Unfortunately all funds in excess of Euro100.000 held in Laiki will go to the so called bad Laiki bank and will only be recovered once the bank is liquidated. With regards to the depositors at Bank of Cyprus, they will assume a haircut of 30% of their bank deposits in excess of 100.000 in exchange for shares at Bank of Cyprus.

It is important to note that the problems were effectively restricted to these two banks only, with the other banks on the Island remaining unaffected.

3. International fall-out

In accordance with Bloomberg (article written by Simon Kennedy) the devil lies in the detail of Cyprus's salvation.

" The island nation's rescue sets precedents for the euro zone that may stick in the memory of depositors and bondholders alike as investors debate who will next fall victim to the debt crisis. Under the terms of the agreement struck yesterday in Brussels, senior Cypriot bank bond holders will take losses and uninsured depositors will be largely wiped out.

The risk is that bank runs and bond market selloffs become more likely the moment a country applies for a new rescue (Slovenia, Italy, Spain, Greece).

Nobel laureate Christopher Pissarides, an adviser to the Cypriot government, told "The Pulse" on Bloomberg Television "We now have a new type of rule and everyone within the euro zone has to sit down and see what that implies for their own finances" .

Eurogroup President

Dutch Finance Minister, Mr Jeroen Dijsselbloem

What we have witnessed over the past few days is unprecedented in the context of post-war economic history, representing an organised attack against the rights of ownership over the assets of individuals.

This was further compounded by the statements of the Eurogroup President Dutch Finance Minister, Mr Jeroen Dijsselbloem, following the announcement of the Cyprus bail-out plan (click here to be re-directed to the relevant link)

During questions from reporters, he warned of the dawn of a new era, where the stakeholders (shareholders, bond holders, depositors) of troubled banks will be called upon to participate in the rescue efforts, before any assistance from tax payers and the European Union can be considered. The consequences of this new way of thinking means that depositors in troubled banks now clearly share in the risks. When also asked what this means for jurisdictions similar to Cyprus, such as Malta and Luxembourg, he was quoted as saying "They will have to reduce their banking sector".

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3. The way ahead

Despite the harshness of the bail-out agreement, we welcome this development, as it ends the uncertainty of the past week.

The decisive action of our new government, in conjunction with the Troika has effectively restricted what was in actual fact a crisis at the two banks from spreading to the wider economy, and has also left our attractive tax regime unaffected.

Cyprus still retains one of the lowest tax regimes in the EU, and clearly remains one of the most attractive low-tax jurisdictions in the world. The beneficial tax regime which has underpinned the success of Cyprus as a leading international financial centre has in essence remained unaffected, offering the following benefits:

- No Capital Gains Tax on the sale of a wide range of financial assets
- No withholding tax on the distribution of dividends to non-resident share-holders, irrespective of their location
- No withholding tax on incoming dividends
- Favourable financing regime
- Favourable IP regime
- Favourable regime in relation to private and listed investment compa-nies

Cyprus President

Mr Nicos Anastasiades

The fact that our well-developed corporate and fiduciary sector can continue under a “business as usual” approach gives everyone hope for a return to growth and prosperity.

In closing, I would like to add my personal note of thanks for the patience you have shown during the difficult past few days, and assure you that my colleagues and I will continue serving you to the highest standards.

Thank you

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