



Cyprus Banking Sector - Lessons From Restructuring And Current Challenges

A Banker / Economist Perspective

Presentation Structure

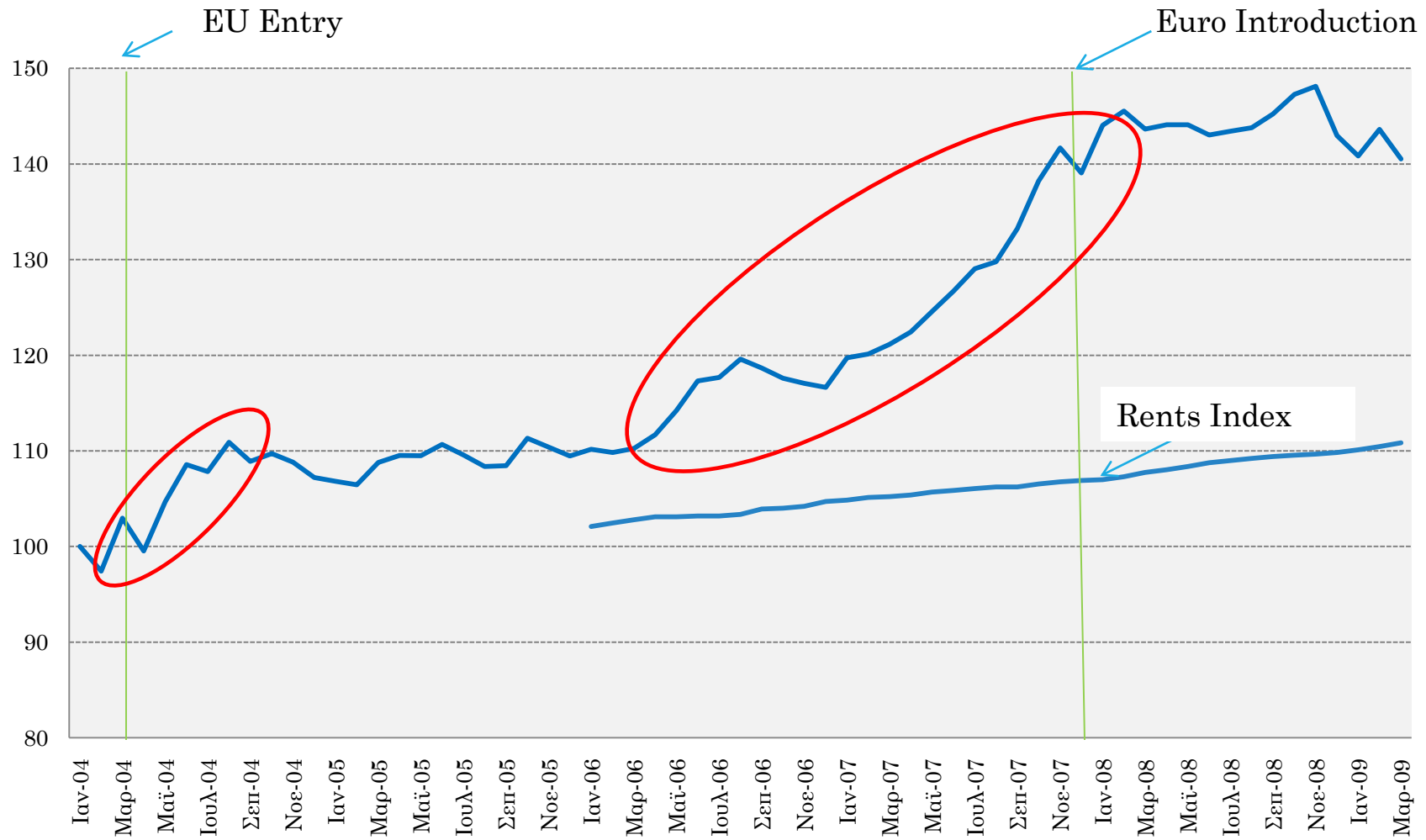
- Part I- The Pre Crisis Situation
- Part II- The Crisis & Current Situation
- Part III- The Challenges Ahead
- Part IV – Epilogue



The Pre Crisis Situation

The Bubble

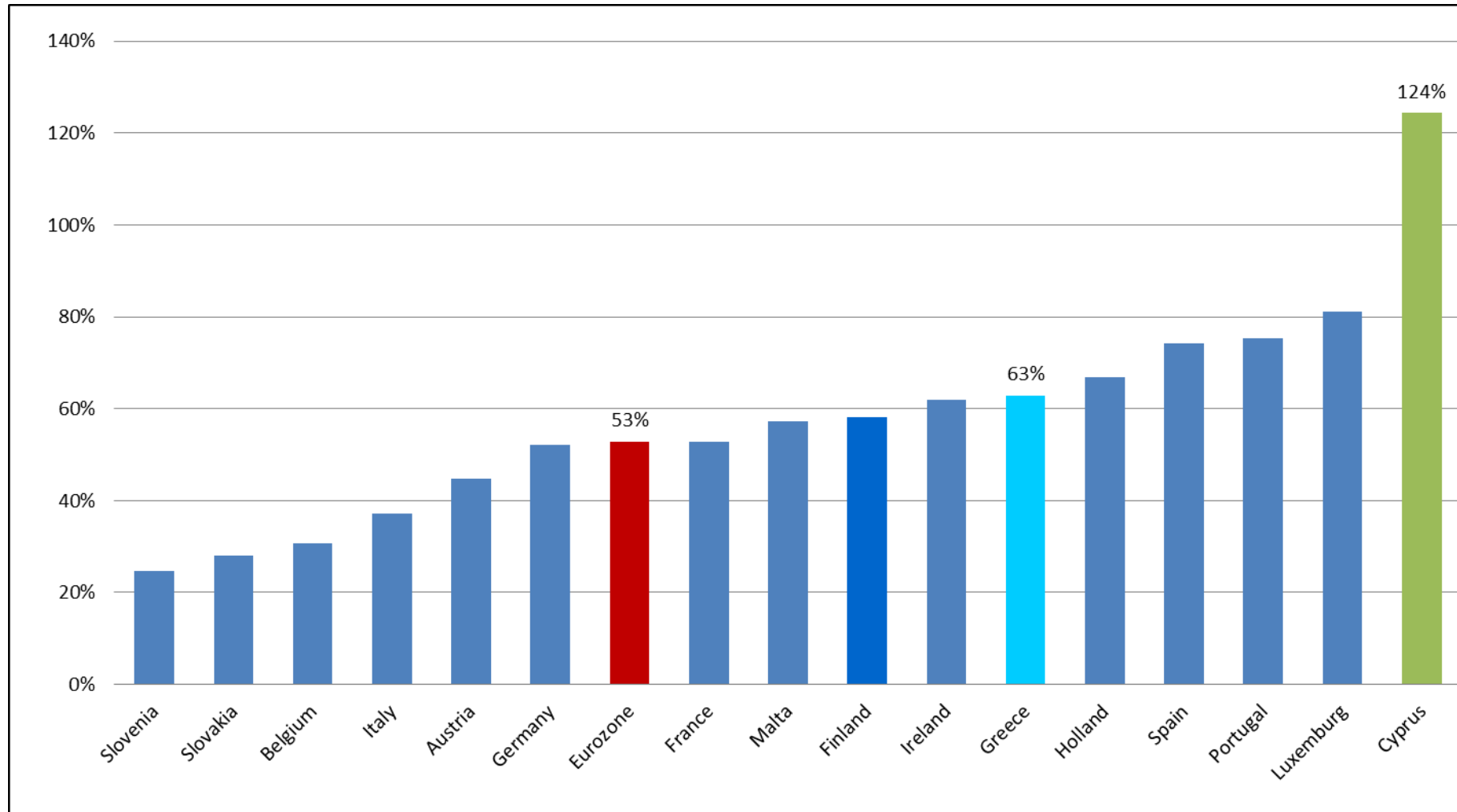
Property Prices



BuySell /MAP Platis Property Index

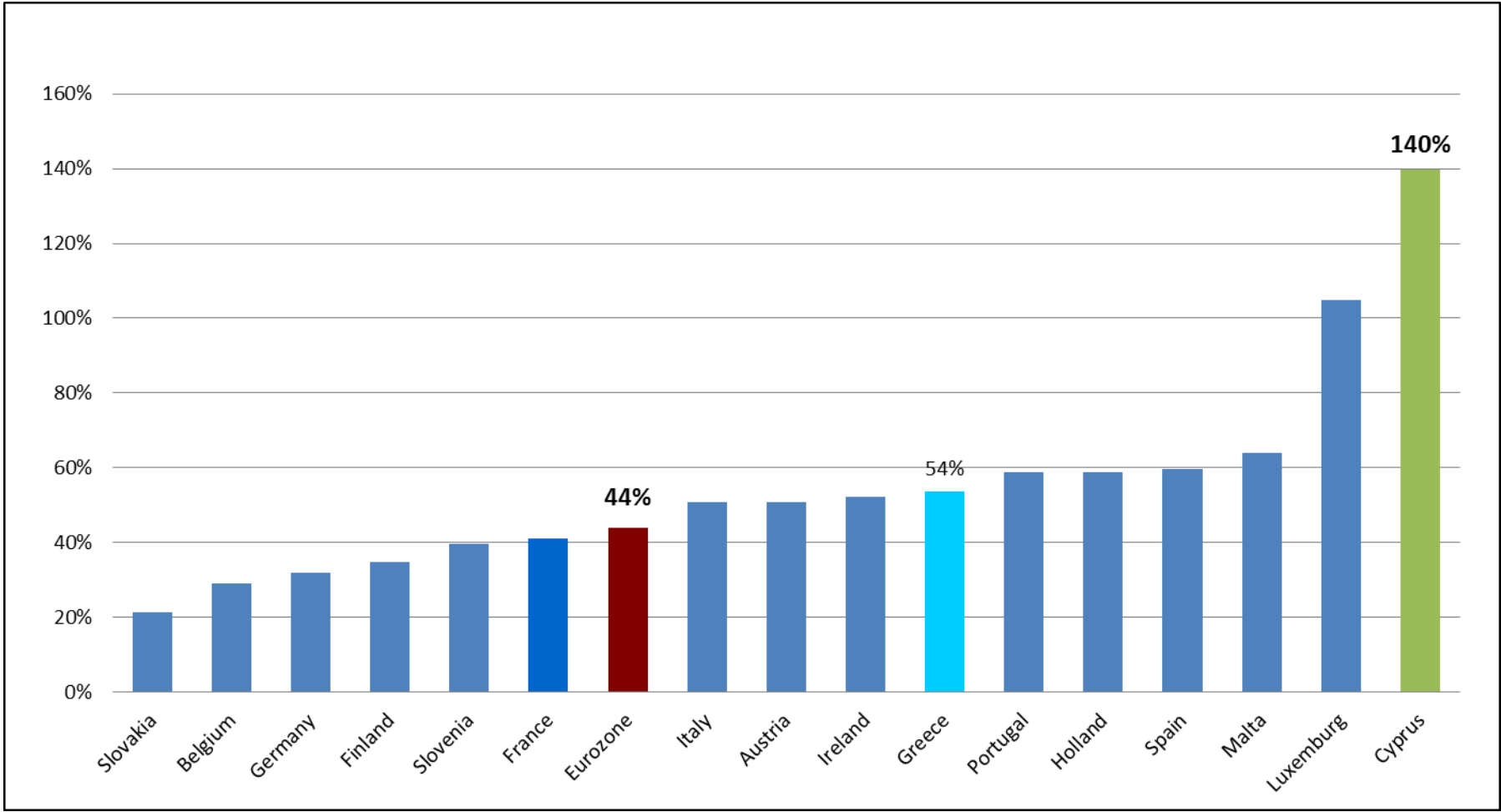
Over leveraged Private Sector

Household Loans/GDP (Eurozone 2013)

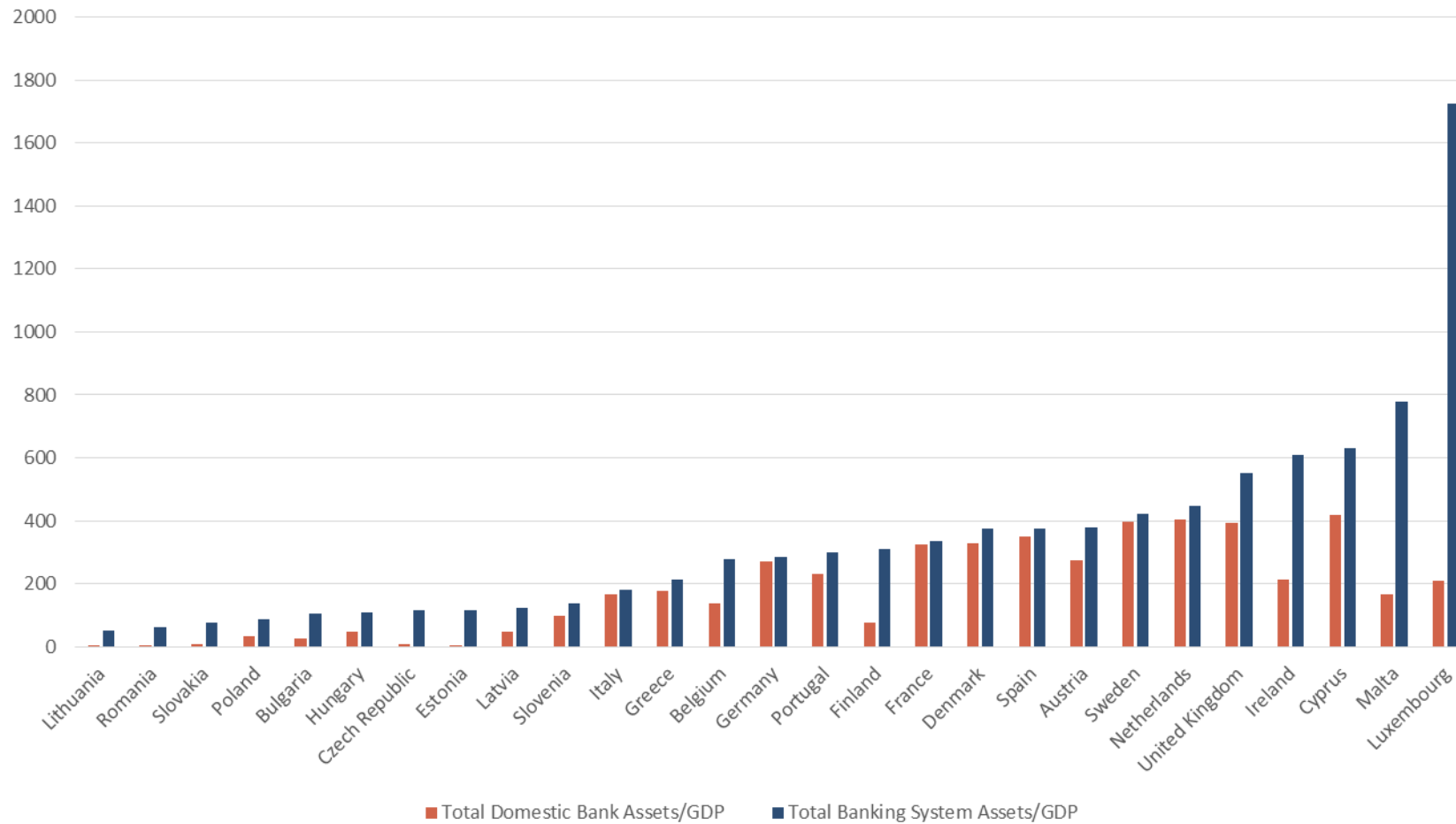


Over leveraged Private Sector

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 – Bad
- BoC got good Laiki – 1 de
- Co-ops got State Aid – to Restructure
- Hellenic Co-ops taken into liquidation and bond conversion
- Capital requirements
- New Banking Rules

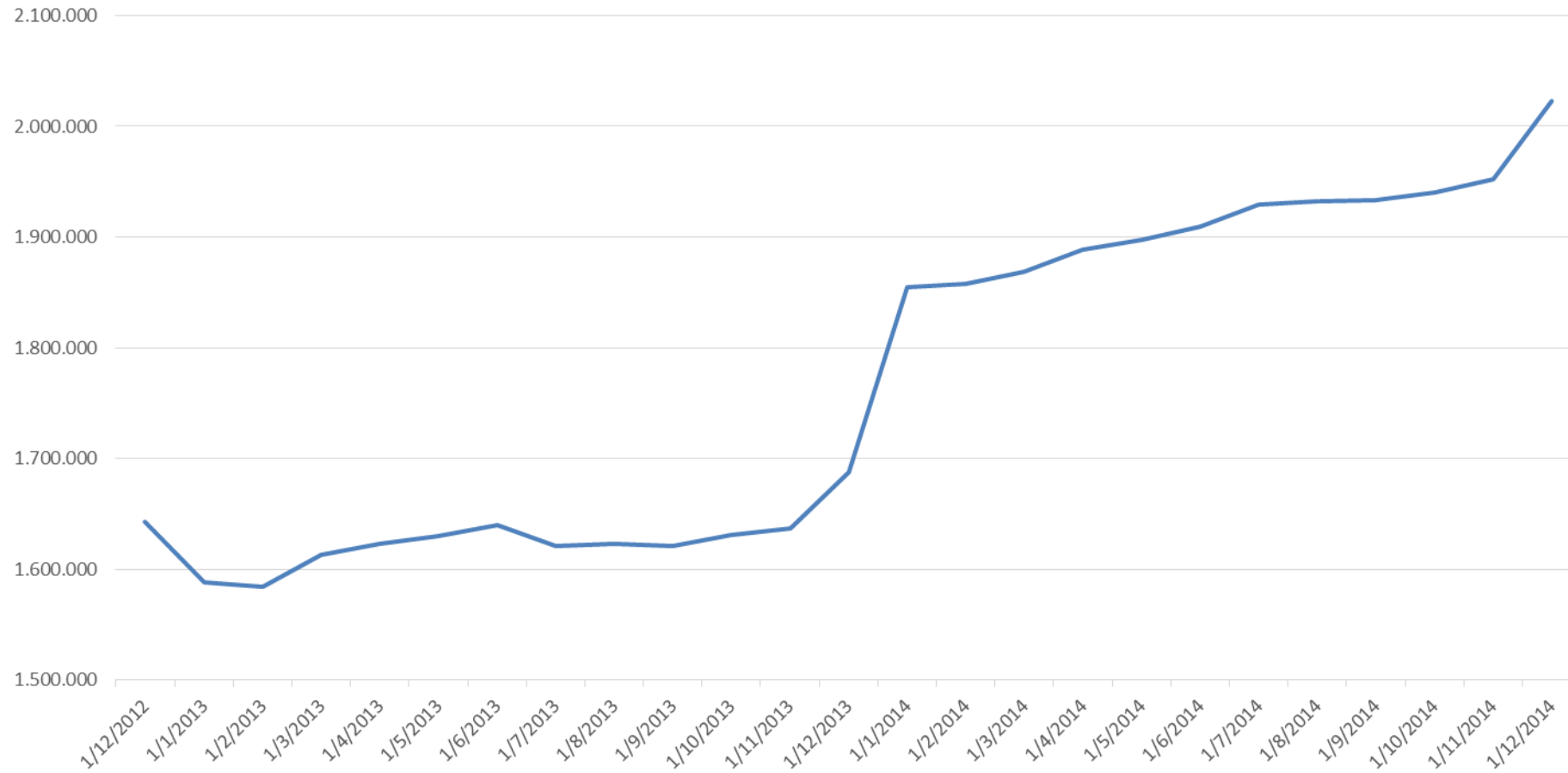
IBU activity severely disrupted
The 2 Largest Systemic Banks badly Hit. If
Co-ops taken into liquidation about 75% of the
banking system badly affected

March Eurogroup Impact



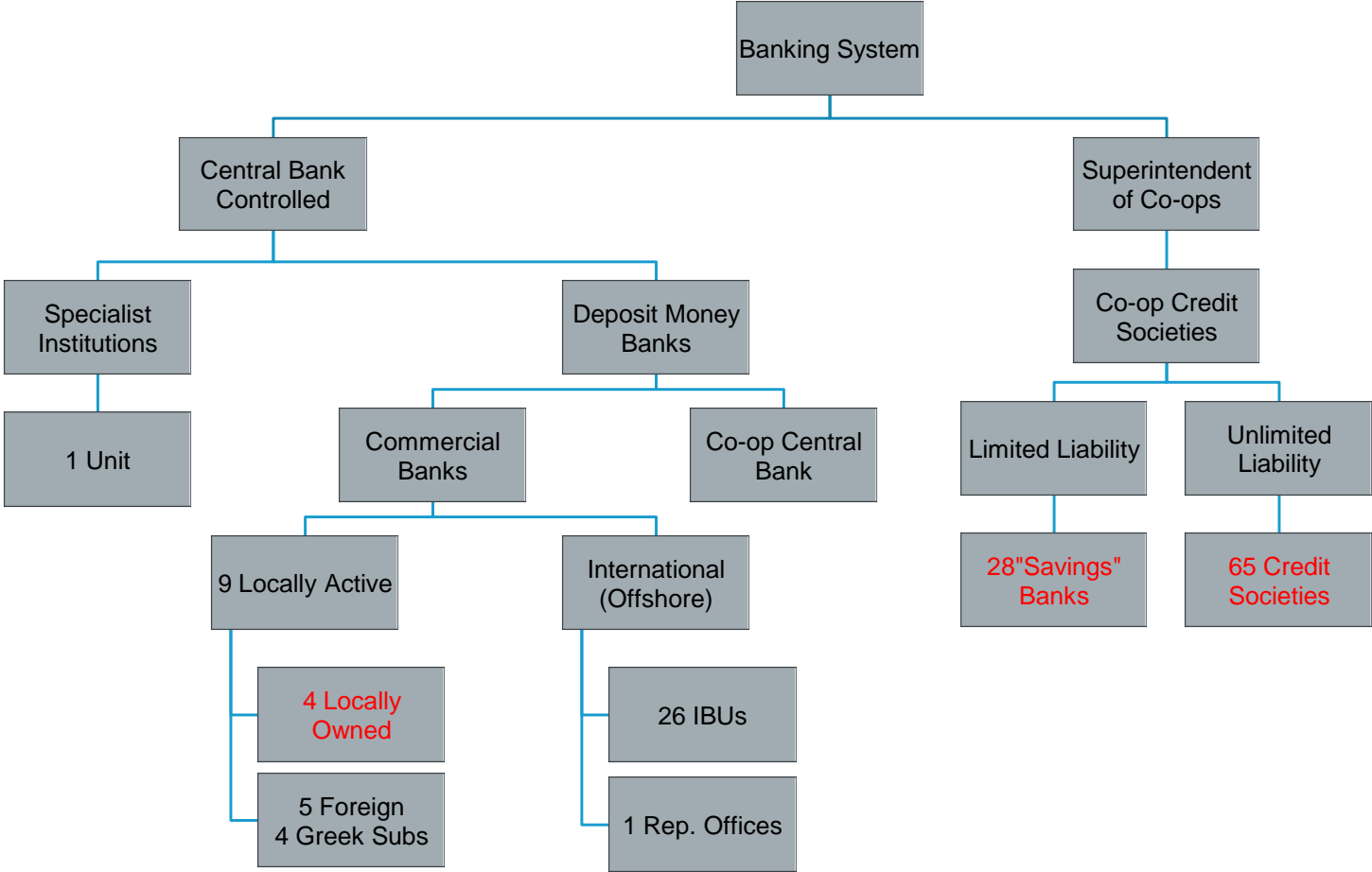
Depositor Confidence

Currency in Circulation



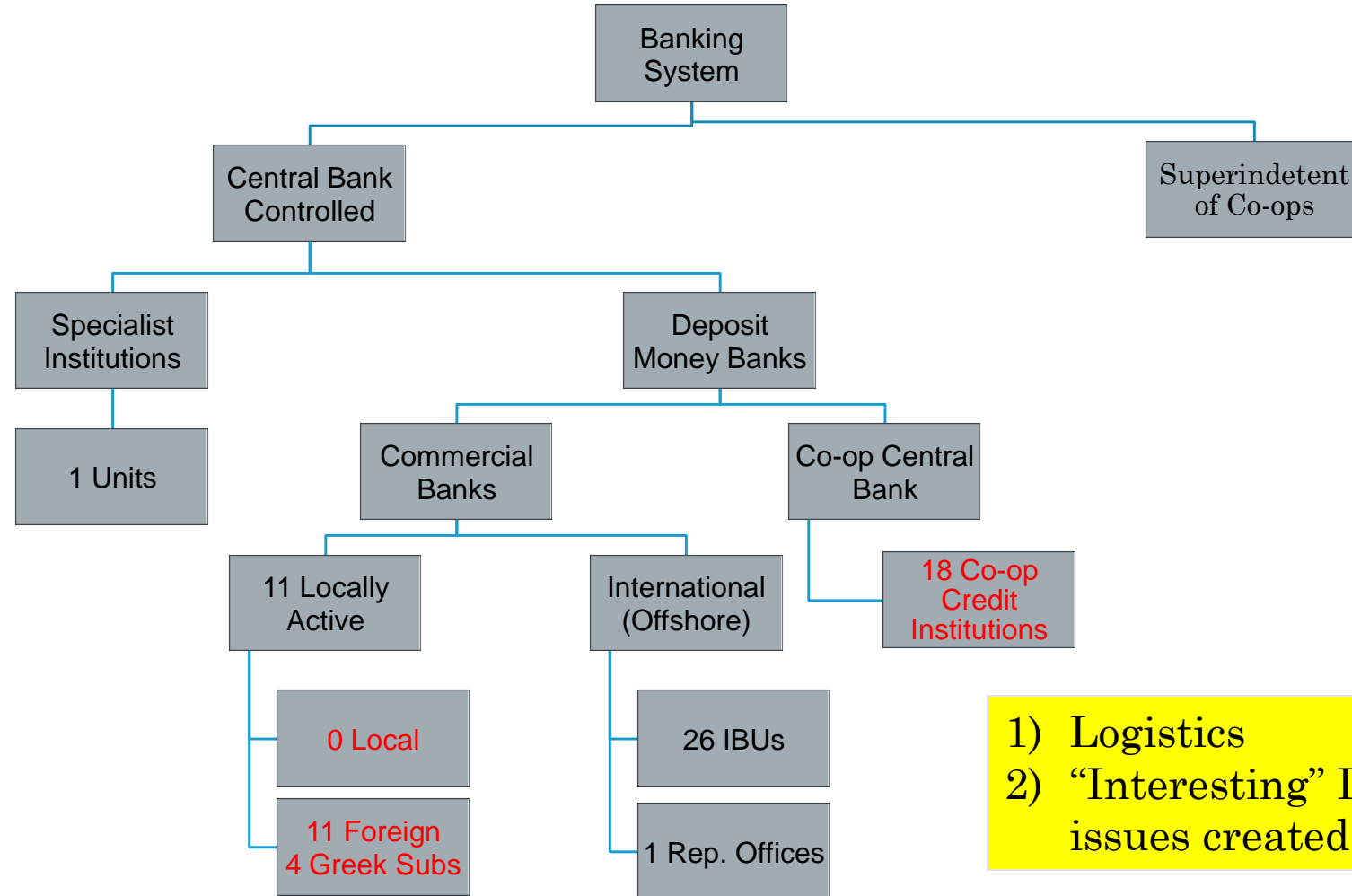
Banking Impact

Banking System Prior to MoU



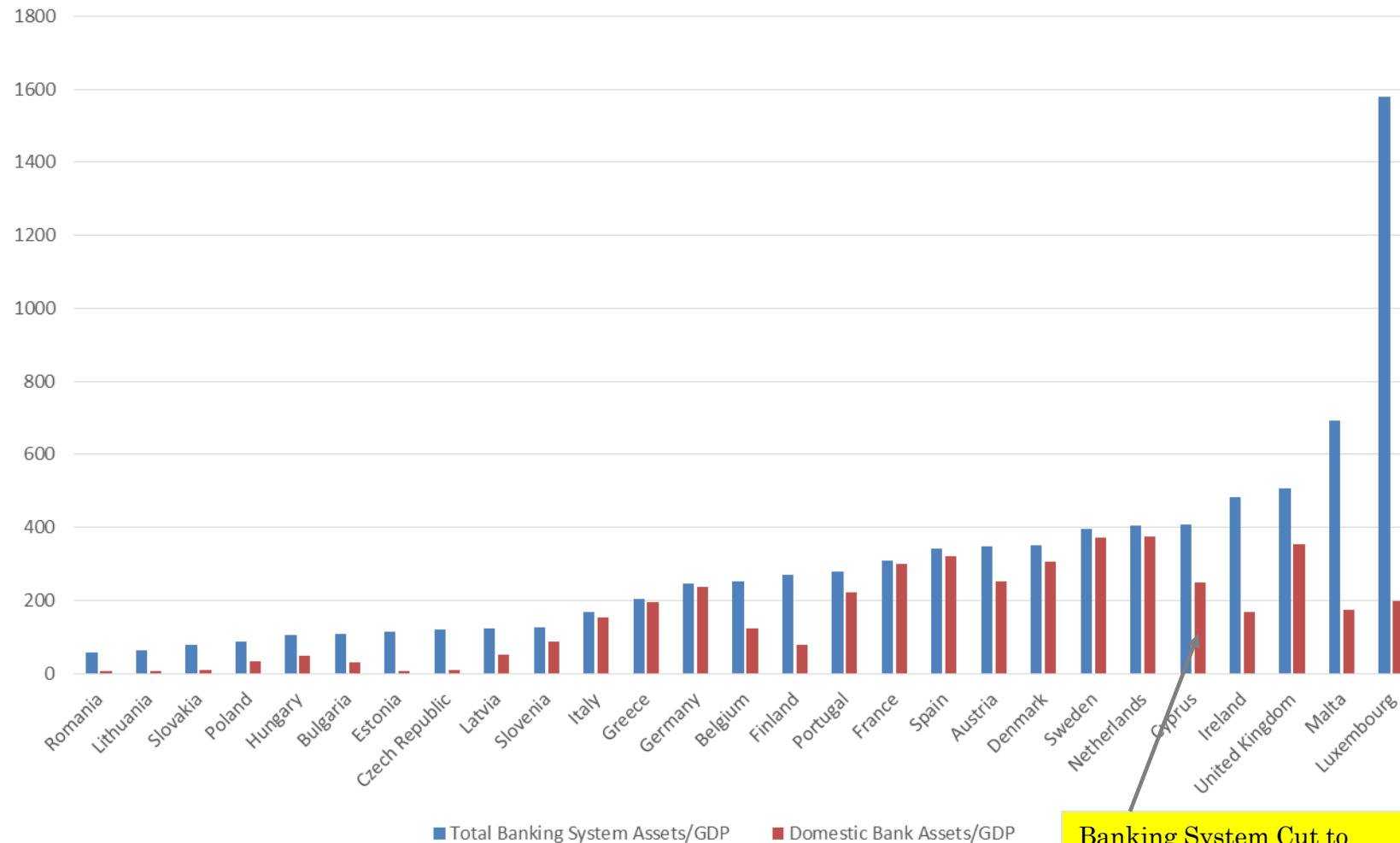
Banking Impact

After MoU



- 1) Logistics
- 2) “Interesting” Legal issues created

Resizing the Banking System*



Banking System Cut to Size?

*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

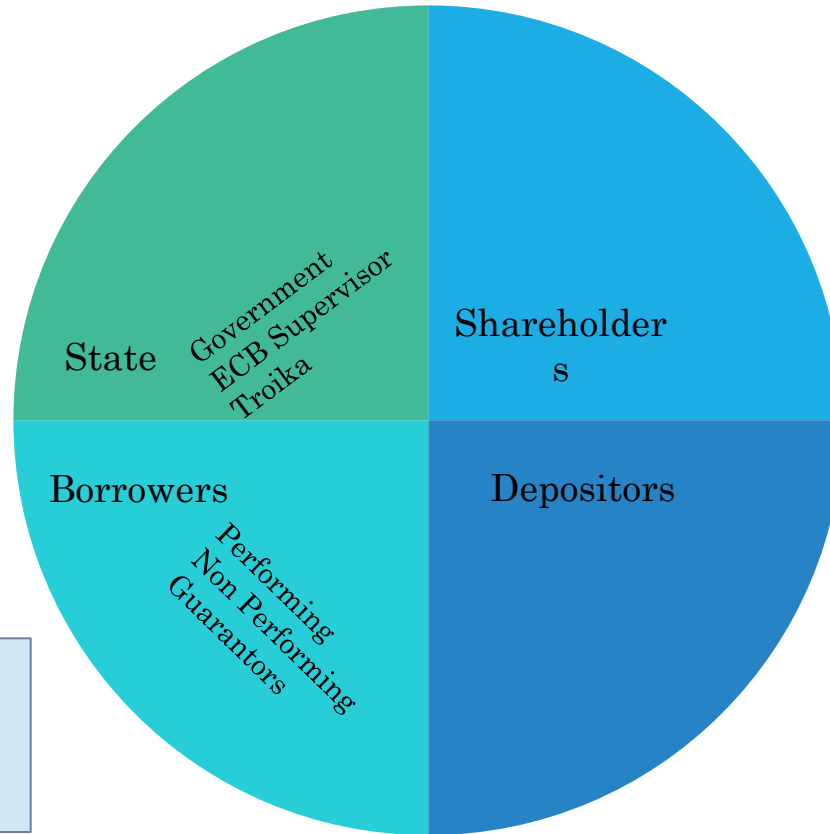
- Problem Loans take time to fix
 - Strategic defaults and asymmetric information
 - Re-contracting and free riders
 - Defaulter expectations
 - Politicians
 - Lawyers

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

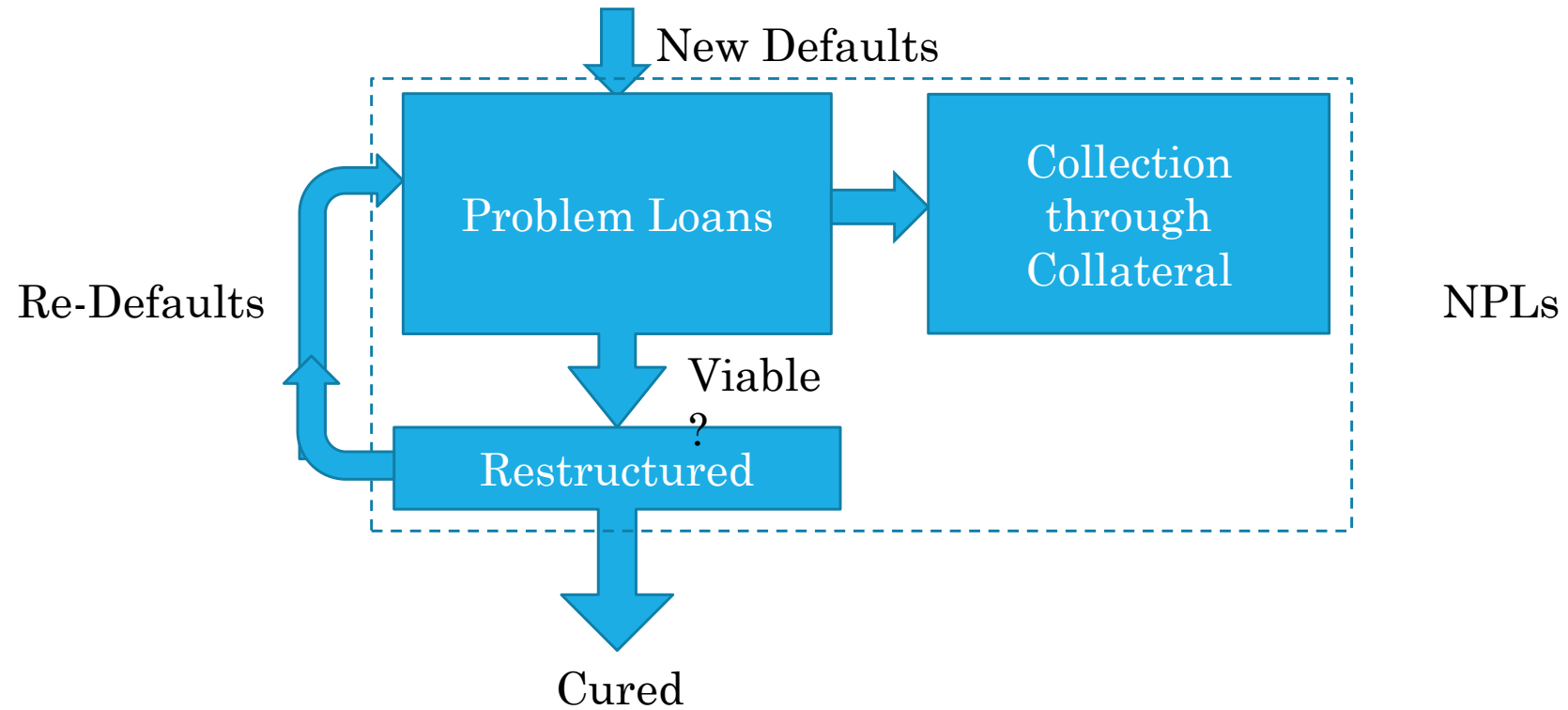
Challenges

- 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



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

POLITICIANS

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

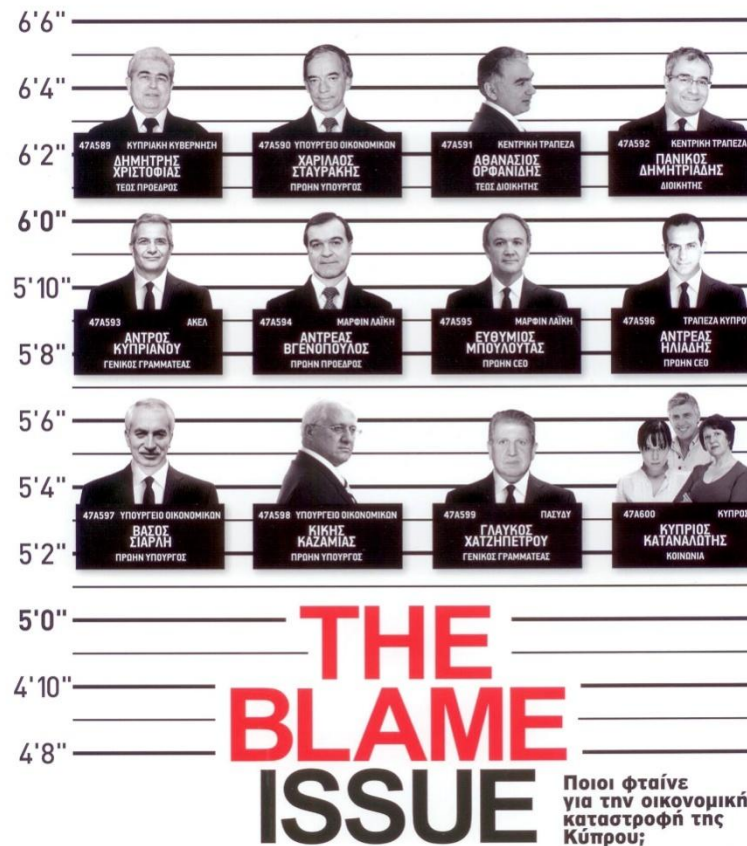
Epilogue

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 ...

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Aftermath 2

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



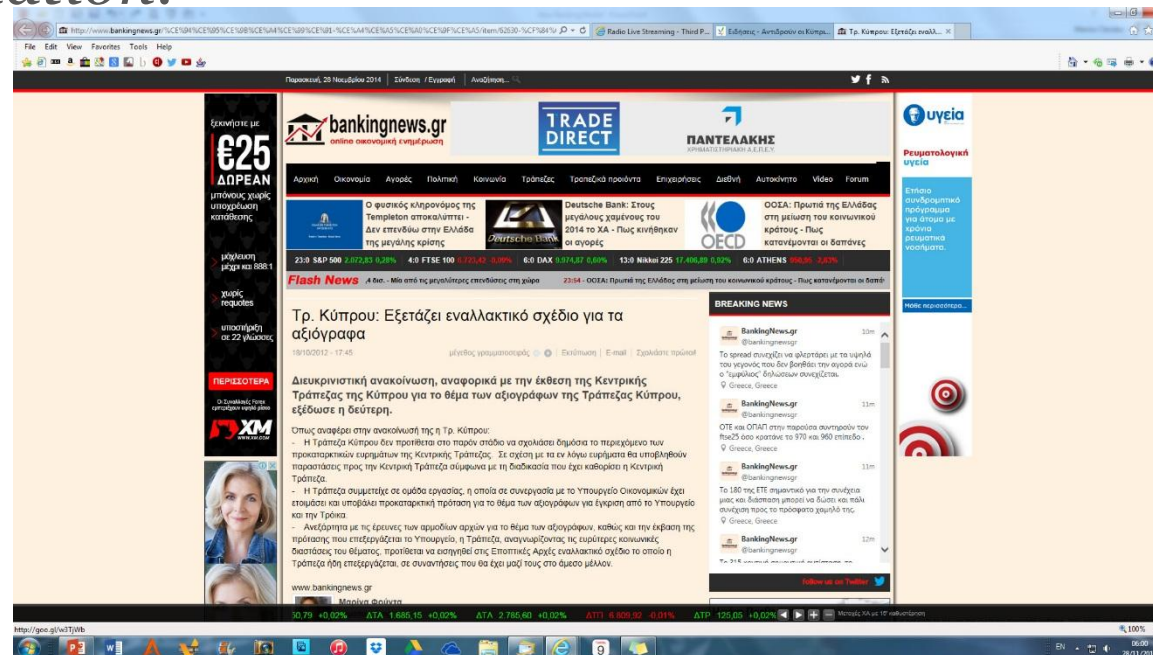
Developer



Businessman

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.

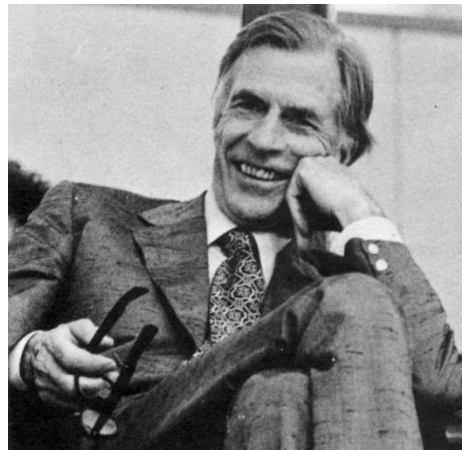


Aftermath 4

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