

Clients & Friends Memo

Cyprus: Time to Trade?

22 April 2014

On 25 March 2013, the Bank of Cyprus and Laiki Bank (also known as Cyprus Popular Bank) entered resolution proceedings under the Resolution of Credit and Other Institutions Law 2013.

Laiki Bank, the second largest Cypriot bank, was immediately resolved and split into three parts: (i) its Greek operations which were sold to Piraeus Bank in Greece, (ii) a “good bank” comprised of deposits below EUR100,000 which were transferred to the Bank of Cyprus, and (iii) a “bad bank” comprised of deposits above EUR100,000 (holders of which will take part in Laiki Bank’s liquidation, including the bank’s remaining overseas operations and the 18% share capital of Bank of Cyprus received by Laiki Bank as compensation in the resolution process). Additionally, Laiki Bank’s EUR9.2 billion Emergency Liquidity Assistance loan liability to the Central Bank of Cyprus was transferred to Bank of Cyprus and enjoys super-priority status in insolvency over all secured and unsecured creditors, including all deposit holders.

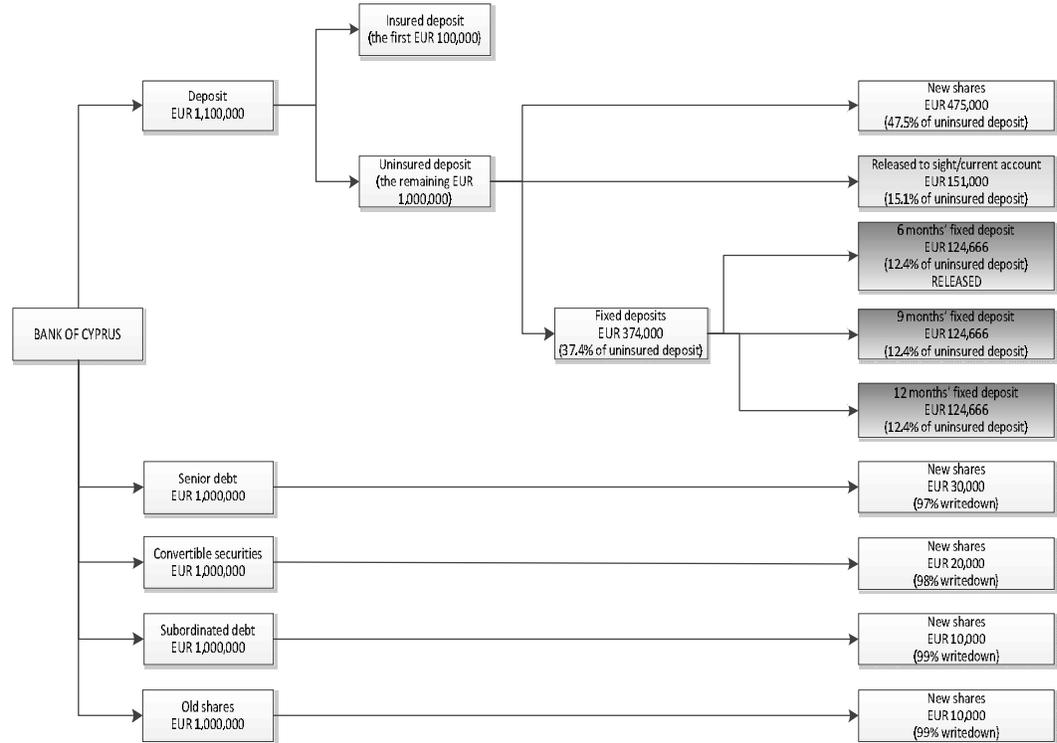
Bank of Cyprus, the country’s largest bank, emerged from its recapitalisation process on 30 July 2013. Greek operations were sold to Piraeus Bank and existing shares and debt securities were written down to almost zero. Deposits below EUR100,000 were treated as insured whereas deposits above EUR100,000 (less the amount of any loans made to the deposit holder) were converted as follows:

- 47.5% into new shares which have been allocated to former deposit holders and are currently suspended from trading on the Cyprus Stock Exchange until at least 31 July 2014 (when the requirements for the shares to become listed will need to have been satisfied).
- 15.1% released to current accounts (subject to capital controls).
- 37.4% into three fixed term deposits of 6, 9 and 12 months' duration paying interest at Bank of Cyprus’s rate plus 10, 12.5 and 15 bps respectively. Bank of Cyprus has discretion to roll these deposits for an additional term but the 6 months’ deposits were released on 31 January 2014 (but remain subject to capital controls). The 9 months’ deposits mature at the end of April 2014.

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The diagram below lays out the key features of the recapitalisation:



CAPITAL CONTROLS

In March 2013, the Cyprus government introduced temporary administrative and capital control measures to contain the risk of significant deposit outflows, relating in particular to domestic transfers, cross-border transfers, cash withdrawals, cash exports and the opening of accounts.

Capital control decrees are generally published once a month by the Minister of Finance. The latest decree entered into force on 31 March 2014 and will remain in force until 4 May 2014. The key restrictions on transactions are summarised below as in effect at the date of publication (noting that local advice should always be sought in relation to any prospective transaction).

- Permitted transfers within Cyprus:
 - There are no longer any restrictions on cash withdrawals.
 - Cashless payments/transfers to accounts at other credit institutions in Cyprus: EUR50,000/month (natural persons) or EUR200,000/month (legal persons).
 - Cashless payments/transfers to accounts at other credit institutions in Cyprus for purchase of goods/services: no limit.

- Permitted transfers abroad:
 - Transfers abroad: EUR5,000/month.
 - Cashless payments/transfers to accounts abroad within a person's normal business activity: EUR1,000,000/transaction (no limit subject to the approval of the Central Bank Committee).
- Physical export by natural persons: EUR3,000 (or equivalent) per journey abroad.
- New accounts for persons who were not customers of the relevant credit institution on 11 April 2013 may be opened (in each of the below cases):
 - Where the account is funded with funds from abroad; or
 - Where prior approval by the Central Bank Committee is given; or
 - For new fixed term deposit accounts created with funds from cash exceeding EUR5,000; or
 - For an account relating to a new loan granted after 2 August 2013.
- Existing current accounts may have new beneficiaries added where prior approval by the Central Bank Committee is given.
- Scope of decree:
 - Credit institutions in Cyprus may not facilitate circumvention of the decree.
 - The measures apply to all accounts, payments and transfers regardless of currency denomination.

HOW TO TRADE?

Pre-Trade Diligence

Given the potential lack of clarity regarding the source of funds held in deposit accounts, buyers will need to carefully diligence seller entities and the purchased assets (including the new shares entitlement and current/deposit account documentation) and should seek seller representations relating thereto including regarding anti money laundering, anti-corruption and sanctions. Buyers will be required to provide extensive "Know Your Client" information to Bank of Cyprus in order to become accountholders. If the agreed settlement mechanic requires use of an escrow account then both the buyer and the seller will additionally be subject to escrow agent diligence.

Transaction Documentation

- LMA (Loan Market Association) trade confirmation governed by English law including a seller obligation to hold the purchased assets on trust for the buyer until settlement.
- Assignment agreement governed by Cyprus law including a power of attorney (permitting the buyer to take all necessary actions regarding the purchased assets) and a notification to Bank of Cyprus.
- Instrument of transfer relating to the new unlisted Bank of Cyprus shares.

- Payment instructions relating to the transfer of seller's current/deposit account balances to the buyer's accounts.

Current/deposit accounts and new unlisted shares may be traded separately or as a package together with all ancillary rights and claims including any related litigation against Bank of Cyprus, Laiki Bank, the special administrator, and/or any relevant Cypriot government entity.

Settlement

Bank of Cyprus: while it is possible to add beneficiaries to the seller's accounts pursuant to the decree, in practice, settlement of the current/deposit account balances is effected by means of a direct transfer from the seller's to the buyer's new account at Bank of Cyprus.

Settlement of the new shares (prior to any listing) must be in accordance with the detailed procedural requirements laid out by Bank of Cyprus in January 2014, including submission of duly apostilled, notarised and/or certified transfer and constitutional documents.

Payment of the purchase price can be tied to (i) delivery of the settlement documents to Bank of Cyprus, (ii) receipt of confirmation from Bank of Cyprus that the seller's current/deposit accounts balances have been transferred to the buyer's accounts and/or (iii) registration of buyer as the holder of the shares.

Laiki Bank: subject to the nature of the underlying claim, transfers can be effected based on a similar LMA based confirm as for Bank of Cyprus (amended to reflect the claim), Cyprus law governed assignment agreement and power of attorney, with settlement linked to acknowledgment of the transfer in the Laiki Bank insolvency proceedings.

Summary

The release of the first tranche of the Bank of Cyprus 6 months' fixed term deposits was perhaps a positive sign regarding the condition of the Cyprus economy, but it remains to be seen whether the second and third tranches are similarly released, and the timing for lifting of the currency controls is still unclear. Political, commercial and legal uncertainties relating to the trading of Bank of Cyprus liabilities are nevertheless resolving gradually. In particular, it has been possible with local counsel assistance to enter into dialogue with the Bank of Cyprus regarding settlement mechanics for individual trades providing a clearer path towards a liquid market in Cyprus transactions.

Panicos Demetriades, outgoing governor of the Central Bank of Cyprus, said on 14 February 2014 that Cyprus could lift all capital controls by the end of 2014 if it made sufficient progress adopting an international bailout programme. His sentiments have been echoed by John Hourican, Chief Executive of Bank of Cyprus who, on 30 March 2014, stated that he expects restrictions on moving money out of the country to last another year. Time could therefore be of the essence for traders to match with willing sellers, but will the price be right?

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