

**PRIVILEGED AND CONFIDENTIAL**

**Discussion draft 18.03.13**

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**PROJECT COSMO**

**Bank resolution – Possible Plan B**

We discussed possible alternative methods of achieving the financial conditions imposed by the Troika without adoption of the proposed levy. This note sets out a possible alternative involving the resolution of the Cypriot banks in question under resolution powers to be adopted by Parliament. It is possible to include the proposed sale of Greek assets as part of this option, to address the Greek disposal separately or indeed to pursue this option instead of the Greek disposal. The passing of resolution legislation as part of Plan B may provide an opportunity to facilitate the Greek disposal.

	Step	Issue/comment
1.	New legislation to be enacted to enable implementation	The legislation may also facilitate implementation of the Greek Transaction if it is not possible or optimal to effect that deal via a private law contract. In order to achieve that, the resolution powers exercised under the legislation for that purpose would need to be "reorganisation measures" under CIWUD and we would need to seek confirmation from Greek lawyers that they would be recognised as such in Greece.
2.	Bridge bank to be incorporated, funded and capitalised and appropriate corporate governance arrangements to be put in place	If the assets and liabilities of more than one Cypriot bank are to be transferred, is there to be a single bridge bank or one for each of the residual banks? Having more than one new bridge bank would create a competitive banking landscape going forward but query whether the new banks would be of a sufficient scale to be separately viable.  Will the shares be held directly by the Minister of Finance or through an intermediate vehicle?  Note: Holding the shares through an intermediate (limited liability) vehicle would have a number of advantages (including liability limitation) and could facilitate any future

	Step	Issue/comment
		restructurings.
3.	<p>Transfer to bridge bank of retail deposit business, including:</p> <p>(i) deposit liabilities (up to the insured limit or such higher amount as may be decided),</p> <p>(ii) matching assets (plus appropriate valuation buffer), and</p> <p>(iii) infrastructure, IT, employees, contracts with service providers etc.</p>	<p>If a customer is both a depositor and a borrower, will its entire deposit book and repayment obligations be transferred to the bridge bank?</p> <p>Do depositors have priority under Cypriot law? If not, should depositor priority be introduced (as happened in Iceland)? See note below on implications of this for potential compensation payments.</p> <p>Should the transfer encompass Cypriot depositors only, or should depositors in other jurisdictions be included in scope. Note EFTA decision in relation to Iceland, whose preferential treatment of Icelandic depositors was held not to be discriminatory.</p> <p>Is the transfer only of deposits up to the insured limit? Consider if it would be preferable to set a higher level. Important to understand how the insured limit is calculated – is it on net or gross basis?</p> <p>Is it appropriate to carve-out any categories of depositor to ensure that their deposit balance is transferred in full (e.g. charities, trust and client accounts, SMEs)?</p> <p>Where do the assets and liabilities sit within the relevant banking groups? Are they in branches of the banks or in subsidiary undertakings? If in subsidiary undertakings, are the subsidiaries directly or indirectly owned by the banks? Need to ensure resolution legislation enables shares in subsidiaries to be transferred and/or assets of non-bank subsidiaries to be transferred.</p> <p>If loan assets are transferred which have continuing lending commitments, need to</p>

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		consider how these should be funded.
4.	The relevant resolution provision will need to specify that those depositors being transferred are not entitled, by virtue of the transfer, to make a claim on the Deposit Guarantee Scheme	Potentially impose a temporary variation to the rules of the Cypriot Deposit Guarantee Scheme stating that the transfer of insured deposits is deemed to be a payout under the Scheme. Important to review the rules of the Scheme to assess how this should be done.
5.	To the extent that relevant systems or infrastructure for the operation of the bridge bank are not transferred, transitional service arrangements to be put in place to ensure that the bridge bank has access to required services.	<p>Key considerations for a TSA include: (i) consideration (lump sum payment or a mechanism for calculating the consideration on a per service basis), (ii) tax (which party bears the cost of VAT on the services being provided), and (iii) duration.</p> <p>There may also be a requirement for a reverse TSA by which the bridge bank provides services to the rump bank to enable it to run its wind-down.</p>
6.	Residual bank placed into liquidation, meaning the balance of each deposit not transferred to the bridge bank ranks as an unsecured claim ( <i>pari passu</i> with all other unsecured creditors) against those assets that remain following the transfer.	<p>To consider whether it is relevant to include a compensation mechanism for creditors of the residual bank to ensure that they are put in the same position as they would have been on a liquidation if the transfer had not taken place. If a compensation mechanism is adopted, to consider who should fund it (the state, the Deposit Guarantee Scheme or the bridge bank). Appropriate assumptions regarding the basis on which compensation is calculated should be included.</p> <p>Note – if depositor priority law is enacted, then that will potentially reduce the amount of the required compensation payment to the residual bank on the basis that that would in any event have reduced returns to all unsecured creditors on a liquidation.</p>