

How Cyprus damaged the ECB's reputation

As Portugal's Vitor Constancio, Vice President of the European Central Bank (ECB), and Luxembourg's Yves Mersch, ECB Executive Board Member, are busy on the speech trail to present their heroic work putting together the building blocks of what will become the European Central Bank's Single Supervisory Mechanism (SSM) – the worst governance breakdown in the rather short history of the Euro system – with the ECB Governing Council's reputation severely damaged – can be visited in the Eurosystem's handling of Cyprus.

What is possible at the supra Eurosystem and ECB level high above national legal systems goes like this: A national central bank can dole out so-called "Emergency Liquidity Assistance". Such ELA funds are liquidity provided to a eurozone commercial bank in a financial crisis by its national central bank under the liability of the respective sovereign. In order to qualify for ELA funds a bank must qualify to have adequate collateral and to be solvent.

So the country's second largest commercial bank for almost a year obtained €9 billion in ELA loans eventually matching 60% of the country's economy. The emergency liquidity assistance is used by the bank's management partly to let well connected subordinated creditors and hybrid capital holders exit by offering them generous buy back terms. This is – as it turns out – a smart move for a few, because the bank eventually is shut down as part of a Troika rescue operation in which the good assets are transferred to the country's largest commercial bank which is rescued by its eurozone partners and the International Monetary Fund (IMF). A large part of the good assets of the ongoing bank will be used to pay back the ELA loan, so the Eurosystem is made hole.

The question arises: Why didn't the ECB governing council stop such a fraudulent ELA lending operation? ECB governing board member Joerg Asmussen gave the explanation to the European Parliament's Economic and Monetary Committee. The ECB governing council can stop such lending only with a two-thirds majority. From this follows: : Since the ECB governing council is voting "one country one vote", the net-payer countries like Germany, the Netherland or Finland - never will reach in the future a two-thirds majority when Club Med debtor countries embark on using the ELA rescue pipe line to keep their zombie banks above water.

This way Cyprus marks an important milestone on the road of debtor countries obtaining control over the liability expansion of the Eurosystem i.e. of the pace and amount of Euro creation through the ELA credit window. In that respect Cyprus shows how the Eurosystem – with an ECB governing council chained to a two-thirds majority – is running an ELA pipeline that is out of control, at least from the net-payer countries central banks.

As follow up it is interesting to look at how the Cypriots are reacting for being – in their view – unfairly treated by their Eurozone partners. Why? When European leaders, at their October 2011 Brussels summit, decided on the haircuts on Greek sovereign bonds they left the deeply interconnected Cyprus banks with operations and branch networks in Greece out in the cold. Only Greek bank ring fencing was the Troika strategy. The Cyprus banks – with losses of more than €5 billion on their Greek sovereign bond holdings alone were put in a hopeless situation. By intention or by default the Eurogroup left the Cyprus banks and their not so much liked large depositors to their fate. The smart investors and depositors got the message and hurried for the exit. Others stayed and lost a lot of money. From the wave of litigations following the Cyprus financial meltdown one can gather bits and pieces on the questionable role of central bankers, bank supervisors and –of course –the failings of bank managements.

Conspiracy theories and litigations

On June 11, court hearings in Cyprus were supposed to shed light into the alarming governance breakdown in the European System of Central Banks (ESCB) and the European Central Bank 's (ECB) Governing Council. But that was not the case. The controversy about providing so-called Emergency Liquidity Assistance “(ELA) of about €9 billion to Laiki is still going on. Although the second largest Cyprus bank was – so it is alleged – technically insolvent since July 2012 when Cyprus sovereign debt was rated junk.

As Georges Psyllides from Cyprus-Mail reports on the basis of press statements of the Central Bank of Cyprus that no longer can be found on the CBC website, a Cypriot court has frozen assets worth around €5.3 billion belonging to former Laiki Bank boss Andreas Vgenopoulos, a Greek national, Laiki CEO Efthimios Bouloutas and Kyriacos Magiras. The Central Bank of Cyprus announced June 1, 2013 that about €3.79 billion of the frozen assets belong to Vgenopoulos and Bouloutas and €1.5 billion belong to former Laiki board member Magiras. The court order also banned Vgenopoulos 'Marfin Investment group (MIG) Holdings SA from making any payments or transfers to the benefit of the three men.

The orders were secured after a lawsuit was filed against the three and eight other former Laiki executives –including CEO Christos Stylianides –and MIG, demanding damages. The defendants were accused of granting unsecured or insufficiently secured loans or loans that entailed undue risk, violating prudent banking practices, and insufficient supervision and management in relation to the merger between Greece 's Marfin Egnatia and Laiki. From the three and MIG, Laiki is demanding compensation for the loss incurred through the merger due to a “conspiracy between the four”. A

court ruling was also sought that any money related with the claims in the suit will be transferred to the bank.

Vgenopolous denies any wrongdoing. “The positive in these developments is that all claims are led before justice so that the mudslinging and slander will be finally dealt with court decisions”, he said in a statement. Vgenopoulos blames Cypriot authorities for the demise of the bank because they mistakenly accepted the EU-sanctioned writ-down of Greek (sovereign) debt in October 2011. Cyprus was forced to shut down Laiki 18 months later and impose massive losses on depositors.

The court hearings are take place in a poisoned climate of reprehensions in the aftermath of the European Cyprus rescue of March 24-25, with Troika supervised loans of €10 billion and a Cyprus contribution of €5,8 billion, coming with a major bail-in of large depositors above €100 000 . Part of the rescue deal was that Laiki will be dissolved, after split in good bank and bad bank assets. The good bank assets were transferred to ongoing Bank of Cyprus which also took over the liability of paying back the €9 billion of emergency liquidity assistance on which Laiki was kept above water.

Under pressure from Cyprus citizens the islands lawmakers are up in arms. They want the state of to sue the European Central Bank and perhaps “ even ECB president Mario Draghi personally for authorizing the transfer of billions in emergency liquidity to prop up Laiki despite the fact the bank was broke. The ECB argues that post-May 2012 Laiki was illiquid but not insolvent. When in May 2012 the state of Cyprus provided Laski with €1.8 billion it already had received €3.8 billion of emergency assistance from the Cyprus central bank.

In two letters to ECB president Mario Draught on 15 April and June 6 of this year, Cyrus president Nikos Anastasias accused the islands` central bank governor Panics Demitriades for allowing that emergency assistance was doled out to insolvent Laiki ; but by implication he also made the ECB and its leadership responsible for this calamity.

Demetriades meanwhile is feeding conspiracy theories, arguing that Laiki, once the islands second largest bank, in spite of being insolvent was kept afloat by the European Central Bank up to March this year in order to “protect” foreign investors . As member of the ECB Governing Council Demitriades should know. As he explains, this gave large investors and depositors enough time to withdraw the money in due course. As Demitriades told the Tagesspiegel, the better informed quarters were able to protect their investments. And as the Tagesspiegel’s investigative reporter Harald Schumann found out in Nicosia from different sources: “The burden (of the bail-in) was to be shared among Russian investors, Cypriot pension funds and businesses, with losses totaling at €6 billion”. There are estimates that foreign investors and depositors have withdrawn about €10 billion since the

October 2012 EU summit decision to push private sector investors into deep haircuts on Greek government bonds leading up to the eventual Cyprus bank rescue with severe losses of larger depositors.

Bank of Cyprus governor Demitriades had to appear before the Cyprus parliament's House ethics Committee to defend allegations to have misled parliament or to have withheld information over the terms of reference of the audit firm Alvarez& Marsal which appeared to focus on Bank of Cyprus. Their findings, so the allegations, did not contain much information on Laiki, which had been bailed out by the state to the tune of €1.8 billion and had been granted some €9 billion in ELA support. . In the House Finance Committee of the Cyprus parliament, there are allegations that the ECB breached its own regulations in allowing the continued provision of emergency liquidity to Laiki, which ultimately hurt the Cyprus economy. Members of parliament urge the government to bring the matter up with the European Court of Justice. George Perdakis, a parliamentarian of the Greens, compiled a report by financial experts, detailing "irregularities" committed by both the ECB and Draghi and urging the president of Cyprus to take action.