

BRRD – The Cyprus position

In early 2013 the Cyprus banking sector was in severe difficulties. As a result of the disproportionately large banking sector, Cyprus was facing a major economic crisis. Laiki bank, the second largest bank in Cyprus was on the verge of bankruptcy, a factor which would inevitably have led to the collapse of the Cyprus economy if no steps were taken. At the time, there was no concrete banking resolution infrastructure or regulation in Cyprus to assist in such a dire situation. The Parliament convened an emergency session on 22 March 2013 lasting just two days and passed the Resolution of Credit and Other Institutions Law (17(I)/2013)(the **Resolution Law**) in order to facilitate the restoration of the viability of the financial sector in Cyprus and to satisfy the criteria imposed by the Eurogroup as a condition to the Euro 10 billion bailout to the Cyprus economy.

The Resolution Law gave the power to the Central Bank of Cyprus (the **CBC**) as resolution authority to impose certain measures to credit, banking and co-operative institutions. These measures included: (i) the increase of share capital of the affected institution; (ii) the sale of operations of an affected institution; (iii) the transfer of assets rights or liabilities; and (iv) the bail in of the affected institution. The Resolution Law resulted in Laiki being placed under resolution whereby substantially all of Laiki's assets were transferred to Bank of Cyprus, leaving a "bad bank" with minor, mainly insignificant assets, and Bank of Cyprus, the "good bank" absorbing the largest part of Laiki's operations.

Although the Resolution Law allowed for the resolution of credit institutions, due to the hasty nature of its application and as this was enacted prior to the implementation of Directive 2014/59/EU on the establishment of a framework for the recovery and resolution of credit institutions and investment funds (the **BRRD**)(which was published by the EU Commission on 12 June 2014), this law provided insufficient detail on certain vital aspects of its implementation.

The New Resolution Law

In March 2016, the Cyprus Parliament enacted a new law for the Resolution of Credit Institutions and Investment

Companies, Law 22(I)/2016 (the **New Resolution Law**). The New Resolution Law replaced the existing legislation in order to fully align Cyprus national law with the EU provisions.

Scope of the New Resolution Law

The New Resolution Law gives the CBC as resolution authority (the **Resolution Authority**) the power to impose, together with the Ministry of Finance, certain measures on:

- An institution (this means an authorised credit institution or an investment firm)
- A financial institution established in the Republic of Cyprus when the financial institution is a subsidiary of a credit institution or of a company referred to in (c) and (d) and is covered by the supervision of the parent undertaking on a consolidated basis in accordance with Articles 6 to 17 of Regulation (EU) No 575/2013
- Financial holding companies, mixed financial holding companies and mixed-activity holding companies that are established in Cyprus
- Parent financial holding companies and mixed financial holding companies established in Cyprus

- Branches of institutions which are established outside Cyprus in accordance with the specific provisions laid down in the New Resolution Law (together will be referred to as the **affected institutions**). The Resolution Authority may impose these measures on an affected institution provided that certain conditions are met and in order to achieve the resolution principles as stated in the New Resolution Law

Resolution measures

The resolution measures may be implemented with the following means (i) sale of business tool, (ii) bridge institution tool, (iii) asset separation tool (iv) bail-in tool (together, the **Resolution Measures**). A brief summary of each of the Resolution Measures is set out below.

- Sale of business tool

The Resolution Authority has the power to transfer to a purchaser that is not a bridge institution of: (1) shares or other instruments of ownership issued by an institution under resolution; (2) all or any assets, rights or liabilities of an institution under resolution. Subject to certain provisions in the New Resolution Law, this transfer is deemed valid and enforceable against third parties and can take place without obtaining the consent of the shareholders of the institution under resolution or any third party other than the purchaser and without the need to comply with any requirements of any law or contract term.

- Bridge institution tool

In order to ensure the critical function of the bridge institution, the Resolution Authority may issue a decree for the transfer to a bridge institution: (1) shares or other instruments of ownership issued by one or more institutions under resolution (2) all or any assets, rights or liabilities of one of more institutions under resolution. As with the Sale of Business Tool, subject to certain restrictions this transfer may take place without obtaining the consent of the shareholders of the institutions under resolution or any third party other than the bridge institution and without complying with any procedural requirements under company or securities law.

- Asset separation tool

The Resolution Authority may also issue a decree for the transfer of assets, rights or liabilities of an institution under resolution or a bridge institution to one or more management vehicles. This may also be obtained without the consent of the shareholders or any third party. For this purpose, an asset management vehicle is deemed to be a legal person who is (1) wholly owned by the Resolution Fund and controlled by the Resolution Authority; (2) has been created for the purpose of receiving some or all of the assets, rights and liabilities

of one or more institutions under resolution or a bridge institution.

- Bail-in tool

The bail-in tool allows the Resolution Authority to recapitalise a failing institution through the write-down of liabilities and/or their conversion to equity so that the bank can continue as a going concern.

The Resolution Authority may use the bail-in tool for any of the following purposes:

- To recapitalise an institution or a relevant person that meets the conditions for resolution to the extent in which it is able to:
 - (a) restore the ability to comply with the conditions for the authorisation in order to continue to carry out the activities for which the entity is authorised or if a relevant person is subject to such conditions, to such person
 - (b) allow the continuation of operations which have been authorised pursuant to the Provision of Investment Services Law or the Business of Credit Institutions Law 66(I)/1997 (as amended)(the **Business of Credit Institutions Law**)
 - (c) sustain sufficient market confidence in the institution or entity
- To convert to equity or reduce the principal amount of claims or debt instruments that are transferred:
 - (a) to a bridge institution in order to provide capital to that bridge institution; or
 - (b) within the scope of the sale of business tool or the asset separation tool

Although the scope of the bail-in tool is generally broad, the New Resolution Law does contain exclusions from the scope, implementing Article 44 of the BRRD, regardless of whether the liabilities are governed by the laws of a member state or a third country. These include, but are not limited to: (i) covered deposits; (ii) secured liabilities including covered bonds and liabilities in the form of financial instruments used for hedging purposes which form an integral part of the cover pool and which according to national law are secured in a way similar to covered bonds; and (iii) liabilities to institutions, excluding entities that form part of the same group, with an original maturity of less than 7 days.

Contractual recognition of bail-in

The New Resolution Law includes the provision for the contractual recognition of bail-in. Under this provision, institutions and related persons must include a contractual term by which the creditor or a party to the agreement

creating the liability recognises that liability may be subject to write-down or conversion powers and agrees to be bound by any reduction of the principal amount or the outstanding balance due, conversion or cancellation that is effected by the exercise of those powers by the Resolution Authority under certain conditions.

Overrides and stays

The Resolution Authority has, in addition to the implementation of the Resolution Measures, a number of powers pursuant to the New Resolution Law which are as follows:

- The power to suspend obligations to make a payment or delivery under a contract where one of the parties is an institution under resolution measures
- The power to restrict secured creditors of an institution under resolution from enforcing security interests in relation to any assets of that institution under resolution
- The power to temporarily suspend termination rights (which would include a right to close out, set-off or net obligations or any similar provision that extinguishes an obligation of a party to the contract and a provision that prevents an obligation from arising under contract) of any contract with a bank under resolution assuming that all the obligations under the contract to make payment or deliveries or provide collateral continue to be performed

The period of restriction for the above powers ends at midnight at the end of the first business day following the publication of the restriction.

It is noted that a person may exercise a termination right under a contract before the end of the period of restriction, if that person receives notice from the resolution authority that the rights and liabilities covered by the contract shall not be:

- Transferred to another entity; or
- Subject to write down or conversion on the application of the bail-in tool

Where a resolution authority exercises the power to suspend termination rights, and where no notice has been given for the exercise of a termination right before the end of the period of restriction, those rights may be exercised on the expiry of the period of suspension, subject to section 70, as follows:

- If the rights and liabilities covered by the contract have been transferred to another entity, a counterparty may

exercise termination rights in accordance with the terms of that contract only on the occurrence of any continuing or subsequent enforcement event by the recipient entity

- If the rights and liabilities covered by the contract remain with the institution under resolution and the resolution authority has not applied the bail-in tool in accordance with section 53(1)(a) to that contract, a counterparty may exercise termination rights in accordance with the terms of that contract on the expiry of a suspension

Safeguards of Articles 76-80 of the BRRD

The safeguards set out in Articles 76-80 of the BRRD have been implemented through Sections 78-82 of the New Resolution Law. These provisions provide for safeguards for the following: (i) shareholders and creditors, whereby if a shareholder or creditor has incurred greater losses than it would have incurred in a winding up under normal insolvency proceedings, it is entitled to the payment of the difference from the Resolution Fund; (ii) counterparties in partial transfers; (iii) financial collateral, set-off and netting arrangements; (iv) security arrangements (v) structured finance arrangements and covered bonds; and (vi) in relation to partial transfers, protection of trading, clearing and settlement systems.



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