Bank Deposits Confiscation: The "Cyprus Experiment" and the Launch of a Global Trend

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In March 2013 the events in Cyprus shock the world to hit the radar screen of world media.

The bank deposits were confiscated.

Some tried to make it look as an emergency measure, an exclusion from the rules that define banking activities and the functioning of market economy.

But there is a solid ground to believe the confiscations are to become a routine feature of everyday life.

Deposit confiscation: a well-planned impromptu

The events were normally painted as some kind of poorly planned ad libbed decision on the part of the European Union carried out by Cyprus government. It was a one-time action, a step taken under the pressure of circumstances. We view it differently, in our opinion it was a well prepared concerted action approved at top level including actors outside Europe. The very operation should be defined as a precedent, an experiment or a test. Or, to be exact, the test to launch a global trend and the confiscation spread around the world.

As far back as in 2009 – 2010, when the ways out of the global crisis were discussed at international summits (G7, G8, G20 and other structures), non-standard ways of banks rescue in contingency were part of the agenda, including the schemes of bailing them out at the expense of account holders. For instance, things like introducing cuts on deposits, full or partial, or freezing accounts (either till a bank has fully recovered or by compulsive conversion into shares (authorized capital stock).

Even after the first wave of the financial crisis died down, the ideas never stopped hitting the agenda of world financial agencies (the Bank for International Settlements (BIS), the International Monetary Fund (IMF), the Financial Stability Oversight Council – FSOC), central banks, banking and financial oversight agencies of the «gold billion» countries.

For instance in December 2012 the Resolving Globally Active, Systemically Important, Financial Institutions, a joint paper by the Federal Deposit Insurance Corporation and the Bank of England, saw light. The authors cede that the recent banking crisis was in great measure managed thanks to financial injections. As they see it, the measure is wrong because by violating the market economy laws it shifts the burden on taxpayers, aggravates budget deficits and boosts state debts. The report says the use of deposits for the purpose of rescuing creditors is a more just, effective and market oriented way to tackle the issue.

The prescription envisions the following ways to use the money of account holders: a) no return subsidies; b) credits; c) investments (acquisition of shares and stock). The paper admits the deposits converted into shares of the bank make a money owner lose the right for compensation of losses guaranteed by state insurance. Let me recall that the US Federal Deposit Insurance Corporation (FDIC) offered guarantees for the deposits below $250 thousand. It is also noted in the report that the state insurances of the United States, Great Britain and other states of «gold billion» will not be able to provide safety cushions to deposits. This way the use of deposits for banks rescue becomes inevitable.

Somehow the authors get around the question if the proposed measures are just, democratic or market like. They come to a rather under-substantiated conclusion that the state deposit insurance has obviously become an anachronism nowadays.

The idea of deposit cuts in Cyprus banks hung in the air a few months before the European Union and Cyprus announced their decision. On January 2013 the New York Times used the Russian word strizhka while describing the Cyprus happenings, «Russians, who hold about one-fifth of bank deposits in Cyprus, would take a big hit». No surprise the US journalists knew what would take place in Cyprus two months before the events. What is striking is the carelessness of many Russian clients who believed the offshore was a safe haven. According to European Commission estimates (evidently understated) the depositors of the two largest Cyprus banks – Laiki Bank and the Bank of Cyprus lost €8, 3 billion of depositors’ money because of cuts.

In April 2013 Cyprus President Nicos Anastasiades said, «Regrettably, this fundamental EU principle was not respected. On the contrary, decisions reached beforehand by the interested parties were coercively imposed». He added, «I sincerely hope that this precedent in relation to Cyprus is not going to be applied elsewhere in Europe, although, as it is well known, the main raison d’etre of a precedent is that it can serve the purpose of establishing norms and guidelines to be repeatedly and universally applied». Indeed. Thus some countries started to discuss the Cyprus experience for practical purposes.

Some states individual initiatives

Right after what happened in Cyprus, Portugal, Spain, Italy, Ireland, Greece; Slovenia came into the focus of public scrutiny. These are economically weak links; the banking bankruptcy risks are especially high. It was expected back in March the same bank rescue steps would be applied in one of these states. Significant deposit outflows went to the banks of states boasting more stable economies, especially Switzerland. Quite unexpectedly the Cyprus goings-on were echoed thousands of miles away – in New Zealand and Canada.

The government of New Zealand started activities to push through the same decision on tackling the financial institutions bail-out problem: the essence is that the deposits are to be subject to cuts in order to save the banks. The scheme is called the Open Bank Resolution (OBR) by Bill English, Deputy Prime Minister of New Zealand and Minister of Finance. He had put it forward before what happened in Cyprus; the events just inspired him to shift the discussion into the parliament of the country. «Bill English is proposing a Cyprus-style solution for managing bank failure here in New Zealand – a solution that will see small depositors lose some of their savings to fund big bank bailouts». said Green Party Co-leader Dr. Russel Norman. «The Reserve Bank (central bank – author’s note) is in the final stages of implementing a system of managing bank failure called Open Bank Resolution. The scheme will put all bank depositors on the hook for bailing out their bank. «Depositors will overnight have their savings shaved by the amount needed to keep the bank afloat. While the details are still to be finalized, nearly all depositors will see their savings reduced by the same proportions».

The Open Bank Resolution is an instrument of confiscations planned in advance. Back then (March 2013) it was unprecedented. Normally the «gold billion» states practice $100-250 thousand level insurance. In the given case the money belonging to people is to be confiscated. Many experts view with bewilderment the New Zealand's innovations thinking the implementation will bury the country's banking system.

The government of Canada annually submits to the parliament Economic Action Plan prepared by the Department of Finance. On March 21 the 2013 Plan went to MPs. On page 155 it says, «The Government proposes to implement a – bail in regime for systemically important banks. This regime will be designed to ensure that, in the unlikely event that a systemically important bank depletes its capital, the bank can be recapitalized and returned to viability through the very rapid conversion of certain bank liabilities into regulatory capital This will reduce risks for taxpayers. The Government will consult stakeholders on how best to implement a bail in regime in Canada Implementation timelines will allow for a smooth transition for affected institutions, investors and other market participants». In other words, the depositors' money could be used to bail out banks.

The Cyprus events raised the issue of deposit cuts in the United States of America. Some lawmakers have tried to come up with initiatives aimed at introducing the right of using deposits to bail out US banks, but the efforts have failed lacking even minimum support. Here is the reason why. The Cyprus cuts decision is called a «tax for rich», and the commentators said the depositors got what they deserved because the bulk of money kept in Cyprus bank accounts was held by foreign oligarchs, tax evaders and money launders. Applying the same scheme in the United States will be tantamount to imposing a poor and middle class tax. Well to do Americans keep away from keeping the bulk of their savings in bank accounts, giving priority to stock exchange, equity, off exchange securities, gold, and silver and so on. The idea of imposing cuts on deposits has not resonated with general public in the United States of America. It contradicts the views spread around in American society calling for more equal distribution of wealth. By the way, in America they remember that it's not deposits only that could be subject to cuts, but also the property kept in bank lockers (mainly by people of means). It has nothing to do with the Cyprus experience. It's American know how. Back in 2010 the US Department of Home Security circulated a letter among banks with a warning that the Federal Bureau of Investigation and other law enforcement agencies had a legal access to bank clients' vaults and lockers. Papers, gold, other precious metals and valuables could be confiscated in the interests of national security if need be. Of course, at the moment (2010) the information was related to fighting organized crime, drug trafficking, funding terrorists etc. The letter was to the effectiveness of complying with the Patriot Act in force after the 9/11events. The things have changed and in 2013 some experts read the letter as saying that a bank failure is a serious threat to national security. So they have come to unexpected conclusion: a revision of lockers is allowed and valuables kept there can be used to rescue failing banks. Here is the sanctity of private property! It smells of Bolshevism which in its time taught that the «end justifies the means».

Europe gets ready for big «haircut»

Europe is leaving others behind on the way to introducing the haircuts of deposits. Or the European Union, to be exact. The first step was made on April 24 this year when the Economic and Monetary Affairs Committee (ECON) of the European Parliament voted on its report on the proposal for a directive on bank recovery and resolution. This is a key pillar in the reform of EU banking legislation, following the agreement on the capital requirements and single supervisor package. Gunnar Hökmark, MEP, Sweden's Conservative Party, was one of the new system's architects. In the middle of May the deposit cuts issue was debated by Economic and Financial Affairs Council (ECOFIN) session chaired by Michel Barnier, European Commissioner for Internal Market and Services. On May 20 a group of lawmakers in the European Parliament's economics committee overwhelmingly voted that, from 2016, large depositors in the EU might suffer losses if a bank gets into serious trouble. The plan was similar to a deal in Cyprus, where wealthy depositors at two banks took hits to save the country from bankruptcy. The European Parliament has joint say with the 27 countries in the EU on the law that would give regulators powers to impose losses on creditors and take other steps during a bank rescue. The legislation envisions creation of national resolution funds based on bank contributions. As of today the main provisions are:

1. Deposits under 100,000 euros would be spared.

2. A bank would dip into large deposits of over 100,000 euros once it had exhausted other avenues such as shareholders and bondholders.

3. The new banks bail out system will become effective in 2016.

4. The legislation envisions creation of national resolution funds based on bank contributions. Some lawmakers are calling for a Europe-wide resolution fund and the European Commission is due to propose such a fund in the coming months but that faces resistance from Germany.

5. Bank depositors are divided into reliable and risky. The confiscation measures are defined by what category a depositor belongs to.

The last provision is the most interesting one. There are no definite criteria for defining the depositors. But some analysts read the provision as follows.The reliable ones are «ours», that is those who belong to Eurozone. The risky ones come from outside. Evidently, the depositors from Russia will be considered to be risky account holders. This attitude towards the clients from Russia is not new. This spring the Russian Cyprus depositors started to look for «back-up airports» in Latvia, Lithuania, Estonia, Poland and some other states of Eastern Europe. A stern warning came from Brussels. The eurobeaurocrats said the bankers in Eastern Europe should keep away from dealing with Russian clients – the reason was that the Russian depositors' sources of income did not meet the legitimacy requirements. So, there should be no surprise that the money of Russia's citizens deposited in the European Union member countries will be constantly under the Damocles sword of confiscation.

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