

FBME

Activation of the Deposit Guarantee scheme

Introduction

In July 2014, the Central Bank of Cyprus (CBC) placed FBME Ltd – Cyprus branch (FBME) under administration, after the Financial Crime Enforcement Network (FinCEN), a division of the US Treasury, raised money laundering concerns.

Following two years in administration, on Saturday, 9 April 2016, the CBC, activated for the first time since its introduction, the Deposit Guarantee Scheme (DGS) compensation for FBME deposit holders.

In an unprecedented step, the CBC, the island's Resolution Authority, determined FBME is not, and will not, be in a position to return to deposit holders any of their deposits, amounting to circa €1.4bn.

More than 6,500 FBME depositors are expected to be completely compensated through DGS.

The purposes of this article is to:

- provide some background to the Deposit Guarantee Scheme
- set out the consequences to FBME deposit holders
- outline the process by which eligible deposit holders can claim compensation
- outline some key questions arising

Background to DGS

The Deposit Guarantee Scheme was first introduced in Europe in 1994¹. Deposit Guarantee Schemes reimburse a limited amount of deposits to depositors whose bank has failed.

From the depositors' point of view, this protects part of their wealth from bank failures. From a financial stability perspective, it prevents depositors from making panic withdrawals from their bank (bank runs), thereby preventing severe economic consequences.

DGS covers all types of deposits (demand, savings or time deposits), including accrued interest, belonging to physical or legal persons, denominated in all currencies². Compensation is payable in Euros.

DGS is activated if it is determined that a particular credit institution is unable to repay its deposits. Such a determination is effected either by the local Central Bank or through an order issued by a Court of the relevant country.

In Cyprus, DGS, in its current form, was established in March 2013³, as the Cyprus Deposit Protection and Resolution of Credit and Other Institutions Scheme. Under the Cyprus Protection Guarantee scheme, there is the Deposit Protection Fund (DPF), specifically established for depositors of locally established banks and branches of international banks in Cyprus.

¹ DIRECTIVE 94/19/EC, 30 May 1994 on deposit-guarantee schemes

² In the case of deposits denominated in a currency other than the euro, the conversion rate of the relevant currency against the euro as specified by the European Central Bank at the close of business of the date on which the deposits were rendered unavailable, will be used for the purpose of calculating the amount of compensation

³ section 34 of the Business of Credit Institutions Law of 1997(as amended), the Law on the Establishment and Operation of Deposit Protection and Resolution of Credit and Other Institutions Scheme of 2013(as amended) and the Establishment and Operation of the Deposit Protection and Resolution of Credit and Other Institutions Scheme Regulations of 2013(as amended)

What does this mean for FBME customers and clients

Activation of DPF means the Management Committee of DPF has determined that FBME is not (and will not be) in a position to return their deposits held to the rightful beneficial owners.

DPF will now compensate all eligible FBME deposit holders and proceed with liquidation proceedings. The amount of compensation, per depositor (per covered institution), is €100.000. This is the maximum amount **all eligible** ⁴FBME deposit holders will be able to claim.

There are a number of exclusions of eligibility and special cases of eligible deposit holders such as Trustees and Insurance companies that may be of direct relevance to Deloitte clients. An overview of these can be found in the Appendix.

For the purposes of calculating the compensation payable to each depositor, the amounts of each depositor's existing deposits will be set off against any loans, credit facilities granted by FBME or any other counterclaim of the bank in respect of which a right to set off exists.

Any deposit holder with more than €100.000 deposited with FBME may obtain additional compensation upon completion of the liquidation proceedings.

During liquidation proceedings:

- DPF is deemed to represent the rights and remedies of depositors from the moment the latter are compensated by DPF, up to the amount which is paid to each depositor from DPF
- A depositor, cannot seek any other claim against FBME until the DGS recovers the compensation amount from FBME

⁴ Appendix A identifies exclusions of eligibility and special cases of eligible deposit holders such as Trustees and Insurance companies that may be of direct relevance to Deloitte clients.

In case DPF recovers from the liquidator an amount greater than the compensation amount paid, DPF shall refund to the beneficiaries this excess amount.

Compensation process

FBME eligible depositors are invited to submit the required information for compensation, using a standardised **Statement of Particulars form**⁵.

Evidence of beneficial ownership identification of depositors (either natural or legal persons) is also required.

Any information provided on the Statement of Particulars, needs to be verified by the Special Administrator of FBME or authorised persons before it is submitted to CBC.

DPF's management committee will prepare a list of depositors (based on the evidence submitted to it by FBME or its administrator) which it will then use to verify all claims submitted by depositors. In all cases, the Committee acts on the basis of data maintained by FBME until 9 April 2016.

DPF will then proceed to calculate the amount of compensation payable to each depositor.

A depositor is deemed to agree with the compensation amount and that, as of the payment date he/she has no further claim against DPF, unless the depositor informs the Committee of the contrary within 30 calendar days from the date of the compensation amount notification.

Depositors who submit their statement of particulars and provided this is accepted, are expected to be compensated within 7 working days (up to a maximum of 20 days).

⁵ The relevant form can be found in: http://www.centralbank.gov.cy/media/pdf/Statement_of_particulars_V1.ENG_09042016.pdf

Worth noting that the process for compensation, although prima facie straight forward, is hindered by current litigation proceedings by FBME shareholders against CBC, making the compensation process lengthy and arduous in what has already been a two year journey.

Interesting questions

In the EU, under Bank Recovery and Resolution Directive, bank resolution and activation of DGS are measures of last resort. The case of FBME has therefore created a number of questions that need answering:

Why was FBME allowed to reach the point of non-viability following two years in administration? The CBC should reflect and learn from this process to avoid repetition of such an incident.

What qualitative and quantitative metrics were used by CBC to determine that FBME will not be in a position to return its deposit holders any amounts due? Lack of clarity renders the process opaque and may have a direct impact on depositors' confidence levels, thereby negating the primary purpose of DPF's existence. It is imperative that CBC provides clarity on the basis under which the DPF was activated and FBME is being pushed into liquidation.

Consistency in the basis of activation of DPF is also key for financial stability and the island's reputation as a banking and financial centre.

The CBC and all other financial institutions forming part of the Cyprus DGS should consider what this means for the deposit holders of other Credit Institutions and Banks covered by DPF and for the funding needs of DGS. Activation of DGS may mean that Banks will now be required to

provide additional DPF funding to cover the gap created by FBME.

Related to this, the EBA intends to undertake a stress test of European DGS over the summer. This may identify additional issues that CBC may have to resolve to ensure financial stability and confidence to deposit holders

How Deloitte can help FBME depositors

Deloitte can support⁶ affected deposit holders by:

acting on behalf of FBME *eligible deposit holders* during the compensation process:

- Completing the Statement of Particulars,
- Providing assurance that forms have been appropriately completed and that eligible deposit holders have the appropriate identification evidence prior to submission
- Assess whether the compensation amount calculated by CBC is accurate
- Assist the client with the appeal process if compensation amounts is not accurate

Supporting ineligible deposit holders through the administration process, by engaging with the FBME administrator directly.

Concluding remarks

Activation of DPF for FBME depositors creates important questions about the operation of DPF in Cyprus that would need to be carefully evaluated and resolved if depositors' confidence levels are to be maintained.

The process by which eligible depositors can claim compensation, albeit straight forward, is hindered by the ongoing litigations between FBME shareholders and CBC, making the compensation process lengthy and arduous in what has already been a two year journey. Deloitte can help clients manage effectively this stressful process.

⁶ Any prospective engagement will be subject to Deloitte's independence and Client engagement requirements

APPENDIX

Special cases

- if a person is entitled to a deposit together with other deposits on a clients' account or for the purpose of compensation, the total amount on the account shall be treated as being made up of 8 separate existing deposits with the corresponding amount being the amount each person is entitled to
- in the case where a person is entitled to a share of an occupational retirement benefit fund which is registered with the Registrar of Occupational Retirement Benefit Funds, for the purpose of compensation, the total amount on the account shall be treated as being made up of 8 separate existing deposits with the corresponding amount being the amount each person is entitled to
- in case a person acts as Trustee or Nominee for one or more persons under the same deed of trust or other similar agreement, the existing deposit in question shall be deemed to belong equally to beneficiaries (unless there exist specific contractual terms determining a different distribution for each beneficiary);
- in case a person acts as trustee and maintains a deposit in his capacity as Trustee, under different deeds of trust, he shall be treated as a separate and distinct person with respect to each one of the trusts

Exclusions from DGS

- Deposits by other banks or cooperative credit institutions held for own account
- deposits by credit institutions established in other countries and which are licensed to carry out banking business locally
- deposits by persons against which criminal proceedings or confiscation order have been instigated
- deposits by government departments, semi-government organizations and local authorities;
- deposits by financial institutions, as these are defined in the Business of Credit Institutions Law,
- deposits by insurance companies either in their own name or in the name of trustees;
- deposits by collective investment companies;
- deposits belonging to person(s) who, in the opinion of the Committee, are responsible for the institution's bankruptcy or have profited out of circumstances which led to the its bankruptcy or any other similar situation, so that the credit institution is unable to repay its deposits
- deposits by pension and retirement funds (except of the special cases noted in Special Cases);
- deposits by public authorities;
- debt securities issued by a credit institution and liabilities arising out of own acceptances and promissory notes

Contacts

Please do not hesitate to contact any of the following Deloitte professionals for any questions or comments you may have.

Clea Evagorou
Strategy Consulting
Email: clevagorou@deloitte.com
Direct line: 22 360 600

Alexis Agathocleous
Financial Services Leader
Email: alagathocleous@deloitte.com
Direct line: 25 868710