



REPUBLIC OF CYPRUS

PRESIDENTIAL PALACE  
The President

Nicosia, 15 April 2013

Mr. Mario Draghi,  
President of the European Central Bank,  
Frankfurt

Dear Mr Draghi,

I refer to your letter dated 10 April 2013 through which you have conveyed concerns as regards reports of discussions in the House of Representatives suggesting that a procedure for the dismissal of the Governor of Cyprus Central Bank, Mr. Panicos Demetriades, might be initiated, and I would like to note the following:

(a) As you are well aware, Cyprus has a Presidential system of government, not a Parliamentary one, and, as such, the competences of its executive branch are clearly distinct from those of its legislative. My Government fully respects the constitutional separation of powers and, therefore, I believe that it is understandable that its executive branch cannot in a way intervene or preempt decisions, procedures, or even intentions, of the independent legislative body.

(b) The House of Representatives, within the context of its constitutional rights and competences, instigated an investigation as to whether Governor Demetriades withheld or provided misleading and untrue information in relation to the objectives, terms of reference and instructions he gave to the audit firm "Alvarez & Marsal" ("A&M"), which had been hired to investigate the circumstances under which the Bank of Cyprus and Laiki Bank sought state assistance.

(c) The above mentioned parliamentary practice by no means constitutes a procedure for the dismissal of Governor Demetriades. However, this does not exclude the possibility for the House of Representatives, following the findings of the said investigation and having reached the conclusion that Governor Demetriades was engaged in serious misconduct, to communicate its report to the Attorney General of the Republic, who, as the competent authority, is the only one responsible to judge whether or not there are reasonable grounds for initiating a procedure for the dismissal of Governor Demetriades.



Such a procedure, of course, will, undoubtedly, be in conformity with the Constitution of the Republic of Cyprus and the Central Bank of Cyprus Laws, as well as the EU law provisions, as you also refer to your letter.

Dear Mr Draghi,

Taking this opportunity, I feel obliged to bring to your attention some facts, which you might not be aware of, but which would render all those who are of knowledge either individually or jointly responsible to all that has taken place or is taking place as a result of the actions or inactions of Governor Demetriades:

(a) A systemically important financial institution of Cyprus, Laiki Bank, which according to Troika and the European Central Bank was already bankrupted, received 9.5 billion Euros of Emergency Liquidity Assistance (ELA), an amount that accounts for about 60% of Cyprus' annual Gross Domestic Product (GDP). The assistance received by ELA does not include the 1.8 billion Euros bailout provided by the State and the former Government to Laiki Bank in June 2012, about 10% of Cyprus' annual GDP. Therefore, in total, Laiki Bank received 11.3 billion Euros, almost 70% of Cyprus' annual GDP, whilst the amount that is required for the financial needs of the Government does not exceed 7.5 billion Euros.

(b) The motive for allowing Laiki Bank to receive 11.3 billion Euros can be partly answered by Governor Demetriades himself, who in a Press Conference on March 28, stated: *"I was constantly informing the Government about the risk for the banking system to collapse and that is why I pushed the former Government to reach an Agreement for a bailout deal in June (2012), as the situation was evident since then. Emergency Liquidity Assistance of Laiki reached 60% of the Gross Domestic Product of Cyprus. This was not something pleasant, but we had to sustain Laiki. It was required to sustain Laiki in order for the elections to take place, a new government to come to power and take its decisions, to reach an Agreement with our European Partners so as to avoid not only the bankruptcy of Laiki, but also the bankruptcy of the country".*



I believe that the decision of Governor Demetriades not to annul the ongoing liquidity assistance provided to Laiki Bank by ELA with the aim of holding elections in February 2013, despite the fact that the "situation was evident" since June 2012, demonstrates his failure of effective prudential regulation and supervision of the banking system, and of the monetary policy of the Eurozone in general, he is obliged to protect and, at the same time, raises questions related to the independency that the Governor enjoyed with the former Government.

However, this does not exclude questions as to the reasons that permitted the Central Bank of Cyprus to carry on funding an insolvent bank, especially as, and I quote the opinion of the ECB (CON/2012/4): "***The ECB notes that emergency liquidity assistance, granted by the national central bank (NCB) independently and at its full discretion to a solvent credit institution***".

In relation to this, it is also appropriate to raise the following as per the relevant ECB Annual Report of 1999: "***The main guiding principle is that the competent NCB takes the decision concerning the provision of ELA to an institution operating in its jurisdiction. This would take place under the responsibility and at the cost of the NCB in question. Mechanisms ensuring an adequate flow of information are in place in order that any potential liquidity impact can be managed in a manner consistent with the maintenance of the appropriate single monetary policy stance***".

Moreover, pertinent to Laiki Bank and the State aid it received and whether the necessary measures were adopted is the opinion of the ECB (CON/2012/4): "***In this respect, it is essential that Member States comply with the European Commission's communications on the application of State aid rules to support measures in favour of banks and government guarantee schemes for bank debt, including with regard to the temporary nature of the acceptability of such aid measure and the need for credit institutions receiving State support to submit to the Commission restructuring plans***".



(c) Concerning the mandate given to "A&M", which as Governor Demetriades in writing informed would involve investigating the responsibilities of both the Bank of Cyprus and Laiki Bank, the final report of "A&M" focused exclusively to the Bank of Cyprus, selectively ignoring to examine the activities of Laiki, irrespective of the fact that it had received 9.5 billion euros from ELA.

Following heated reactions by all parties of the House of Representatives, besides the former party in Government, Governor Demetriades withdrew his initial statement in that the report by "A&M" was the final one, arguing that it was an interim one and that the investigation by the A&M" would include Laiki, albeit failing to adequately explain about his contrasting statements and when the investigation about Laiki should be expected.

In my opinion, Governor Demetriades, for his own reasons, clearly failed or omitted to properly instruct "A&M" to carry out a full inquiry, especially for Laiki Bank, which, as he had stated was insolvent.

Dear Mr. Draghi,

I also feel obliged to raise an issue of concern, which can help provide a clearer picture and that may be of particular interest for the orderly performance of the European Central Bank and the Eurozone system in general.

Despite the assurances of Troika, which includes the ECB, in that all the necessary measures for implementing the procedure of resolution would be immediately effective, three weeks have already gone by and this has yet to happen.

This is largely attributable to the shortcomings of the Central Bank of Cyprus. Whether these include the failure of the Central Bank to adequately prepare to execute decisions reached, its inability to comprehend them, or even its incompetence to materialize what has been agreed, is irrespective of the fact that the ECB should have been alerted by the delays being displayed.





At the same time, it is understandable that this is of particular concern to me and my government, as it raises several questions concerning the co-operation between the ECB and the Central Bank of Cyprus and the consequent capability to effectively implement decisions or even abide to Article 3.3. of the Statute of the ESCB and the ECB which states that *"In accordance with Article 105(5) of this Treaty, the ESCB shall contribute to the smooth conduct of policies pursued by competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system"*.

Moreover, Governor Demetriades, has yet to appoint the Board Members of the Bank of Cyprus and a Chief Executive Officer, leaving the bank leaderless and to be supervised by a special administrator appointed by the Governor himself, nor did he proceed with the issuance of bank stocks for those depositors who have incurred financial losses.

It is obvious that these various delays in implementing agreed measures and in properly supervising and handling the banking system, in conjunction with the actions or inactions of Governor Demetriades as I have presented them to you, negatively contributes on the ongoing uncertainty in the banking system and the economy of the country and has a deteriorating effect by increasing the reasonable apprehensions of not only the people of Cyprus, but also of the resident and non-resident depositors and investors in Cyprus, who, besides the financial losses which they have incurred, are already facing a number of additional difficulties in their financial dealings and transactions.

*Dean Ku Dragli,*

I would like to stress that consciously and with a sense of responsibility, neither I, nor officials of my Executive made any public statements about an initiation of a procedure for the dismissal of Governor Demetriades, with the aim of avoiding public confrontation and ensuring that in the midst of the financial crisis the necessary collaboration would, through the adoption of the necessary measures, help restore trust and confidence in the economy and its banking system.



This also intended to safeguard the Governor's independence and avoid putting additional pressure on his person from the one already facing by the House of Representatives, professional organizations and the public in general.

Concurrently, in the past few days three more members of the six-member Central Bank of Cyprus Board resigned, in disagreement with the policies conducted by the Governor. I believe that these resignations clearly indicate that Governor Demetriades does not even enjoy the trust and confidence of the Institution he is running.

Dear Mr Draghi,

In concluding, I would like to reassure that my full and outmost respect to all independent institutions and their officials should be taken as granted. In parallel, it should also be taken as granted that the independent institutions and their officials should reciprocate this respect to the elected president, as he reflects the popular sovereignty of the people.

Yours sincerely  
  
Nicos Anastasiades  
President of the Republic