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Cyprus Fails to Obtain Kremlin Aid

By Howard Amos

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Cypriot Finance Minister Michalis Sarris speaking to reporters Wednesday after meeting with his Russian counterpart, Anton Siluanov, in Moscow. **Misha Japaridze**

A desperate effort by Cypriot authorities to win financial aid from the Kremlin failed to yield any results Wednesday, as a deal eluded Cyprus' finance minister, Michalis Sarris, during a visit to Moscow.

Russian companies are being hit by a freeze on Cypriot bank accounts as officials from the Mediterranean island country shuttle between Nicosia, Brussels and Moscow in a bid to save the country's financial system.

Sarris did not manage to negotiate a Russian bailout despite a 1 1/2 hour meeting with his counterpart, Anton Siluanov.

"We had a very good first meeting, very constructive, very honest discussion," he told journalists afterward, Bloomberg reported.

Sarris subsequently attended a second meeting with Deputy Prime Minister Igor Shuvalov, Siluanov and Deputy Finance Minister Sergei Storchak. An undisclosed source told Russian newswires that negotiations had not yielded any results and would continue Thursday.

European Commission President Jose Manuel Barroso is due to visit Moscow on Thursday for scheduled talks.

"We understand how difficult the situation is, and we'll continue negotiations to find the solutions that will help us obtain Russia's support," Sarris said, adding that the Cypriot delegation would remain in Moscow "until we reach any agreement."

Sarris, who arrived in Moscow on Tuesday evening, was accompanied by Energy, Commerce, Industry and Industry Minister George Lakkotrypis, RIA-Novosti reported Tuesday, citing an EU source. His presence sparked speculation that Cyprus was prepared to use its offshore gas reserves as a bargaining chip.

"It's an opportunity for the Russians to make a major play," one Western banker in Moscow said on condition of anonymity in order to speak freely.

Aside from a renegotiation of the terms of a 2.5 billion euro ($3.2 billion) loan that Cyprus received from the Kremlin in 2011, Wednesday's talks also included "things beyond that," Sarris said.

Nicosia is also seeking a new 5 billion euro loan, according to the Russian Finance Ministry, Reuters reported.

Nicosia needs a solution for its teetering financial system after its parliament rejected an initial plan agreed by its president with the "troika" of the European Commission, European Central Bank and the International Monetary Fund on Saturday. The plan envisaged imposing a levy on bank deposits to help raise 5.8 billion euros locally and trigger a 10 billion euro bailout from the euro zone.

EU officials have repeatedly suggested that Cyprus is a money laundering destination for corrupt Russian officials.

"It is now for the Cypriot authorities to present an alternative scenario," the European Commission said in a statement Wednesday.

Unconfirmed reports swirled in Moscow that Cyprus was willing to offer Russia access to lucrative gas deposits, chunks of its major banks, or even a Mediterranean naval base in exchange for financial assistance.

In one version of events, Cyprus would charge a tax of 20 to 30 percent on Russian deposits in local banks in exchange for giving Russia stakes in its energy projects, The Wall Street Journal reported Tuesday, citing an unidentified official in the Cypriot government.

Sarris' failure to reach an agreement with his counterpart Wednesday took place against a background of growing criticism from Russian officials of any compulsory levy on deposits.

"Such idiocy was hard to expect from the European Union," said Federal Financial Markets

Service head Dmitry Pankin, Interfax reported.

Deputy Prime Minister Arkady Dvorkovich pointed out that the move would undermine trust in the global banking system.

"If such a solution is possible in Cyprus, it's possible everywhere. ... It will mean that there's no place to keep money and that the banking system has stopped working," he said, Interfax reported.

President Vladimir Putin, who has described the forced levy as "unjust, unprofessional and dangerous," discussed the situation with Cypriot President Nicos Anastasiades in a half-hour telephone call after the parliamentary vote late Tuesday evening.

With about $19 billion in Cypriot accounts at the end of 2012, according to rating agency Moody's, Russian businesses stand to lose heavily if a haircut is applied to bank deposits.

"Shocked Russian businessmen have been reminded of the requisitioning of Soviet times," said Alexander Galushka, co-chairman of business lobby group Delovaya Rossia.

And an ongoing bank account freeze, which was imposed by Nicosia on Monday, is disrupting the day-to-day functioning of Russian firms that move cash through Cyprus.

A significant number of Russian companies are being affected by the current hiatus, Galushka said.

The amount of money flowing between Russia and Cyprus every year is so large that Cyprus is officially the second biggest foreign direct investor in Russia.

"We use Cyprus as our operations hub for payments because it is very difficult to make small payments from Russia," said Annette Loftus, an executive at adventure travel specialists Aspera Explorations, an international firm with a Moscow subsidiary. "There are hundreds of companies like ours who operate out of Cyprus."

Loftus, a U.S. citizen, said she was hoping that Russia would step in and rescue the Mediterranean island. "We have hundreds of thousands of dollars that people have paid us for their May holidays and is now stuck in Cyprus. ... So far, our partners have been patient, but we are very worried."

Large companies have also been seriously hit.

VTB, Russia's second-biggest lender, is exposed through a subsidiary in Cyprus called Russian Commercial Bank. In the worst-case scenario, the bank could lose "tens of millions of euros," according to a statement posted on VTB's website Wednesday.

And when Cyprus does once again open its banking system, there is a strong risk that Russian firms will withdraw their funds and remove their operations from the island state.

"Of course, if such a decision [to tax depositors] is made, VTB will be forced to reconsider the development strategy of its Cypriot business," the bank said.

It was possible that Alfa Bank, Russia's largest private bank, would also change its operational structure on Cyprus, said Alfa Bank's credit business head, Andrei Sokolov, Interfax reported.

Even if deposits remain untouched, however, there is a high risk of currency controls being imposed by Nicosia to prevent a wave of capital flight once banks reopen their doors.

Alternative offshore destinations for affected Russian companies fearful of ongoing instability could include Latvia, said Yekaterina Manskaya, a Cyprus expert at Cliff Legal Services.

Non-resident deposits in Latvian banks are almost 50 percent of total deposits, and the country is aiming to join the European single currency in 2014.

More traditional destinations in Western Europe such as Holland or Luxembourg will also benefit, said Michael Pugh, a capital markets and restructuring partner at Hogan and Lovells who has worked with Russia and Cyprus for a decade.

"It is difficult to imagine that the EU and the IMF believed that the cap on deposits would stabilize the situation in Cyprus," he said. "It is almost as if they have picked up Cyprus like a dusty rug to give it a good shake and drive certain businesses over to what appear to be more stable Western European jurisdictions."

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