



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

The Rt Hon. Lord Boswell of Aynho
Chairman
European Union Committee
Committee Office
House of Lords
London SW1A 0PW

19 April 2013

Dear Tim

EURO AREA CRISIS UPDATE – CYPRUS

Thank you for your letter of 26 March 2013 on recent developments in the euro area. I am writing in response to the questions you've raised.

As I told the House of Commons on 18 March 2013, the UK was not party to discussions between Cyprus and the euro area on the financial assistance package and the levy that had initially been proposed as part of the deal. It was clear that the Cypriot government and the euro area had agreed that the Cypriot financial sector must shoulder some of the burden. The precise means of achieving this was ultimately a matter for the Cypriot government, as a number of euro area policy makers made clear at the time.

That said, had we been consulted or party to those discussions, we would have cautioned against any hit on insured depositors. We chose to make our views known privately to the Cypriot government. You will note that the Prime Minister reinforced this sentiment when he stated in Parliament on 20 March 2013 that where deposit protection schemes are in place, as they are in the UK and across Europe, those schemes should be respected. We are pleased that the final deal does not affect covered deposits.

We are pleased that Cyprus has reached an agreement with euro area Member States and the International Monetary Fund. We offered technical assistance to the Cypriot authorities, and this offer was accepted. The Government has taken a number of steps to protect and reassure British nationals living in Cyprus.



The full implications of the actions in Cyprus will only become clear over time, but we will of course monitor the situation – including temporary capital controls - closely.

I can agree with Jeroen Dijsselbloem's argument that we must end the era of taxpayer-funded financial assistance packages to banks. That is why we are reforming the banking sector in the UK and implementing the recommendations of the Vickers Commission.

This situation has also demonstrated the need for a number of the reforms that the UK has pressed for in the Recovery and Resolution Directive. For example:

Firstly, it has shown the need for robust resolution plans. These are essential contingency plans for worst case scenarios and can help avoid the kind of disorder we have seen in recent days.

Secondly, in the process of resolving a non-viable bank, insured depositors must be given preference in the creditor hierarchy. This would give them the confidence that they would be protected. Similarly, we must avoid attempts to circumvent deposit insurance by imposing levies on small depositors.

Third, being able to bail-in creditors is important to ensure that moral hazard is avoided, therefore ensuring that taxpayers are not forced to take on excessive costs.

With regards to the wider implications for banking union, the Cypriot crisis has illustrated the need for the euro area to have in place a well established supervisory architecture.

We do not think, however, that there is a one-size-fits-all approach to providing medium-term financial assistance to countries nor to the policy conditionality that should be attached to such assistance. Countries, and the problems they face, often vary markedly. I would note that the euro area's and the IMF's approach to date has varied from country to country and that Jeroen Dijsselbloem subsequently made clear his view that "Cyprus is a specific case with exceptional challenges; macro-economic adjustment programmes are tailor-made to



the situation of the country concerned and no models or templates are used."

I am copying this letter to William Cash MP, Chairman of the House of Commons European Scrutiny Committee; Sarah Davies, Clerk to the Commons Committee; Jake Vaughan, Clerk to the Lords Committee; Stuart Stoner, Clerk to Lords Sub-Committee A; Les Saunders, Cabinet Office; Kunal Patel and Thomas Kenny, HM Treasury.

Yours sincerely,

A handwritten signature in black ink that reads "Greg Clark". The signature is written in a cursive, slightly stylized font.

GREG CLARK MP
FINANCIAL SECRETARY TO THE TREASURY

