Lenders Reject New Plans to Assist Cyprus

Tapping Pensions for Bailout Spurned; Moscow Cool to Gas-for-Cash Proposal

By MATINA STEVIS and MICHALIS PERSIANIS in Nicosia, Cyprus, and JAMES MARSON in Moscow

Cyprus on Wednesday was left with narrowing options to rescue its outsize financial-services sector from collapse—something that could end its membership in the euro zone—after international lenders rejected an alternative government plan to secure a multibillion-euro bailout and Russian officials remained cool to a Cypriot gas-for-cash deal.

In parallel talks in Nicosia and Moscow, Cypriot officials tried to broker a three-way agreement aimed at rescuing the country, but without having to resort to a bank-deposit levy that euro-zone and International Monetary Fund officials have insisted on, which Cyprus's parliament snubbed in a vote on Tuesday.

Cyprus's counterproposals include tapping the country's pension-fund assets, restructuring and selling the island's two biggest banks, and offering Russia a sweetheart deal to the island's natural-gas reserves in exchange for a multibillion-euro loan.

But Cyprus found few takers, either from officials of the troika of European Commission, IMF and European Central Bank, now on the island, or in face-to-face talks with Russian officials in Moscow.

Undaunted, Cypriot Finance Minister Michalis Sarris said his meeting with Russian counterpart Anton Siluanov was "very constructive" and that the talks would continue "for as long as it takes." But a later meeting with First Deputy Prime Minister
Igor Shuvalov also appeared to yield no deal.

Russian Prime Minister Dmitry Medvedev blasted the handling of the crisis on Wednesday, but didn't make any specific offer of assistance, calling for cooperation among all the countries involved, the official RIA-Novosti news agency reported.

In an effort to buy more time, Cyprus's central bank said late Wednesday it would extend a bank holiday into next week. Taking into account a national holiday Monday, Cyprus's banks would reopen no earlier than Tuesday, which would mean they had been shut for 10 days.

Despite accounting for just 0.2% of the euro zone's economy, Cyprus's debt problem has become a major conundrum for its European partners. Few observers think the collapse of the island's banking sector—or a government debt default—could pose a systemic risk to Europe's banks. But a messy, uncontrolled crash among any of the euro zone's 17 members could reawaken fears in international markets about the currency bloc's integrity.

European policy makers have grappled with how to pay for the rescue of Cyprus and its big financial sector, which accounts for roughly 45% of the country's gross domestic product. With an economy too small to support the debt of recapitalizing its banks, Europe is offering Nicosia a difficult choice: shrink the banking sector and impose a levy on deposit holders in exchange for aid, or see the country's cash-starved banks fail.

By rejecting that offer Tuesday, Cyprus appeared to be engaged in a game of high-stakes brinkmanship.

"It would be suicidal for both sides if no agreement is reached; this would be a lose-lose situation," said Miranda Xafa, at EF Consulting, an Athens-based financial consultancy.
Preparing for the worst, Cyprus’s parliament is expected to convene Thursday to discuss two pieces of legislation to cope with a potential financial-sector collapse. The first would impose emergency capital controls to prevent a flood of cash rushing out of the country when the banks reopen. On Tuesday, the country’s central bank governor warned that at much as 10% of banking deposits could flee when banks reopen, but some analysts said that could be higher. The second piece of legislation would set rules for closing insolvent banks.

Nicosia’s Plan B foresees using some €4.2 billion ($5.4 billion) of pension-fund assets to fund a €10 billion bailout, an amount that would cover a large part of the €5.8 billion the euro zone says Cyprus needs to find in order to unlock its aid package. But troika officials weren’t convinced, said two officials with direct knowledge of the talks. The plan would bring money into state coffers, but would further inflate the government’s debt burden.

The proposal also calls for winding down the country’s two biggest lenders—Laiki Bank PCL and Bank of Cyprus PCL—transferring their bad assets into a so-called bad bank, and merging their good assets into a new, smaller entity. The Cypriot government hoped to sell the good bank to Russia’s VTB Bank, one person said, but VTB later said it had no plans to do so.

Earlier Wednesday, the European Commission said it was now up to Cyprus to put forward an alternative rescue plan after its lawmakers voted down the bailout package.

"It is now for the Cypriot authorities to offer an alternative scenario respective of the debt-sustainability criteria and of the financing parameters," Olivier Bailly, a commission spokesman said.

Cyprus is also hoping that Russia—a longtime friend of the country and the main source of foreign deposits in its banks—could offer billion of euros in financial aid in return for stakes in the island’s troubled banks and its energy assets. Apart from VTB, Cypriot officials have been courting OAO Gazprombank—part-owned by state gas giant

OAO Gazprom—as a possible white knight and have offered natural gas assets as a sweetener. But a Gazprombank spokesman on Wednesday said it isn’t in talks on providing financial aid to Cyprus, while a Gazprom spokesman also denied any offer had been made.

Likewise, Russia's government has been reluctant to increase its support to the island
beyond an existing €2.5 billion loan. Nicosia has asked to delay repayment and pay a lower interest rate on that loan.

"Russia is likely to wait and see what the euro zone does first," said Peter Westin, chief strategist at the Aton brokerage firm in Moscow. "Russia is likely to wait for the Europeans to come through with the money, and then step in if they think it's not enough."

European Commission President José Manuel Barroso is due to visit Moscow Thursday for scheduled talks, but without the EU's top economics official, Olli Rehn, who canceled his trip because of the crisis in Cyprus. A spokesman for Mr. Rehn said Cyprus isn't on the official agenda, but will be discussed if raised by Russian officials.

Speaking to lawmakers in the European Parliament Wednesday, European Council President Herman Van Rompuy urged a quick resolution. "The current, highly uncertain situation is highly damaging, especially for the people of Cyprus, and has to be addressed as soon as possible," Mr. Van Rompuy said. "We are all very concerned and of course I am following developments closely."

So too are many Cypriots. In the island's capital, residents were glued to televisions, radios and smartphones Wednesday as they tracked the dual talks that would determine the country's future. There was a palpable sense of suspense in the air.

"We are very anxious to see what the outcome will be," said Andreas Pedios, a retired banker, as he sat in a local cafe with others watching the evening news on television.

—Audrey Ostroukh in Moscow, Philip Pangalos in Athens and James Angelos in Nicosia contributed to this article.

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