



STATEMENT OF PROTOCOL TO REPORT OF INVESTIGATIONS INTO SPECIFIC ASPECTS OF CYPRUS BANKING CRISIS

PREPARED FOR THE CENTRAL BANK OF CYPRUS

26 MARCH 2013

ALVAREZ & MARSAL GLOBAL FORENSIC AND DISPUTE SERVICES, LLP

STRICTLY PRIVATE & CONFIDENTIAL

Table of Contents

PRELIMINARY STATEMENT.....	3
STATEMENT OF GOVERNOR PANICOS DEMETRIADES, CENTRAL BANK OF CYPRUS, 26 MARCH 2013	4
1 INVESTIGATION GUIDELINES AND MANDATE	5
2 SCOPE OF THE INVESTIGATION	8
3 LIMITATIONS OF THE INVESTIGATION.....	10
4 WORK PERFORMED	12
5 POSSIBLE AREAS OF FURTHER INVESTIGATION.	22
6 REPORTING.....	23

Preliminary Statement

The Investigation undertaken by Alvarez & Marsal for the Central Bank of Cyprus focused upon the specific instructions and mandate of the Engagement Agreement and Service Agreements, described herein. As advised by the Governor of the Central Bank of Cyprus, the impetus for the Investigation grew from a need to protect the banking system and prevent repetition of the Cyprus Popular Bank crisis which precipitated State-aid of €1.8 billion. The Investigation addressed discrete inquiries of the Central Bank relating to events and actions of certain banks and the Central Bank concerning the banking crisis affecting the Republic of Cyprus. The banking crisis and the limited issues addressed herein, were by the nature of events subsumed within the broader Cyprus crisis. Although the Cyprus crisis is interlaced with the investigative matters, it was not the subject of the Investigation.

Statement of Governor Panicos Demetriades, Central Bank of Cyprus, 26 March 2013

The month after my appointment as Governor of the Central Bank of Cyprus ("CBC") in May 2012, the Cyprus Popular Bank ("CPB") sought and received state-aid of €1.8 billion. This left Cyprus the 84% equity holder of CPB, and began the downward cascade of our banking system. As a first restructuring plan was

being prepared for CPB and financial deterioration was mounting in Europe, the financial health of the Cypriot banking system was of paramount concern. The overarching question was whether CPB was isolated or a primer of a systematic problem. It was determined that it was necessary to develop comprehension and transparency into the two domestic pillar banks, Bank of Cyprus ("BOC") and CPB. Although a full analysis of the underlying basis of the broader Cyprus crisis was preferred, my mandate as Governor of the CBC necessitated an expeditious investigation isolated to the banks. The terms of reference were driven by the viability and supervision of the banks. The investigation was to focus on the banks' acquisition of Greek government bonds ("GGBs") and international expansion, along with the supervision by the CBC. Being that CPB was under state control with management having been replaced, an exigency existed to determine if BOC might have issues that could cause it a fate similar to CPB. As such, the investigation prioritised BOC related matters. The investigative effort has now completed BOC GGBs and international expansion, as well as the CBCs supervision of the conversion of CPB Greek banking assets from a subsidiary to a branch. The investigation shall continue. Next matters to be addressed include CPB acquisition of GGBs and international expansion, along with oversight by the CBC and the status of supervision. Once completed, we will have clarity into the deficiencies of our past banking practices and a clear path to remediation and long term health.

1 Investigation Guidelines and Mandate

1.1.1 Alvarez & Marsal ("A&M") was instructed by an engagement agreement ("Engagement") entered into with the Central Bank of Cyprus ("CBC") on 21 August 2012 to carry out an investigation under terms including in part:

"A&M shall provide consulting and advisory services to the Bank and the Governor of the Central Bank of Cyprus in connection with their efforts to carry out an investigation by independent experts under Article 24 of the Central Bank of Cyprus Law ("the Investigation") by making available individuals to be appointed by the Bank under the above Article of the Central Bank of Cyprus Law ("the Law") in order to act as independent experts ("Experts") in accordance with the "Service Agreement Individual Expert" ("the Service Agreement") attached as Annex 1 to this Agreement.

The specific procedures to be performed by the Experts will be established based on discussions with you as the engagement progresses and additional information is obtained. Although the Experts may provide advice and recommendations concerning the specific procedures they might perform, A&M is not responsible for the sufficiency of the Investigation or for the accuracy of the information provided to the Experts or for responding to the Bank's obligations to shareholders, lenders, regulators, and other stakeholders.

A&M's staff engaged in the Investigation will be acting as Experts and so their reports or advice must be objective and impartial." [Emphasis added]

1.1.2 As a part of the Engagement to conduct the Investigation, a Service Agreement for an Independent Expert ("Service Agreement") was entered into with each member of the A&M investigation team ("Expert"). The Service Agreement set out the responsibilities of each expert, including in part:

"The Expert undertakes to perform tasks under Article 24 of the Central Bank of Cyprus Laws of 2002 to 2007 to assist the Governor to take all necessary legal and regulatory remedies, whether they concern the conduct of supervision by the Bank, the procedures followed by some systemically important local banks (hereinafter referred to as "the Cypriot banks") to acquire Greek Government Bonds and / or investing abroad in the form of a branch network and/or subsidiaries banks, having regard to the requirements specified by the provisions of the Banking Laws of 1997 to (No. 2) 2011 and the Central Bank of Cyprus Laws of 2002 to 2007 and the Regulations / Directives/ Guidelines issued under these Laws, or otherwise at the discretion of the Governor.

Subject always to [the Engagement], the Expert shall provide his services under the terms of this Service Agreement and as requested by the Governor within the

framework of the Service Agreement, but not subject to the instructions of the Governor or any other officer of the Bank, nor subject to the normal working hours of the Bank, but always act as an Independent Expert.

In discharging his duties the Expert may, in the name of the Bank, carry out interviews under oath with officers and / or employees of the Cypriot banks and direct the production of any documents he deems appropriate. The Bank undertakes within the framework of its statutory powers, to send relevant notifications and / or to take any appropriate action to make this possible/"

1.1.3 The Engagement was conditioned upon conducting the Investigation within a narrow fixed fee and limited time constraints as described, in part, in the Engagement:

"A&M will receive fees based on ... a discount of 20% on the standard hourly rates [...and...] a fixed fee for four months of €275,000 per month. The fixed fee is based on 200 man hours, performed by the Experts and other A&M personnel assisting the Experts in accordance with Article 26 of the Banking Laws per week spread across the levels.

In the event that the services are certified by the Experts to be incomplete, [after four months] then this engagement shall continue after four months for a period of up to two additional months with a further 10% discount to our fees representing a fixed monthly fee to €250,000 per month".

As the Investigation could not be completed in four months, the Investigation was thus extended to 26 February 2013.

1.1.4 As described in the Engagement, "[t]o the extent that there is any conflict between the terms of the [Engagement] and the Service Agreement, the terms of the [Engagement] shall prevail".

1.1.5 In accordance with the Engagement, the CBC made available books, records, documents and other information deemed necessary by A&M, as described in part as follows:

"In providing the services referred to in this Agreement, the Bank will promptly provide or procure the provision to the Experts of all information available to it which is relevant to them for the proper provision of the services as set out in this Agreement, and all such further information as the Experts may reasonably request, all of which will be to the Bank's best knowledge, accurate and complete in all material respects at the time it is provided.

The Bank confirms that it has the right to supply such information to the Experts and that the supply of such information by the Bank and its receipt by the Experts for the purposes of the services as set out in the Agreement, will not infringe any rights held by any third party, involve the unauthorized use of confidential information belonging to a third party or result in a breach by the Experts of any law, regulatory

obligation, fiduciary duty owed to any third party, intellectual property rights or agreement."

2 Scope of the Investigation

2.1.1 As described above, the investigation has been directed by the Governor of the Central Bank of Cyprus ("the Governor") and A&M has taken advice from the Governor as to the matters to be included within the scope of our review. By agreement with the Governor, the Investigation mandate ("Mandate") was set to cover an examination of the following four areas:

2.1.1.1 The losses suffered by Bank of Cyprus ("BOC") on its holdings of Greek Government Bonds ("GGBs"), following the private sector involvement ("PSI") programme in which holders of Greek debt participated in a haircut on their holdings of GGBs;

2.1.1.2 The purchase of shares by BOC in a Romanian bank, Banca Transilvania, in December 2009 ("Romania");

2.1.1.3 The acquisition by BOC of a stake in a Russian bank, Uniastrum, in October 2008 ("Uniastrum"); and

2.1.1.4 The conversion, in March 2011, of Marfin Egnatia Bank ("MEB") from a Greek subsidiary of Marfin Popular Bank, now Cyprus Popular Bank, ("MPB" or "CPB"), to a branch of Cypriot based CPB ("Laiki Conversion") (See: 2.1.2.4 below).

2.1.2 The agreed scope of the Mandate was governed by a number of factors including, but not limited to, the following:

2.1.2.1 The Mandate addressed all of the initial areas for review as set out by the Central Bank;

- 2.1.2.2 The strict and largely untested Cypriot laws relating to data privacy resulted in significant delays in obtaining the electronic data required for the investigation. As set out in this report these issues of data privacy continued to delay parts of the investigation;
- 2.1.2.3 Although BOC are deemed to be compliant with the responses to documentary requests, significant amounts of electronic data requested were missing from specific BOC employees' computers and electronic media. These are fully described in our Greek Government Bond Report and at Section 3.2;
- 2.1.2.4 The Mandate originally anticipated a robust investigation of the need for CPB to have required State-aid and the rights offering by which the State became the 84% equity-holder. This was to have addressed the shifting of CPB Greek liabilities to the Cypriot balance sheet. We were advised early in the investigative process, that the CEO of CPB, Andreas Philippou, discussed with a Senior Director at the CBC, litigation being brought by the State-owned CPB against Greece and the concern that an internal CBC investigation of the same would impact or jeopardise any potential recovery. This began an internal dialogue that resulted in a narrowing of the CPB investigation. As a result, the Investigation in respect of MPB was limited to the Laiki Conversion and only from the perspective of the CBCs supervision of this conversion;
- 2.1.2.5 The short duration of the Investigation of six months along with the Investigation fixed fee arrangement; and
- 2.1.2.6 The investigative team was instructed to undertake a number of urgent and unanticipated but related ad-hoc internal CBC inquiries, which expended already constrained resources.

3 Limitations of the Investigation

3.1 Powers of the CBC

- 3.1.1 This Investigation was mandated by the CBC and, as a consequence, the breadth of its scope has been restricted to those entities, individuals and activities which fall under the supervision of the CBC. Accordingly, the powers of the Investigation team have been restricted to those powers which are afforded to officers of the CBC.
- 3.1.2 Powers of officers of the CBC are not as broad and strong as those that are afforded to the Attorney General or the Parliament of the Republic of Cyprus. In this regard, the following limitations of the Investigation's powers should be noted:
 - 3.1.2.1 The Investigation team could not issue subpoenas or compel anyone to attend an interview if they do not presently work for an entity supervised by the CBC. For those individuals, we have had to rely on their voluntary co-operation. As described herein, certain persons refused voluntary compliance including making unacceptable demands as a pre-condition to their co-operation.
 - 3.1.2.2 The Investigation team could not issue documentary subpoenas or compel the production of data and documentation from individuals and entities not supervised by the CBC. For example, if the Investigation team requested information relating to an entity that was not supervised by the CBC or business/personal information of such an entity, the team was often thwarted due to the need to rely on voluntary disclosure.
 - 3.1.2.3 Whilst the CBC does have greater powers to affect compliance than the Experts, such were exercised in favour of the Investigation judiciously. An example of important assistance provided by the CBC was the procurement of opinion letters from the Commissioner for Personal Data Protection to aid in the document production. Copies of such opinions letters are attached hereto (Exhibit 1).
- 3.1.3 Whilst neither the Investigation team nor the CBC have the authority to undertake a criminal investigation, we are advised by the CBC that any conduct identified *in* this investigation that may be suspected of being criminal will be surrendered to the Attorney General in accordance with the Central Bank of Cyprus Laws of 2002 to 2007.

3.2 Deletion of data

3.2.1 On 21 August 2012, the CBC issued a letter to each of CPB and BOC advising that an Investigation had commenced and that all books, records and documents, physical and electronic, were to be preserved and that all routine document destruction and deletion was to be suspended. On 24 August 2012, the CBC transmitted a similar letter to the employees of the CBC. Copies of each of these letters are attached hereto (Exhibit 2).

3.2.2 The e-mail data provided by the BOC to the Investigation team appears to be incomplete, with certain key custodians having little or no e-mail data during the period of 2009 and 2010. It was only possible in limited instances to determine the reasons for gaps in the electronic data collected. Potential explanations include deliberate deletion of data, poor archiving or inadequate data management by certain individuals. Furthermore, we are unable to confirm whether or not some or all of the absent critical data exists elsewhere.

3.2.3 The Investigation team received written approval from the CBC to obtain and analyse forensic images of the computers of the BOC employees on 8 November 2012. Based on an initial review of this data, our computer forensic technologists have found that the computers of two employees, Mr Andreas Eliades ("Mr Eliades") and Christakis Patsalides, have had wiping software loaded which is not part of the standard software installations at the BOC. Mass deletion of data appears to have been undertaken on the Patsalides computer on 18 October 2012. It appears that some deletion was undertaken after a data preservation notice was issued to BOC by the CBC on 21 August 2012.

3.2.4 There are no e-mail files, mailboxes or user documents on Mr Eliades' desktop computer. We have been unable to recover or identify any such documents from the hard drive of this computer, which would suggest that either:

- the computer was not used by Mr Eliades; or
- the hard drive was formatted and/or wiped by BOC IT after Mr Eliades left the bank; or
- the hard drive was wiped using data removal / wiping software such as CCleaner

installed on the desktop.

3.2.5 A chronology in regard to electronic data collection issues is set out at Appendix A of our Investigation Report into BOCs holdings of Greek Government Bonds.

3.3 Other gaps in data collection

3.3.1 We had significant gaps in the e-mail data received from BOC for the period 2007 to 2010, a key period for our scope of Investigation. This was due to the lack of e-mail archiving process prior to around late 2010 or early 2011, which is when the e-mail systems were upgraded at BOC. According to Mr Leonidas Isodiou (BOCs IT department), since the upgrade, the "live" e-mail data from the e-mail servers is now being preserved within the e-mail and archive systems. BOC provided to A&M these "live" mailboxes containing such e-mails (with the exception being where employees deleted some individual e-mails manually). There were no e-mail backups performed prior to the upgrade of the system.

3.3.2 Moreover, prior to 2011 there were no procedures in place at BOC to ensure employees' local e-mail archives were archived by the company. Therefore, any e-mail archives that were created by the employees and stored on their computers were not backed up. The employees were also able to move or remove such e-mail archives from their computers as they wished to do so.

4 Work performed

4.1 Introduction

4.1.1 In order to conduct our work in relation to the reports, we have been provided with access to information held by the CBC and third parties. We have also considered information in the public domain. The Investigation team has been very mindful of issues of data privacy and confidential and sensitive banking information, and legal privilege. We have obtained domestic and international external legal advice concerning data privacy, as well as consulted with CBC in-house counsel. The Governor also requested and obtained guidance for the Investigation from the Commissioner for

Personal Data Protection. We designed and followed strict procedures to ensure that we reviewed relevant and appropriate materials in accordance with that legal advice.

4.2 BOC-GGBs

4.2.1 Our work to date has involved the following principal steps in relation to this investigation:

- 4.2.1.1 Submitted a request for key documents and records, followed by supplementary requests as the need for additional information was identified;
- 4.2.1.2 Conducted meetings with the employees of BOC, including the current and former executives of the Bank, Senior Manager of Group Treasury and various Treasury employees, Manager of Market Risk, Manager of Group Finance, Head of Internal Audit, Chairman of the Audit Committee, Chairman of the Board Risk Committee and Mr Xenophontos (an independent non-executive member of the Board of Directors);
- 4.2.1.3 Obtained live and archived e-mail data from desktops, laptops and BOC's e-mail server for 37 out of 40 BOC selected custodians as three of the custodians did not have computers or there was no data available. In addition, images of certain employees' desktops and laptops, in both Cyprus and Greece, were received in order to preserve, and subsequently extract data;
- 4.2.1.4 Keyword searches were performed on the data obtained for 31¹ of the selected BOC employees. In regard to the keyword "GGB" alone, 106,694 responsive documents were generated (across all periods, 2007 to 2012), of which 47,339 were prioritised and reviewed;
- 4.2.1.5 Obtained live and archived e-mail data for all of the 31 CBC custodians selected. In addition, images of certain CBC employees' desktops and laptops were acquired and data extracted. Keyword searches were performed on the e-mail data acquired from 17 CBC employees, generating 41,217 responsive documents, of which 22,007 were prioritised and reviewed;
- 4.2.1.6 Consistent with specific legal advice procured and CBC approvals, reviewed relevant e-mails and attachments of the former Governor of CBC, Mr Orphanides;
- 4.2.1.7 Reviewed CBC Banking Laws and Directives on Country Risk, Market Risk and Concentration Risk (from an operational, management and supervisory perspective);
- 4.2.1.8 Reviewed BOCs Risk Management policies (the market risk management and concentration risk policies provided by BOC are extracts from reports submitted to CBC - no separate written policies were found to be in place until 2011);
- 4.2.1.9 Reviewed copies of Board of Directors' meeting minutes, Audit Committee meeting minutes, Board Risk Committee meeting minutes and Group Asset and Liability Committee ("Group ALCO") meeting minutes for all meetings held between 1 January 2009 and 30 June 2012;
- 4.2.1.10 Undertook analysis of GGB purchases and sales between 1 January 2007 and 30 June 2012;
- 4.2.1.11 Undertook analysis of BOCs financial statements so as to build a picture of the Bank's financial performance from 2004 onwards;
- 4.2.1.12 Undertook analysis of publicly available information regarding European bank holdings of GGBs;
- 4.2.1.13 Completed the review of BOC employees' relevant e-mails and attachments;
- 4.2.1.14 Completed the analysis and attempted recovery of deleted data from BOC computers; and
- 4.2.1.15 Obtained and reviewed formal translations of a selection of BOC Board of Directors, Audit Committee and Risk Management committee meeting minutes.

4.3 BOC - Banca Transilvania

4.3.1 Our work to date has involved the following principal steps in relation to this investigation:

- 4.3.1.1 Submitted requests for key documents and records, followed by supplementary requests as the need for additional information was identified;
- 4.3.1.2 Undertook site visits to BOC, in Cyprus and Romania, to review hard copy files maintained by the Mergers and Acquisitions Department ("M&A Department"), Project Finance Department and International Business Unit, and obtained copies of

relevant documents (limited by approval from BOCs in-house legal department);

- 4.3.1.3 Conducted meetings with current and former employees of BOC, as follows: Georgios Christoforou (General Manager BOC Romania), Marianna Pantelidou (ex- Manager in BOC's M&A Department), George Zornas (Manager in Internal Audit department), Anastasios Isaakidis (Credit Sanctioning Manager BOC Greece), Eliza Liviadiotou (General manager Group Finance and tax planning); and Kyriacos Tsolakis (Head of Finance, BoC Cyprus);
- 4.3.1.4 Held interviews with current and former BOC senior executives, as follows: Yiannis Kypri (Current Group CEO, Group Chief General Manager in 2009), Nicolas Karydas (former Group Chief General Manager Risk Management and Markets) and Christis Hadjimitsis (Group General Manager Finance and Strategy);
- 4.3.1.5 Attended meetings with the following external consultants: Lefkios Joannides (Joannides & Co Cyprus), Florin Dutu (Voici & Filipescu Romania) and Andrei Burz- Pinzaru (Reff & Associates Romania);
- 4.3.1.6 Keyword searches were performed on the e-mail data obtained for 31 out of 40 BOC custodians selected. We focused our attention on specific search terms and consequently reviewed a total of 11,331 prioritised documents/e-mails.
- 4.3.1.7 Reviewed the CBCs directive on the Investment in the capital of other companies;
- 4.3.1.8 Reviewed the EU Market Abuse Directive, Document ESC 48/2003 and the Committee of European Securities Regulators ("CESR") guidance thereon;
- 4.3.1.9 Reviewed CNWM (the Romanian National Securities Committee) Regulation No. 1/2006;
- 4.3.1.10 Reviewed the DIICOT (the Romanian Directorate for Investigating Organised Crime and Terrorism) Indictment dated 9 July 2010 on case no. 191D/P/2010; and
- 4.3.1.11 Reviewed BOCs BOD, ALCO and Executive Committee meeting minutes from 1 January 2008 to 30 June 2012, to identify and analyse references to Banca Transilvania.

4.4 BOC - Uniastrum

- 4.4.1 Our work to date has involved the following principal steps in relation to this investigation:
 - 4.4.1.1 Submitted requests for key documents and records, followed by supplementary requests as the need for additional information was identified;
 - 4.4.1.2 Requested further documentation not already received, such as: Executive Committee meeting minutes, Board of Director minutes for 2012, copies of transaction documents, etc;
 - 4.4.1.3 Conducted meetings with the employees of BOC, including General Managers, employees related to the Uniastrum acquisition such as in M&A and Group Finance and Internal Audit employees;
 - 4.4.1.4 Conducted meetings with George Piskov and Gagik Zakaryan, minority shareholders of Uniastrum;
 - 4.4.1.5 Conducted meetings with CBC employees from the licensing department;
 - 4.4.1.6 Conducted meetings and telephone calls with BOC advisors from White & Case, Polyviou & Co, Ernst & Young and JP Morgan relating to the Uniastrum due diligence;
 - 4.4.1.7 Keyword searches were performed on the e-mail data obtained the selected 31 BOC custodians;
 - 4.4.1.8 Obtained live and archived e-mail data for 31 CBC custodians. In addition, images of certain employees' desktops and laptops were taken and data extracted. Core keyword searches were performed on the e-mail data obtained from 17 select CBC employees, generating 51 responsive documents, all of which have been reviewed.
 - 4.4.1.9 All searches over BOC and CBC custodians resulted in 102,265 responsive documents. We focused our attention on relevant documents dated up to 31 December 2008 and any relevant documents from 1 January 2012 to 31 December 2012 which resulted in a total of 29,913 documents/e-mails.
 - 4.4.1.10 Reviewed CBC Banking Laws and Directives on Country Risk, Market Risk and Concentration

Risk (from an operational, management and supervisory perspective);

- 4.4.1.11 Performed a preliminary review of business valuations and related commentary provided by JP Morgan;
- 4.4.1.12 Reviewed financial and tax due diligence reports prepared by Ernst & Young;
- 4.4.1.13 Reviewed acquisition documents such as the Share Purchase Agreement and Non-Binding Offer;
- 4.4.1.14 Reviewed the Escrow account agreements, and related commentary provided by Ernst & Young concerning related party and non-performing loans;
- 4.4.1.15 Discussed the BOC application for the acquisition of Uniastrum with licensing employees from CBC, and reviewed related documentation such as internal reports prepared;
- 4.4.1.16 Reviewed Board of Directors' meeting minutes and certain personal notes for references and approvals relating to the Uniastrum acquisition;
- 4.4.1.17 Reviewed Executive Committee meeting minutes for references to the Uniastrum acquisition;
- 4.4.1.18 Reviewed Internal Audit reports relating to concerns raised by Internal Audit relating to the Uniastrum acquisition, as well issues post acquisition date (e.g. loans in the escrow account and related party loans);
- 4.4.1.19 Reviewed legal advice provided by White & Case in October 2008 relating to the legal possibility of withdrawing or re-negotiating the purchase price of the acquisition;
- 4.4.1.20 Liaised with the BOC Treasury and Finance departments regarding loans provided to Uniastrum pre and post-acquisition;
- 4.4.1.21 Reviewed general market conditions in Russia during the period 2007 to 2009;
- 4.4.1.22 Performed market research for Russian bank acquisitions during 2008;
- 4.4.1.23 Reviewed the multiples paid in other Russian bank acquisitions;
- 4.4.1.24 Performed a brief review of other potential acquisition targets identified by BOC, TransCredit and Master Bank, and reviewed their financial statements for 2007; and
- 4.4.1.25 Reviewed the financial statements of Uniastrum for the period from 2006 to 2010.

4.5 CPB - Conversion of MEB from a subsidiary to a branch of MPB

- 4.5.1 Our work to date has involved the following principal steps in relation to this investigation:
 - 4.5.1.1 Submitted requests for key documents and records, followed by supplementary requests as the need for additional information was identified;
 - 4.5.1.2 Conducted meetings with the following employees of CBC: Elena Gregoriadou (former head of licensing within CBC), George Ioannou (Assistant Director, Supervision) and Maria Kettirou (CBC Legal Services Department);
 - 4.5.1.3 Attended a meeting with Andreas Vgenopoulos (former Chairman of Marfin Popular Bank), Ethimithos Boloutas (former CEO of Marfin Popular Bank) and Fotios Karatzenis (former Chief Legal Counsel at Marfin Popular Bank);
 - 4.5.1.4 Obtained live and archived e-mail data for 7 of MPB's Cyprus employees from the bank's central e-mail server, network archives and hard-drive data from laptops and desktops. We also received data from MPB Greece on 17 December 2012. For the reasons set out in paragraph 2.1.2.4 above, this data was not loaded for review;
 - 4.5.1.5 Keyword searches were conducted on CBC data in relation to the merger. MPB data was preserved for subsequent extraction as necessary;
 - 4.5.1.6 Reviewed correspondence between CBC and MPB Group between 1 January 2009 and 30 June 2012;
 - 4.5.1.7 Reviewed the MPB Group Statutory Review and Evaluation Process ("SREP") reports for 2009 and 2010;
 - 4.5.1.8 Reviewed the findings of the joint CBC and Bank of Greece ("BOG") onsite audit of MEB undertaken in March 2009;
 - 4.5.1.9 Reviewed EU directives 2005/56/EC and 2006/48/EC on cross border mergers and the freedom of establishment of credit institutions in EU member states, respectively;

4.5.1.10 Reviewed MPB's internal documentation on the cross-border merger, including BOD presentations, meeting minutes, resolutions and correspondence;

4.5.1.11 Reviewed Parliamentary minutes for 13 July 2009; and

4.5.1.12 Researched and reviewed publicly available information.

4.6 Interviews and Consultation performed

4.6.1 Interviews have been held with the following persons in regard to one or more of the four areas of the Mandate or the acquisition of data:

Past and Present BOC Executives

4.6.1.1 Nicolas Karydas

4.6.1.2 Yiannis Kypri

4.6.1.3 Christis Hadjimitsis

Current BOC employees

4.6.1.4 ' Georgios Christoforou

4.6.1.5 Anastasios Isaakidis

4.6.1.6 Constantinos Tsolakkis

4.6.1.7 George Zornas

4.6.1.8 Christakis Patsalides

4.6.1.9 Despina Kyriakidou

4.6.1.10 Theodoros Alepis

4.6.1.11 Maria Christofidou

4.6.1.12 Panicos Nicolaou

4.6.1.13 Eliza Livadiotou

4.6.1.14 Kyriacos Tsolakis

4.6.1.15 Leonidas Isodiou

4.6.1.16 Michalis Yiannikouris

4.6.1.17 Andreas Stylianou

4.6.1.18 Savvas Konstantinidis

Former BOC employees

4.6.1.19 Marianna Pantelidou

4.6.1.20 Jack Beighton

4.6.1.21 Antonis Jacouris

4.6.1.22 Kyriacos Iacovides

4.6.1.23 Vassos Shiarly

Remaining Directors of BOC (present at relevant times)

4.6.1.24 Andreas Artemis

4.6.1.25 Anna Diogenous

4.6.1.26 Christakis G. Christofides

4.6.1.27 Christos Mouskis

4.6.1.28 Costas Hadjipapas

4.6.1.29 Manthos Mavrommatis

4.6.1.30 Costas Z. Severis

4.6.1.31 Evdokimos Xenophontos

4.6.1.32 George Georgiades **CBC**

4.6.1.33 Costas Poullis

4.6.1.34 George Ioannou

4.6.1.35 Elena Gregoriadou

4.6.1.36 Alexandra Theophilou

4.6.1.37 Christodoulos Christodolou

4.6.1.38 Koulla Savva

4.6.1.39 Eleni Poulli

4.6.1.40 Marios Klitou

4.6.1.41 Chrystalla Kenne

4.6.1.42 Nicos Constantinou

4.6.1.43 Argyro Procopiou

4.6.1.44 Christos Phanopoulos

4.6.1.45 Maria Kettirou

4.6.1.46 Chrystella Haili

4.6.1.47 Constantinos Christoforides

4.6.1.48 Spyros Stavrinakis

External to the Banks

4.6.1.49 Lefkios Joannides (accountant)

4.6.1.50 Alina Zayko (E&Y Russia)

4.6.1.51 Andreas Demetriou (E&Y Cyprus)

4.6.1.52 Walter Schuster (JP Morgan)

4.6.1.53 Aristidis Vourakis (JP Morgan)

4.6.1.54 Florin Dutu (Voicu & Filipescu Romania)

4.6.1.55 Andrei Burz-Pinzaru (Reff & Associates Romania)

4.6.1.56 Micheal Olympics

Uniastrum

4.6.1.57 George Piskov

4.6.1.58 Gagik Zakaryan

4.6.1.59 Michael Ergatoudes

4.6.1.60 Andonis Sophocleous

Marfin Investment Group

4.6.1.61 Andreas Vgenopoulos (Chairman)

4.6.1.62 Efthimios Bouloutas (CEO)

4.6.1.63 Dr Fotios Karatzenis (Chief Legal Counsel)

Miscellaneous

4.6.1.64 Criton Tornaritis (Tornaritis law firm)

4.6.1.65 Kikis Kazamias (Former Minister of Finance)

4.7 Interviews not performed

4.7.1 Requests for meetings have been made to certain 'deemed important' persons for voluntary interviews, which did not occur:

- 4.7.1.1 The former BOC CEO, Mr Eliades, did not participate or assist in the Investigation. This was despite significant effort, including the assistance of the BOC and its external counsel to contact and request a meeting with Mr Eliades. Mr Eliades did not respond to our email requests and calls until the end of the Investigation, on 26 February 2013, when he offered his assistance on provision of the terms of A&M's
- 4.7.1.2 Similarly, requests for meetings with the former CBC Governor, Mr Athanasios Orphanides ("Mr Orphanides"), were also unsuccessful. In this instance, Mr Orphanides' counsel demanded copies of the Engagement and Service Agreement as a pre-condition to advising Mr Orphanides on whether he could assist the Investigation. The authority of A&M to conduct the Investigation and the willingness of the CBC to provide confirmation that Mr Orphanides could disclose information regarding the CBC to A&M was conveyed to Mr Orphanides' counsel, though this was deemed insufficient. Accordingly, no interview was conducted with or assistance provided by Mr Orphanides.

5 Possible areas of further investigation

- 5.1.1 As a result of the Mandate outlined above, there are several areas of particular note within the *originally envisaged remit* that were not designated for investigation which include, but are not limited to:
- 5.1.1.1 The losses suffered by MPB on its holdings of GGBs;
- 5.1.1.2 The conversion of MEB from a subsidiary to a branch of MPB, from the bank's perspective;
- 5.1.1.3 Allegedly questionable and preferential loans at BOC and MPB; and - 5.1.1.4 The expansion of BOC in Greece.
- 5.1.2 During the course of any investigation, additional issues are typically identified which could form the subject of an *additional investigation*. In the current circumstances, we provide two discrete recommendations:
- 5.1.2.1 Each aspect of the Mandate provides an opportunity for follow up. Specific recommendations are contained at the conclusion of each such report; and
- 5.1.2.2 Whereas the Mandate is a subset of the Cyprus crisis, those additional matters which contributed to and affected the crisis are a proper focus for additional investigation.

6 Reporting

- 6.1.1 Full forensic investigations have been completed for each of the four areas comprising the Mandate. Reports have been prepared for each such area as well. It should be noted that the reports prepared in relation to BOC's acquisition of Uniastrum and the MEB conversion from a subsidiary to a branch exclude certain granular detail in the presentation due to the Investigation constraints. These reports can be presented in a more comprehensive manner as additional services, if required. These four reports set out our findings and conclusions based on work conducted to 26 February 2013.
- 6.1.2 All four of these reports should be read in conjunction with this Statement of Protocol to ensure that the reader understands the basis on which the work was performed and any limitations to the findings.
- 6.1.3 We have highlighted additional areas of work related to the specific investigations that could be performed to learn more about the issues under investigation. Where this is the case, it should be recognised that the findings and conclusions included in such reports are subject to further verification and may change if this additional work is performed.
- 6.1.4 All documents referenced in the reports are available for inspection in the Investigation team's office at the CBC.
- 6.1.5 This Statement of Protocol and the accompanying four reports have been prepared for the CBC solely for use in relation to the Investigation. They may not be used for any other purpose,

reproduced or disclosed to any other party in whole or in part without our prior notice. In no event, regardless of whether notice has been provided, will we assume any liability or responsibility to any third party to which this report is disclosed or otherwise made available.

6.1.6

Our work does not constitute an audit under generally accepted auditing standards.



INVESTIGATION REPORT

BANK OF CYPRUS - HOLDINGS OF GREEK GOVERNMENT BONDS

PREPARED FOR THE CENTRAL BANK OF CYPRUS

26 MARCH 2013

ALVAREZ & MARSAL GLOBAL FORENSIC AND DISPUTE SERVICES, LLP

STRICTLY PRIVATE & CONFIDENTIAL

Table of Contents

DRAMATIS PERSONAE	3
1 INTRODUCTION	4
2 EXECUTIVE SUMMARY	6
3 OVERVIEW OF THE BANK OF CYPRUS.....	14
4 THE PURCHASE AND MANAGEMENT OF GGB HOLDINGS	17
5 BOC'S LOSSES ARISING DUE TO GGBS TO DATE	40
6 FINANCIAL DISCLOSURES BY BOC.....	41
7 MANAGEMENT AND GOVERNANCE	46
8 CBC SUPERVISION OF BOC'S HOLDINGS OF GGBS	56
APPENDIX A - CHRONOLOGY IN REGARD TO ELECTRONIC DATA COLLECTION ISSUES	63

DRAMATIS PERSONAE

I Name	Defined name	Role within Bank of Cyprus ¹
BANK OF CYPRUS		
Mr Andreas Eliades	Mr Eliades	Group Chief Executive Officer until 10 July 2012
Mr Nicolas Karydas	Mr Karydas	Group General Manager Risk Management and Markets
Mr Yiannis Kypri	Mr Kypri	Group Chief General Manager, now Group Chief Executive Officer
Mr Christis Hadjimitsis	Mr Hadjimitsis	Group General Manager Finance and Strategy
Dr Christakis Patsalides	Dr Patsalides	Senior Manager Group Treasury and Private Banking
Mr Theodoras Alepis	Mr Alepis	Head Group Treasury Asset Liability Management

¹ Job titles taken from contemporaneous documentation, including BOC 2009 Annual report, Central Bank of Cyprus' website, organisation

Ms Despina Kyriakidou	Ms Kyriakidou	Manager Group Treasury Asset Liability Management & Foreign Treasuries
Ms Maria Christofidou	Ms Christofidou	Manager Group Market Risk
Mr Constantinos Tsolakkis	Mr Tsolakkis	Group Internal Auditor
Mr Costas Pitsillos	Mr Pitsillos	Manager Group Back Office & Treasury
Ms Eliza Livadiotou	Ms Livadiotou	Manager Group Finance and Tax Planning
Mr Evdokimos Xenophontos	Mr Xenophontos	Member of the Board of Directors and Audit Committee
Mr George Georgiades	Mr Georgiades	Member of the Board of Directors and Chairman of Risk Committee
Mr Costas Severis	Mr Severis	Member of the Board of Directors and Chairman of Audit Committee
Mr George Koumantaris	Mr Koumantaris	Group Treasury
Ms Annita Domianou	Ms Domianou	Group Treasury
Mr Kryiacos Tsolakis	Mr K Tsolakis	Group Finance
Mr Christos Mouskis	Mr Mouskis	Former Non Executive Director
CENTRAL BANK OF CYPRUS		
Mr Athanasios Orphanides	Mr Orphanider	Former Governor of the Central Bank of Cyprus
Mr Christos Phanopoulos	Mr Phanopoulos	Director Bank Supervision and Regulation Department
Mr Costas Poullis	Mr Poullis	Former Senior Director Bank Supervision and Regulation Department
Mr Spyros Stavrinakis	Mr Stavrinakis	Senior Director
Ms Argyro Procopiou	Ms Procopiou	Assistant Director, Bank Supervision and Regulation Department
EXTERNAL AUDITORS		
Mr Savvas Pentaris	Mr Pentaris	Senior Manager, Assurance & Advisory Business Services, Ernst & Young Cyprus

1 Introduction

1.1 Instructions

1.1.1 Alvarez & Marsal ("A&M") was instructed by the Central Bank of Cyprus ("CBC") on 21 August 2012 to conduct an Investigation as independent persons, appointed in accordance with Section 24 of the Central Bank of Cyprus Laws of 2002 to 2007, to assist the CBC in accordance with the Mandate² (the "Investigation").

1.1.2 Specifically, the Investigation was tasked with assisting "the Governor to take all necessary legal and regulatory remedies, whether they concern the conduct of supervision by the Bank, the procedures followed by some systemically important local banks (hereinafter referred to as "the Cypriot banks") to acquire Greek Government Bonds and / or investing abroad in the form of a branch network and/or subsidiaries banks, having regard to the requirements specified by the provisions of the Banking Laws of 1997 to (No. 2) 2011 and the Central Bank of Cyprus Laws of 2002 to 2007 and the Regulations / Directives/ Guidelines issued under these Laws, or otherwise at the discretion of the Governor".

1.1.3 This report sets out the findings and conclusions based on work conducted up to 26 February

² All capitalized terms herein shall have the meanings set forth in the Statement of Protocol, which is fully incorporated herein and must

2013 in relation to examining the substantial losses suffered by BOC on its holdings of Greek Government Bonds ("GGBs"), following the private sector involvement ("PSI") programme in which holders of Greek debt participated in a haircut on their holdings of GGBs. We have not assessed whether any further losses may be incurred as a result of potential buybacks proposed as part of the agreement reached by Eurozone finance ministers on 27 November 2012.

1.1.4 We provided the CBC with an interim report setting out preliminary findings and conclusions based on work conducted up to 28 November 2012.

1.1.5 This report has been prepared for the CBC solely for use in relation to the Investigation and must be read in conjunction with our Statement of Protocol of 26 March 2013. It may not be used for any other purpose, reproduced or disclosed to any other party in whole or in part without our prior notice. In no event, regardless of whether notice has been provided, will we assume any liability or responsibility to any third party to which this report is disclosed or otherwise made available.

1.2 Structure of this report

1.2.1 We have conducted interviews of certain key individuals identified in this report, and therefore our findings incorporate responses or comments of these individuals. Where transcripts of those interviews are available, page references to those transcripts are noted.

1.2.2 The report is structured as follows:

- Executive summary - summary of findings (Section 2);
- Overview of BOC-summary of the bank's history (Section 3);
- Chronological summary of GGB purchases, sales and losses (Section 4);
- BOC's losses arising due to GGBs to date (Section 5);
- Financial disclosures made by BOC (Section 6);
- Management and governance at BOC (Section 7);
- Supervision of BOC by the CBC (Section 8); and
- Chronology in regard to electronic data collection issues (Appendix A).

1.2.3 We have only exhibited a selection of documents referred to in this report. All documents referenced in this report are available for inspection in the Investigation team's office at the CBC.

13 Co-operation provided by the Bank of Cyprus

1.3.1 Although BOC has generally complied with the documentation requests provided to them, there have been a number of unnecessary delays and general frustrations during the course of the investigation of the Bank. These have resulted from the slow documentary responses of the Bank, the constant need to double check the information that has been provided and the need to chase the Bank for key missing documentation.

1.3.2 By way of example, the way that BOC acted in respect of the provision of electronic data to the investigation team not only resulted in unnecessary delays of over one month, but there is also evidence to demonstrate that during these delays people within the Bank were able to delete data and have attempted to ensure the deleted data could not be retrieved by the Investigation team. This is demonstrated in the chronology set out in Appendix A to this report.

2 Executive Summary

2.1 The accumulation of BOC's GGB position

2.1.1 Until 2009, the level of GGB holdings by BOC remained below €500 million³. During the first half of 2009 holdings of GGBs increased significantly peaking at €1.75 billion. During 2009, BOC appears to have actively traded (i.e. bought and sold) GGBs such that by the end of

³ Analysis has been undertaken on purchases and sales of GGBs from 2007 onwards, and cumulative positions have been calculated assuming a zero opening position, whereas holdings of GGBs were €351 million as at 1 January 2007. The analysis does not take into account reductions in volume due to debt maturing, but this is unlikely to have a significant effect.

October 2009, BOC's holding had been divested to around €30 million. BOC's GGB portfolio remained at a negligible level throughout November 2009.

2.1.2 On 10 December 2009, Mr Kypri informed the market that BOC had sold €1.7 billion of GGBs; stating that from the beginning of the year, the Bank had decreased its exposure of GGBs from €1.8 billion to €0.1 billion⁴.

2.1.3 On 10 December 2009 (i.e. the same day), BOC began repurchasing GGBs, with a rapid increase in the Bank's GGB portfolio to almost €2.4 billion by June 2010.

2.1.4 According to information provided by BOC to the Investigation team on 16 November 2012⁵,¹ total losses as a result of its GGB holdings stand at €1.9 billion, of which:

2.1.4.1 €910 million relates to the cost of restructuring due to the PSI programme;

2.1.4.2 €562 million relates to mark to market adjustments on the new bonds;

2.1.4.3 €48 million relates to transfers from AFS reserves; and

2.1.4.4 €399 million relates to the costs of unwinding hedges related to the bonds.

2.2 The key questions addressed in Report

2.2.1 BOC's GGB position that resulted in significant losses being incurred was accumulated subsequent to 10 December 2009. As a result, the key questions addressed herein are as follows:

2.2.1.1 What was the rationale for BOC to accumulate such a significant position in GGBs post 10 December 2009?

2.2.1.2 Who made the decisions to accumulate the GGB position and by what process were such decisions reached?

2.2.1.3 Were these decisions consistent with the BOC's risk management procedures and in compliance with applicable regulations?

2.2.1.4 How was the BOC position in GGBs treated and reported internally (within BOC's financial records) and externally to the CBC and others? Was this treatment and reporting accurate?

2.2.1.5 Why did BOC continue to maintain significant holdings of GGBs from the second half of 2010 to the date on which PSI was implemented?

2.2.1.6 What interaction was there between the CBC and the BOC concerning the trading in ■ GGBs and the accumulation of BOC's GGB position?

2.2.1.7 Did the CBC fulfil its supervisory role appropriately? Are there lessons to be learnt from a review of CBC's conduct in this area?

23 BOC's apparent rationale for accumulating the GGB position

2.3.1 There were many different factors which would have been considered by BOC in determining its strategy whether to invest in GGBs at different points in time.

2.3.2 Whilst we have reviewed internal documents from the relevant BOC committees where the limits were approved that allowed the investment in GGBs to be made to the ultimate level of €2.4 billion, these documents do not record a clear justification or rationale for the decision to accumulate the GGB position. Notwithstanding the above lack of formal documentation, there are a number of emails which provide some detail as to the strategy and contributing factors to the decision to invest / trade in GGBs. Whilst incomplete as records they appear to indicate the following:

2.3.2.1 BOC management's desire to deliver net interest income and profit growth:

(i) Underlying profitability from 2009 onwards was being eroded by the Bank's Non-Performing Loan ("NPL") portfolio;

(ii) Based on emails and activity in 2009, it appears that BOC pursued an "absolute yield" strategy purchasing GGBs to deliver net interest income combined with a "relative value" strategy where they took advantage of selling opportunities to generate disposal gains, especially as reporting periods approached;

(iii) The Treasury department invested in amongst the highest yielding bonds, including longer maturity inflation linked bonds, which resulted in BOC ultimately experiencing higher losses on

⁴ Stockwatch news dated 10 December 2009 (written in Greek)

http://www.stockwatch.com.cy/ngcontent.cfm?name=news&view&ann_id=110243&lang=gr (Exhibit 2)

- account of the related hedging that was entered into - these bonds comprised over 50% of the GGB portfolio, apparently purchased to benefit from the high yields. Hedges were put in place to swap longer dated bonds onto floating rates and maintain target durations; and
- (iv) BOC became reliant on Treasury profits and its GGB strategy, with the equivalent of almost 30% of profits before tax coming from GGB related activity in 2009. For 2010, BOC set a first quarter target for profit of €25tn for Treasury⁶.
- 23.2.2 Dr Patsalides stated in interview that Treasury was not a profit centre but that profit targets were set by Mr Eliades based on unrealised gains in the AFS portfolio⁷. Mr Karydas in interview⁸ acknowledged that BOC treated the Treasury department as a profit centre but that *"people in the treasury [department] were not remunerated based on their profits"*. Mr Kypri⁹ thought that part of the reason for his removal from Treasury was that he was too conservative and that Mr Eliades believed *"Karydas could do a better job to make additional profits"*
- 23.2.3 The bonus structure for Mr Eliades and Mr Kypri was such that underperformance of the Bank would result in a reduction in the bonus payable to them. Mr Eliades' and Mr Kypri's bonuses included an element based on the Bank's actual performance against its budget and an element that relied on a favourable comparison of the BOC's performance with that of the largest Greek banks and the two largest Cypriot banks¹⁰. In 2009 and 2010, those banks were also investing in high yield GGBs and thus generating significant interest income. We note, however, that both Mr Eliades and Mr Kypri waived the bonus due to them for the year ending 31 December 2008¹¹.
- 23.2.4 On 16 December 2009, BOC applied and received €3 billion of European Central Bank ("ECB") funding¹². We understand that this was not required to fund the Bank's existing Balance Sheet, but was obtained to invest in Government and/or Government guaranteed bonds¹³¹⁴. Shortly thereafter, on 21 December 2009, Group ALCO approved an increase in the overall limit of the Bank's bond portfolio to €6 billion¹³, with the limits for investments in Greek and Cypriot bonds set at €2 billion each. The yields on Greek and Cypriot bonds were significantly higher than the rates paid on the ECB funds, and thus the ECB funding provided BOC with the opportunity to increase net interest income.

2.4 Who made the decisions at BOC to invest in GGBs?

- 2.4.1 As with any Bank, the BOC's risk governance structure was comprised of several committees, each of which had a defined role. Our review indicates that:
- 2.4.1.1 Group ALCO, the committee responsible for market risk management, approved increases to BOC's limits for GGB holdings without any documented rationale or evidence to support the levels approved.
- 2.4.1.2 There was a dominance of senior executives, in particular Mr Eliades and Mr Karydas, within the Bank resulting in a culture whereby senior management decisions were not challenged. Mr Eliades and Mr Karydas were members of the executive decision making committees and those risk committees designed to monitor the Bank's activities. Mr Eliades was also a member of the Board Risk Committee ("BRC"), with Mr Karydas, whilst not a member of the BRC, in attendance at their meetings during 2009 and 2010.

⁶ Document ID: 0.7.12.1443992 (Exhibit 4)

⁷ Dr Patsalides in interview [Page 13 and 14 of transcript/part 4]

Mr Karydas in interview [Page 15 of transcript/part 1]

⁹

Mr Kypri in interview [Page 16 of transcript/part 1]

¹⁰ Mr Kypri in interview [Page 7 of transcript/part 1] advised that *"overall climate in the banking sector in the region especially in Greece and Cyprus at the time was one of growth, so competition if competition was growing faster than you and if competition made bigger profits than you, you were accountable and you would be asked questions."*

¹¹ Dr Patsalides in interview [Page 5 of transcript/part 1] stated that generally there was not a bonus culture within the BOC; Mr Kypri contradicts this [Page 7 of transcript/part 1]

¹² Document ID: 0.7.12.2163717 (Exhibit 5)

ECB funding was to profit from the spread and enjoy the high yield on GGBs.

- 2.4.13 Some of the Non Executive board members did not have banking experience, exceeded allowable credit facilities with BOC¹⁴, and appear not to have received adequate training to fulfil the role.
- 2.4.1.4 Mr Karydas was both the Group General Manager Risk Management and Group General Manager Markets. The holding of these dual roles did not constitute best practice and posed a potential conflict of interest¹⁵. In interview Mr Karydas explained that his role in relation to Risk was not a conflict as it was purely an administrative role in respect of the risk department in Cyprus as its head was based in Greece.¹⁶
- 2.4.1.5 The inherent conflicts arising from senior executives' participation in all major strategic and risk management bodies, at both executive and Board level, possibly prevented these committees from sufficiently questioning the investment in GGBs and the subsequent decision to maintain the portfolio despite the deteriorating GGB market.
- 2.4.1.6 On a day to day basis, Mr Karydas¹⁷, Dr Patsalides, Ms Kryiakidou and Mr Alepis appear to have been involved in the discussions and decisions around GGB purchases.
- 2.5 **Did the BOC follow its own risk management processes / applicable regulations?**
- 2.5.1 We have evaluated the BOC's risk management processes to seek to understand how they operated in practice at the relevant times. However, with the benefit of hindsight, there was clearly an inability to adequately consider the risk associated with the purchase of GGBs, and in particular there was limited recognition that a default could actually take place¹⁸. BOC did not take any mitigating action as the position deteriorated. The Bank appears to have been unwilling to divest its GGB portfolio and thus crystallise the losses that had accumulated, or reduce net profits through the purchase of Credit Default Swaps ("CDSs").
- 2.5.2 Although the Bank had a model for setting guideline concentration limits of Treasury transactions for each country based on country credit ratings, as set out in its iCAAP reports to the CBC¹⁹, the extract of the iCAAP report provided to us by BOC in lieu of a separate written policy also states that an unspecified much higher limit was permitted for Greece and Cyprus. The accumulation of GGBs to a value of over €2.4 billion was therefore allowed under the policy, subject to other considerations within the Risk Policy Statement.
- 2.5.3 We note that during 2009 and 2010, Group ALCO approved increases to the limits of GGB holdings without any clear documented rationale or supporting evidence as to the level being approved. We have also not seen any evidence of the Group ALCO monitoring GGB holdings or subsequently reviewing its previous decisions in relation to approved limits in light of developments in macroeconomic issues (such as changes in Greek ratings).
- 2.6 **How was the BOC position reported internally / externally?**
- 2.6.1 On acquiring bonds, BOC would classify the bonds as either HTM or AFS. The distinction is relevant because bonds held as AFS would be marked to market whereas those classified as HTM would not. Where a bond is classified within the HTM category, the Bank is recognising its intention to hold the bond until it matures and therefore there is no requirement to adjust the bond valuation at each reporting date to reflect the current market price.
- 2.6.2 During the course of 2009 and 2010 the accounting treatment adopted by BOC appears to be inconsistent in as much as documentary evidence suggests BOC may have been moving bonds in and out of the HTM category²⁰ (albeit that the bonds had not been externally reported as HTM prior to moving them). Such reclassifications could potentially be viewed as the Bank using

¹⁴ Letter dated 23 January 2012 from Mr Poullis to Mr Aristodimou, Chairman of BOC Board advised that "based on the data available to CBQ credit facilities granted to Mr Mouskis and persons associated to him exceed the limit provided for under criterion 22(I)(b)(ii) of the Directive." (Exhibit 7)

¹⁵ Letter from CBC dated 9 April 2010 (Exhibit 8)

¹⁶ Mr Karydas in interview, [Page 4 of transcript / part 1] - Mr Karydas stated that his role was purely to ensure the staff were in the office and to approve holidays etc.

¹⁷ Mr Kyprides describes Mr Karydas as the "main instigator" of the GGB investments [Page 9 of transcript/part 1]

¹⁸ Mr Karydas in interview (13 February 2013) [Page 8 of transcript/part 1] acknowledged that he never considered the possibility of a

¹⁹ The iCAAP (Internal Capital Adequacy Assessment Process) report is submitted quarterly by all Cypriot banks to the Central Bank of Cyprus.

²⁰ Document ID 0.7.12.1194775 (Exhibit 9)

accounting conventions to its advantage for reporting or revenue purposes, rather than to reflect the substance of its underlying transactions. The reclassifications also reflect the fact that on at least one occasion the Bank moved bonds out of the HTM category to enable them to be sold prior to maturity²¹.

2.6.3 Dr Patsalides claimed that Group ALCO requested GGBs be classified as HTM so as to avoid volatility in reserves - he could not confirm whether GGBs bonds which had been sold had been classified as HTM in accordance with ALCO decisions (and therefore invoking the tainting rules) or if bonds were actually put into AFS, contrary to ALCO decisions²⁴.

2.6.4 In terms of other statements made internally or to the market:

2.6.4.1 On 10 December 2009, Mr Kypri made an announcement that was reported through Stockwatch that the Bank had divested the majority of its GGB portfolio and therefore had minimal exposure to Greek sovereign debt²²;

2.6.4.2 On 10 December 2009, a meeting was held with Mr Eliades and Dr Patsalides where Mr Eliades instructed Treasury to purchase €400 million of GGBs²³. On the same day €150 million of GGBs were purchased; and

2.6.4.3 On 11 December 2009, Mr Karydas informed the Bank's Board of Directors that the Bank no longer had any significant exposure to GGBs²⁴. In interview Mr Karydas confirmed that he had informed the board on 11 December 2009 that the bank had reduced its exposure to GGBs by disposing of its portfolio²⁵.

2.7 Why did BOC continue to maintain significant holdings of GGBs?

2.7.1 BOC appears to have continued to hold the bonds for a combination of reasons including continued recognition of net interest income in their financial statements and avoiding the crystallisation of losses.

2.8 What **interaction** was there between BOC and CBC concerning the GGB position?

2.8.1 We have reviewed the CBCs practical role, and its interaction with BOC, over the relevant period. Identified interactions of note include:

2.8.1.1 The CBC completed an annual Supervisory Review and Evaluation Process (SREP) and presentation to the BOC Supervisory College in 2009, 2010 and 2011;

2.8.1.2 The CBC initiated quarterly monitoring of GGBs from June 2009. However, the frequency of data collection and lag in receipt of data meant that the CBC had a partial picture of BOCs GGB transactions, in particular during the 1st quarter of 2010

("01 2010);

2.8.1.3 On 1 March 2010, a letter was sent from Mr Poullis (Senior Director in Bank Supervision and Regulation of CBC) to Cypriot banks (including BOC) regarding exposures to Government Bonds, and in particular GGBs. Mr Poullis requested information on the strategy of investing in GGBs and what risk mitigation measures had been taken²⁹;

2.8.1.4 A report by the Cyprus Securities and Exchange Commission²⁶ highlighted that only a verbal conversation took place between someone at BOC and the Governor of the Central Bank in response to the letter of 1 March 2010, and that the Board of Directors at BOC were never made aware of the letter²⁷. The lack of formal response was never followed up. Mr Poullis confirmed²⁸

²¹ Document ID 0.7.12.1194775 (Exhibit 9)

²² Stockwatch news dated 10 December 2009 {in Greek} -

http://www.stockwatch.com.cy/nqcontent.cfmPa_name=news_view&ann_id=110243&lang=gr (Exhibit 2)

²³ interview with Dr Patsalides, 30 August 2012

²⁴ BOC Group Board of Directors minutes from 11 December 2009-'Ο κίνδυνος που αναλαμβάνει η Τράπεζα έναντι των ομολόγων της ελληνικής κυβέρνησης είναι χαμηλός καθώς η Τράπεζα Κύπρου μείωσε σημαντικά τις συμμετοχές της σε ελληνικά ομόλογα από την αρχή του έτους μέχρι τα τέλη Οκτωβρίου" (Exhibit 10)

²⁵ Mr Karydas in interview [Page 7 of transcript/Part 1]

²⁶ Report of the Cyprus Securities and Exchange Commission dated 25 October 2012, entitled "Findings Regarding the Investment of Bank of Cyprus Public Company Ltd to Greek Government Bonds (GGB)" (ΠΟΡΙΣΜΑ ΑΝΑΦΟΡΙΚΑ ΜΕ ΤΗΝ ΕΠΕΝΔΥΣΗ ΤΗΣ ΤΡΑΠΕΖΑ ΚΥΠΡΟΥ ΔΗΜΟΣΙΑ ΕΤΑΙΡΕΙΑ ΛΤΔ ΣΕ ΟΜΟΛΟΓΑ ΕΛΛΗΝΙΚΟΥ ΔΗΜΟΣΙΟΥ (ΟΕΔ)) (Exhibit 12)

²⁷ Mr Karydas in interview (13 February 2013) [Page 18 of transcript/part 1] advised that the CBC was fully aware of the GGB exposure. Mr Kypri in interview (13 February 2013) [Page 6/part 2] advised that the letter was not circulated to the ALCO members or to the Board, only to Mr Karydas by

that his letter of 1 March 2010 was not responded to by BOC but that he and the Governor of the Central Bank discussed this with BOC, and BOC agreed to not buy any further GGBs (albeit Mr Poullis advised that BOC continued purchasing GGBs until April 2010). We understand from a Senior Director at the CBC that a follow-up to the letter of 1 March 2010 was eventually sent to BOC in February 2012.

2.8.1.5 On 28 March 2011 Mr Orphanides wrote to BOC, explaining that the CBC had been informed by the press that *"that the Board of Directors of the Bank of Cyprus decided to distribute a final dividend of 3 cents"*. The letter sets out the CBC's opinion *"that this information was particularly surprising to me [Mr Orphanides] and raised my concerns. It is reminded that by virtue of my letter dated 24 December*

2010, I had strongly recommended that you do not proceed with the distribution of a final dividend with the intention to maintain the maximum possible capital base of your bank so that you are in a position to confront the forthcoming challenges." The letter continued *"I do not consider dividend distribution as a prudent act and I urge you to use all possibilities in reinforcing your capital base"*.²⁹

2.8.1.6 On 28 November 2011 Mr Poullis wrote to Mr Hadjimitsis at BOC requesting *"analysis of the actions you are taking to restore the capital adequacy indexes to the required minimum limits"*³⁰. This was referring to the BoC's letter dated 25 November 2011 in which BOC notified CBC the bank's regulatory capital following the impairment of Greek Government Bonds

2.9 Did the CBC fulfil its supervisory role appropriately?

2.9.1 Our findings suggest that the CBC Supervision department was potentially under-resourced, both in terms of numbers and experience of staff members. In addition, the frequency and timeliness of Sovereign Bond holding reports, prepared by BOC and submitted to CBC, meant that the CBC would not have been aware that BOC significantly increased its GGB holdings between December 2009 and March 2010, until after the event³⁵.

Mr Eliades and it was kept secret until 2012.

²⁸ Mr Poullis in Interview of 25 February 2013

²⁹ Letter from CBC to BOC 28 March 2011 (Exhibit 13)

³⁰ Letter from CBC to BOC - 28 November 2011 (Exhibit 14)

3 Overview of the Bank of Cyprus

3.1 Background

3.1.1 The BOC was established in 1899 and is one of the largest commercial banks in Cyprus. BOC operates predominantly in Cyprus and Greece, but also has operations in Russia, the UK, Ukraine, Channel Islands and Romania³¹.

3.1.2 The Bank's core focus is retail banking, though it offers a range of financial services including leasing, factoring, brokerage, fund management, investment banking and insurance.

3.1.3 The Bank maintains a loan to deposit ratio in the region of 90%³² and, as set out in the June 2010 iCAAP report, "The Group funds its illiquid assets through stable funding (mainly customer deposits) and avoids excessive reliance on wholesale funding".

3.1.4 BOC's annual report for the year to 31 December 2009³³ stated that the "Group's primary objective is to remain robust on the basis of the four parameters which distinguished it during 2009:

- Strong capital adequacy.
- Healthy liquidity which relies primarily on customer deposits.
- Satisfactory profitability.
- Effective risk management."

3.2 The Growth of the Bank of Cyprus

3.2.1 BOC's financial statements demonstrate that the Bank went through a period of rapid growth between 2004 and 2007, more than doubling the size of its Balance Sheet over this period. As can be seen from the table below, BOC's total assets grew from €17.5 billion to €36.1

billion between 2004 and 2008. Profit after tax grew from €64 million in 2004 to €479 million in 2008, a growth of 648%³⁹.

Total Assets	17,530,222	21,873,839	24,882,320	31,763,190	36,107,216	39,411,401	42,637,740	37,475,099
Total Liabilities	16,574,920	20,572,481	23,336,683	29,758,001	34,050,849	36,925,903	39,809,391	35,046,020
Net Assets	955,301	1,301,358	1,545,637	2,005,189	2,056,367	2,485,498	2,828,349	2,429,079

Sources

Audited group consolidated financial statements for each year-end respectively. Years prior to 2008 are published in CYP, and for comparative purposes have been restated here at the rate decided by the EIJ Council upon adoption of the Euro of 61 per C£0.585274

3.2.2 The growth over this period was generated, in part, by overseas expansion. BOC opened its 100th branch in Greece in 2005, established banking services in Romania and Russia in 2007 and acquired Uniastrum Bank in 2008³⁴. The Uniastrum acquisition is the subject of a separate report.

3.2.3 The continued growth of the Bank was emphasised by Mr Eliades in the Bank's annual reports. Continued growth inevitably adds pressure on a business to maintain the year on year growth³⁵:

"Senior Executive Management...managed to transform the three years between 2005 and 2007 into a period of unprecedented achievements for Bank of Cyprus. The financial results for this three-year period highlight the Bank's tremendous progress Profit after tax, at €485 million in 2007, is up sevenfold from €64 million in 2004" - Mr Andreas Eliades, 2007 Annual Report (page 9).

3.2.4 In the 2008 Annual Report the Bank focused attention on Group profits attributable to shareholders being the highest ever delivered³⁶:

"The Group's net profits attributable to shareholders increased from €485 million in 2007 to €502 million in 2008, the highest in the Group's history." - Mr Andreas Eliades, 2008 Annual Report (Page 9).

3.2.5 Alongside these profits in 2008, the Bank recorded €163 million in losses associated with its bond portfolio, made up of €52.3 million of losses from investments in equity securities and €111

³¹ BOC profile - <http://www.bankofcyprus.com/en-GB/Start/About/Structure> (Exhibit 15)

³² iCAAP Report dated June 2010 - percentage as at 31 March 2010 (Exhibit 16)

³³ Page 6 of Bank of Cyprus Group's 2009 Annual Report (Exhibit 17)

³⁴ Bank of Cyprus Group History - <http://www.bankofcyprus.com/en-GB/Start/About/Group-history/> (Exhibit 19)

³⁵ Page 9 of Bank of Cyprus Group's 2007 Annual Report (Exhibit 17)

³⁶ Page 9 of Bank of Cyprus Group's 2008 Annual Report (Exhibit 17)

million of losses from investments in treasury bills and debt securities³⁷. These losses were absorbed within the Bank's reserves and so did not affect its profit and loss performance. In parallel the bank closed its small trading book. It appears that these losses from its bank bond portfolio partly explain the reason for BOC later concentrating its bond portfolio almost exclusively in sovereign debt, which they perceived to be either lower risk or simply opportune.

3.2.6 Mr Eliades and Mr Kypri waived their bonus entitlement for the year ending 31 December 2008, despite the fact that the Bank's performance justified bonus payments per their employment contracts of €288,000 and €135,000 respectively. The minutes of a Board meeting held on 25 February 2009 set out that the decision was taken by Mr Eliades and Mr Kypri due to the fact that the 2008 banking crisis was expected to continue into 2009 and the senior executives wished to send a message to the Bank's shareholders, employees and the wider economy⁴⁴.

3.2.7 Based on discussions with the Bank's staff it is apparent that the Bank considered its peer group to be primarily Greek banks (including the National Bank of Greece, Alpha Bank, Piraeus Bank) and in Cyprus, Cyprus Popular Bank. Interviews conducted indicate that the

³⁷ BOCs 2008 Consolidated Statement of Changes in Equity (Exhibit 20)

4 The Purchase and Management of GGB Holdings

4.1 Summary

4.1.1 In this section we set out the GGB investment strategies pursued by the Bank. Whilst the strategy of optimising income by purchasing high yielding bonds is not in itself a cause of concern, the scale of GGB purchases compared to the size of the Bank and the concentration within the bond portfolio appear to be greater than the market norms for a bank of this size. Considering the impact GGBs had on net interest income and gains recognised from the sales of bonds it would appear that the investment strategy in respect of GGBs was influenced, at least in part, by the income and profits to be generated from high yielding GGBs.

4.1.2 BOC had an internal model that was used to establish the concentration limits of Treasury transactions for each country based on country ratings. This model was to be applied to holdings, including sovereign bonds, as follows³⁸:

- A1 - 30% of Group capital;
- A2 - 20% of Group capital; and
- Bax or less - 2% of Group capital.

4.1.3

BOC made a decision at the end of 2008 that, on account of the banking crisis, the limits above would be used as a guide as to the maximum exposure to any one counterparty; however, a policy remained in place that authorised limits for Greece and Cyprus to be "*much higher*" than those prescribed by the model³⁹. Limits for exposure to Greece and Cyprus were set by Group ALCO, as evidenced by copies of meeting minutes^{47 48}; however, these minutes do not provide any justification for the limits set.

4.1.4 The chart below shows BOC's cumulative holdings of GGBs between January 2007 and December 2011 together with Moody's ratings of GGBs and the dates on which those ratings came into effect⁴⁰:

4.1.5 Until 2009, the level of GGB holdings from purchases after 1 January 2007 remained below €500 million, which on its own (excluding any Greek bank debt) is below the concentration limits as established by the internal model for country holdings, let alone the "*much higher*" limits afforded for Greek holdings⁴¹. During this period, Moody's rating for Greek bonds was stable at A1. During the first half of 2009 ("H1 2009") holdings increased significantly peaking at c.€1.7 billion. At the end of the second quarter of 2009 ("Q2 2009"), just over c.€700 million of the GGB portfolio was sold, followed by an almost immediate repurchase of €500 million GGBs.

4.1.6 During the third quarter of 2009 ("Q3 2009"), BOC rapidly divested almost its entire GGB portfolio, with cumulative holdings falling from approximately €1.7 billion towards the end of August, to around €30 million by the end of October 2009. The GGB portfolio remained at a negligible level throughout November 2009.

4.1.7 On 10 December 2009, Mr Kypri informed the market that BOC had sold €1.7 billion of GGBs; stating that from the beginning of the year, the Bank had decreased its exposure of GGBs from €1.8 billion to €0.1 billion⁴².

4.1.8 On 10 December 2009, BOC began repurchasing GGBs, with a rapid increase in the Bank's GGB portfolio to €2.3 billion by June 2010. During this period there were three downgrades by Moody's; to A2 in December 2009, A3 in April 2010 and further to Ba1 in June 2010. The level of GGBs held by BOC was high and relatively stable from then on despite further downgrades of GGBs by Moody's during 2011 and the eventual PSI agreement.

4.1.9 The table below shows the extent to which BOC's holdings of GGBs were in excess of its internal model for country holdings if this model had been applied rather than the "*much higher*" limits:

Holdings of GGBs compared to limits implied by the Treasury country limit model

³⁸ Page 8 of BOC's concentration risk policy (an extract from 2009 iCAAP) (Exhibit 22)

³⁹ Page 8 of BOC's concentration risk policy (an extract from 2009 iCAAP) (Exhibit 22)

⁴⁰ Sourced from <http://www.moodys.com/credit-ratings/Greece-Government-of-credit-rating-34833Q#> (Exhibit 24)

⁴¹ Analysis has been undertaken on purchases and sales of GGBs from 2007 onwards, and cumulative positions have been calculated assuming a zero opening position, whereas holdings of GGBs were €351 million as at 1 January 2007. The analysis does not take into

⁴² Stockwatch news dated 10 December 2009 (Exhibit 2)

Date of downgrade	Rating per Moody's	Regulatory Capital €000	Guideline Country Limit % I €'000	Country Limit	Holding after PAR €'000	Max after PAR €'000
22/12/2009	A2	2,805,388	20%	561,078	535,678	2,161,852
22/04/2010	A3	2,737,737	10%	273,774	2,301,528	2,301,852
14/06/2010	Ba1	2,737,737	2%	54,755	2,311,528	2,341,852
07/03/2011	B1	3,051,091	2%	61,022	2,411,528	2,292,852
01/06/2011	Caal	3,177,950	2%	63,559	2,411,328	2,078,152
25/07/2011	Ca	2,515,499	2%	50,310	2,411,328	2,068,352

Notes

The guideline model for treasury limits does not define limits for ratings below BaX, therefore we have assumed a 2% limit.

Regulatory Capital levels are per the quarter ending after the downgrade

Holding after is the holding for the first, month-end subsequent to the downgrade. Max after is the largest month-end holding after the downgrade and prior to any further rating change.

Sources

Regulatory Capital levels, for periods up to 31/12/2011, are per 0.7.12.1533872. 30/9/2011 levels from interim financial statements for nine months ending 30/9/2011.

Ratings are per Moody's Sovereign rating for Greece

Guideline limits for treasury country risk exposure are per the Bank of Cyprus Group Concentration Risk Policy, Group Market Risk Management, for 2011, (as specified in the decisions of Group ALCO 03/04/2008)

4.1.10 The accumulation of large GGB holdings occurred over a period of time during which Greece's credit rating suffered a series of downgrades. The guideline country limit would naturally have been expected to reduce in response (had it applied to holdings related to Greece).

4.1.11 BOC had a significant presence in Greece, with €11 billion of loans and €10 billion of deposits at the end of 2009⁴³. The Bank held a level of GGBs that was lower than that of Greek banks or Cyprus Popular Bank as a percentage of assets. The table below shows GGB exposures for a selection of Cypriot, Greek and international banks⁵³:

Bank of Cyprus	600	2,407	1,903	39,411	1.5%	42,638	5.6%	37,474	5.1%
Cyprus Popular Bank	2,690	3,407	3,023	41,828	6.4%	42,580	8.0%	33,762	9.0%
NBG	9,381	12,883	18,600	113,394	8.3%	120,744	10.7%	106,731	17.4%
Alpha	N/A	5,475	4,600	69,596	N/A	66,798	8.2%	59,148	7.8%
Societe Generale	4,000	2,651	1,487	1,023,701	0.2%	1,132,072	0.2%	1,181,372	0.1%
RBS	1,389	1,155	822	1,696,486	0.1%	1,453,576	0.1%	1,506,867	0.1%
Barclays	N/A	93	45	1,378,929	N/A	1,489,645	0.0%	1,563,527	0.0%
HSBC	N/A	919	371	2,364,452	N/A	2,454,689	0.0%	2,555,579	0.0%
BNP Paribas	4,940	4,996	4,101	2,057,698	0.2%	1,998,158	0.3%	1,965,283	0.2%
Deutsche Bank	1,090	1,510	852	1,500,664	0.1%	1,905,630	0.1%	2,164,103	0.0%
Commerzbank	2,900	3,043	2,946	844,103	0.3%	754,299	0.4%	661,763	0.4%
Intesa	N/A	620	847	624,844	N/A	658,757	0.1%	639,221	0.1%
Santander	N/A	177	110	1,110,529	N/A	1,217,501	0.0%	1,251,525	0.0%

*N/A = Not Available

*Cyprus Popular Bank GGB holdings for 2009 derived from analysis of purchases and sales from 1 January 2007

*RBS, Barclays, HSBC, BNP Paribas, Deutsche Bank and Santander Total Assets as of 30 September 2012. Total Asset figures for all other banks as of 30 June 2012.

*2009 Bank of Cyprus figures sourced from data provided by the Bank *2009, 2010, 2011 figures for Greek Banks sourced from Annual Reports *2010

figures for Greek Banks sourced from SNL / EBA Statistics

*2011 figures for Greek Banks sourced from Fitch Ratings

http://inwestycje.pl/resources/Attachment/2011/06_21/file0917.pdf

*2012 figures for Greek Banks sourced from Annual Reports

4.1.12 It would not be atypical for a bank to hold a higher level of sovereign debt in its "domestic" market. For example, Intesa held €57.6bn of Italian sovereign debt in 2010, representing 8.7% of total assets, and Santander held €41.8bn of Spanish sovereign debt in 2010, representing 3.4% of total assets⁴⁴.

4.1.13 As a result of the purchases of GGBs, the BOC bond portfolio became highly concentrated in GGBs. The chart below shows the composition of BOCs sovereign bond portfolio between 2009 and 2012 at book value⁵⁵:

Composition of BOCs Sovereign Bond Portfolio, Nominal Value, €'000

- Other »Ireland
- Cyprus
- Greece

4.1.14 In total, higher yielding Greek, Cypriot and Irish sovereign bonds comprised over 90% of the portfolio in March 2010, with GGBs making up 56% of the portfolio. Following the sale of almost the

⁴³ Page 64, BOC Annual Report 2009 (Exhibit 17)

⁴⁴ Sovereign debt exposure sourced from SNL and EBA data

entire portfolio of GGBs in late 2009, and booking a consequential profit of €72.6 million⁴⁵, the Bank almost immediately started to rebuild its GGB holdings. These purchases of GGBs between December 2009 and April 2010 corresponded with a downgrade of Greece and a significant increase in CDS spreads⁴⁶. The chart below compares BOC's purchase activity with Greece 5 year CDS spreads:



1,200,000,000				
1,000,000,000				
800,000,000				
600,000,000				
400.0. 000				
200.0. 000				
A	I A2 A, 1			3 Be il
		I il		
	f 1 li	1 1		
1 ... 1			III	
c-Ω ra cu	Mar Apr	May Jun	Jul Sep Oct Nov Dec	Jan Feb Mar Apr
>.cµa^>u- r o z s - A r J c u i ^ o a J coza 2010				

8 Sum of Purchased Bonds €
Average of Greece 5 YR CDS

4.1.15 CDS spreads started to rise over the course of 04 2009. There was a significant increase in spreads between December 2009 and April 2010, from 200bps to 500bps; a period of time over which the Bank made most of its purchases of GGBs. Rather than acknowledge the increased risk associated with the widening CDS spreads, the Bank appears to have focussed only on the positive impact the high yields would have on net interest income.

⁴⁵ As per financial data provided by BOC on 22 November 2012 (Exhibit 25)
⁴⁶ CDS spreads are seen as a measure of the likelihood of default. They represent the cost expressed in bps of purchasing protection against an event of default. For example, a CDS spread of 100 basis points ("bps") would mean that it would cost €1 million to protect

- 4.1.16 Up to the point of the PSI agreement, the Bank did not take any significant mitigating actions, such as reducing their holdings of GGBs or purchasing CDS. An informal proposal to purchase CDS was made by Treasury (Mr Alepis) in 2011 but CDS spreads had already widened substantially by this point, making them a costly insurance policy against default. There is no evidence to show that the option to purchase CDS was considered further. During interview Dr Patsalides advised⁴⁷ that Mr Alepis suggested purchasing CDS during 2010. Treasury presented this proposal to Mr Eliades; however, the cost of purchasing the CDS was €300m, and therefore equivalent to BOC's profits. Dr Patsalides advised that Mr Eliades did not believe Greece would default and therefore they did not need CDS. As such, no CDS was acquired.
- 4.1.17 We have undertaken analysis on the counterparties to the GGB trades, which shows there were 289 transactions with more than 40 different counterparties during 2009 and 2010. The majority of these transactions were with large international banks including Barclays, Citibank, Societe Generale, Goldman Sachs and Deutschebank. In relation to the latter, it is noted that BOC only ever purchased GGBs from Deutschebank, whereas with other counterparties it both purchased and sold GGBs.
- 4.1.18 As set out in paragraph 4.2.10 below, there were some trades where GGBs of the same International Securities Identification Number ("ISIN") were bought and sold within a few days; in some cases the purchase and subsequent sale was with the same counterparty.
- 4.1.19 Over 2009 and 2010, BOC generated €57.93 million of additional gross interest income and €99.4 million of one-off disposal gains from its holdings in GGBs⁴⁸. Without these BOC would have reported a significant decline in profits.

4.2 GGB activity in HI 2009

- 4.2.1 The chart below shows sales and purchases of GGBs together with the cumulative net holdings in HI 2009:

GGB Trading Activity and Cumulative Holdings in HI 2009

every €100 million of bonds purchased against the risk of default.

⁴⁸ As per financial data provided by BOC on 22 November 2012 (Exhibit 25)

2.500.0. 000
2.0. 000.000

g?

is

1.500.0. 000 x

m

O

O

1.0. 000.000 |

is

3

€

500,000,000 3

300.0. 000

250.0. 000

-5 200,000,000

m

| 150,000,000

JC

u

I 100,000,000

03

U

50,000,000

r-09 Apr-09
I Sell, PAR, Trade Date
Jan-09 Feb-09
Buy, PAR, Trade Date
May-09 Jun-09
Cumulative buys and sells, PAR, Trade Date

4.2.2 During this period the key events in relation to the GGB portfolio were:

4.2.2.1 There was an increase in cumulative GGB holdings in H1 2009, from €320 million at the start of the year to €1.025 billion at the end of the June 2009, with peak holdings of c€1.7 billion in June 2009;

4.2.2.2 Profit before tax for the 1st quarter of 2009 ("Q1 2009") were weak (€78 million) compared to the 1st quarter of 2008 ("Q1 2008") (€121 million)⁴⁹. The 2nd quarter ("Q2 2009") results showed an improvement with profit before tax increasing to €86 million, of which €21.6 million⁴⁹ was attributable to gains on sales of GGBs; Q2 results would actually have shown a further decline were it not for the profits generated from the sale of GGBs during the quarter. Gains on sales of GGBs were €26.8 million for H1 2009 in total (c.€5.1 million in Q1 2009)⁵⁰.

4.2.2.3 In January 2009, Group ALCO approved an increase in the limit for GGBs of €500 million to €1.005 billion. This was increased to €2 billion in March 2009⁵¹ and to €3 billion on 1 June 2009⁶⁴⁶⁵; and

4.2.2.4 The Greek Government was downgraded by Standard & Poor's from A to A- in January 2009⁵², whilst the Greek economy shrunk in Q1 2009 by 1.2% as compared to Q1 2008, with fears that Greece was heading towards its first recession since 1993⁵³.

4.2.3 In an email dated 23 January 2009 from Dr Patsalides to Ms Christofidou, Mr Alepis and Ms Kyriakidou⁵⁴, he set out that:

"Mr. Eliades would like to take advantage of the of the [sic] GGBs spread and absolute yield - investment from EUR 0,5 bn to 1 bn. The bonds to be classified as held to maturity."

4.2.4 On 27 January 2009, the Group ALCO minutes noted that they *"authorised an increase in the limit for investing in Greek Government bonds (upto five years maturity) by another EUR 500 million, to EUR 1,005 million. Any new holdings in Greek government bonds should be classified as Held to Maturity."*⁵⁵ By classifying the investments as HTM, the Bank would not be required to adjust the

⁴⁹ As per financial data provided by BOC on 22 November 2012 (Exhibit 25)

⁵⁰ As per financial data provided by BOC on 22 November 2012 (Exhibit 25)

⁵¹ Minutes of Group ALCO meeting on 9 March 2009 ((Exhibit 27)

⁵² <http://www.bloomberg.com/news/2012-09-05/greek-crisis-timeline-from-maastricht-treaty-to-ecb-bond-buying.html> (Exhibit 29)

⁵³ http://global.factiva.com/aa/?ref=LBA0000020090515e55f0024n&pp=I&fcpl=en&napc=S&sa_from (Exhibit 30)

⁵⁴ Document ID 0.7.12.1635211 (Exhibit 31)

⁵⁵ Minutes of Group ALCO meeting on 27 January 2009 (Exhibit 32)

bond valuation at each reporting date to reflect the current market price. The Group ALCO minutes do not set out any reasoning for the increase in limits for investing in GGBs.

4.2.5 In an email to the Treasury team dated 27 January 2009, Dr Patsalides set out more specific instructions:

*"We should invest a total of €500 million in 3-5 year GGBs to be funded by ECB repos. The tenors should range between 3-5 years and the expected rise in annual interest income should range between €15-20 million. Theodore, please device [sic] a strategy, and let's discuss with Despina"*⁵⁶

4.2.6 On 9 March 2009, according to the minutes of a subsequent Group ALCO meeting⁵⁷, a decision was taken to further increase the limit for investment in GGBs to €2 billion, in both Euros and USD. The determination of the appropriate accounting treatment, either AFS or HIM, was to be determined by Group Treasury and Finance.

4.2.7 On 11 March 2009, Dr Patsalides sent an email to Ms Damianou and Mr Koumantaris (copied to Mr Alepis, Ms Kyriakidou, Mr Kypri, Mr Karydas and Ms Christofidou) setting out the *"Bonds investment strategy and relative value play"*. In this email, Dr Patsalides stated⁷²:

"i set out below our present strategy, as discussed yesterday - with one or two amendments - and a 'relative value' strategy for further analysis & discussion.

Present strategy

US\$: 500 million

Greece has the higher spreads and we should wait for its US\$ issue...

...EUR:650 million (re: convertible), 90 million (re: structural hedging, targeted amount for Greece 2 billion find. US\$) - we presently hold 924 million, High-yielding Greek/Cypriot banks...

...Greece takes priority. Other government-guaranteed issues follow...

Structural hedging: target maturities such that the weighted average residual life of structural hedging is reduced from 3.46 years to 3 years - we may of course invest in longer duration bonds, but these should be swapped into floating to achieve the targeted duration.

Relative- value play

As and when spreads begin to tighten, there will be profitable sell opportunities (especially given the fact that the market will remain volatile for some time). I would suggest that you actively pursue such opportunities (from the 'available- for- sale' book), subject to the following conditions:...

...2. Absolute yield should not drop. At this point in time, interest income is far more important than trading income. So if there is an opportunity to sell, the sold bond should be substituted with another bond having at least the same yield. Of course one can achieve this, if the new bond has a longer duration. However, I am not comfortable with increasing the duration of the bond portfolio because the trend might reverse and there might be a negative impact on Reserves..."

4.2.8 Following the increase in the limit for GGB holdings, during Q1 2009, the Bank purchased approximately €920 million, and sold c.€430 million, of GGBs, resulting in a cumulative net increase in GGB holdings of c.€500 million⁵⁸.

4.2.9 A review of the purchases and sales of GGBs during Q1 2009 suggests that the Bank traded in GGBs despite the fact that it does not operate trading books⁷⁴. Dr Patsalides stated⁷⁵ trading did not take place in the Treasury department, and that bonds were sold purely to benefit from profits. He advocated that this was not trading i.e. there was not a formal trading desk set up. Mr Kypri in interview⁷⁶ explained the trades as "managing liquidity" and stated that there is a blurred line between trading and liquidity, especially if trading involves "risk free assets".

4.2.10 In Q1 2009, the bank purchased and sold a number of the same GGBs. This is demonstrated by the purchase and subsequent sale of the same ISIN within a matter of days. The fact that many of the ISINs acquired during the quarter were disposed of towards the end of the quarter would suggest that the Bank was trying to generate reportable profits from its bond holdings, rather than investing strategically to manage capital liquidity.

⁵⁶ Email (Document ID 0.7.12.1307664) from Dr Patsalides to Ms Kyriakidou, Mr Kyrou, Mr Alepis, and cc'd to Ms Christofidou and Mr

⁵⁷ Minutes of Group ALCO meeting on 9 March 2009 (Exhibit 27)

⁵⁸ GGB purchases and sales data provided by BOC to the Investigation team in September 2012

4.2.11 The table below sets out the purchases and sales of GGBs during 01 2009 by reference to their unique ISIN:

IS IN	transactions by ISIN in Q1 2009 Residual Maturin at		Price	Date
	Purchased	Sale (€) purchase date (Years)		
		40.0. 000		
GR0002069327	0.5	25.0. 000	0.9877	15/01/2009
GR0002069327	0.5		0.9877	15/01/2009
GR0002069327	0.5	65,000,000	0.9938	11/03/2009
GR0114019442	2.4	95,000,000	1.0099	20/03/2009
GR0114022479	5.5	40,000,000	0.9935	21/01/2009
GR0114022479	5.5	1,200,000	0.9935	23/01/2009
GR0114022479	5.5	3,000,000	0.9940	28/01/2009
GR0114022479	5.5	2,000,000	0.9990	28/01/2009
GR0114022479	5.5	5,000,000	1.0100	30/01/2009
GRO114022479	5.5	4,000,000	1.0098	02/02/2009
GR0114022479	5.5	2,000,000	1.0098	02/02/2009
GR0114022479	5.5	500,000	1.0080	02/02/2009
GR0114022479	5.5	22,300,000	1.0345	23/03/2009
GR0114022479	5.5	200,000,000	1.0223	31/03/2009
GRO 124028623	7.3	40,000,000	0.8915	20/02/2009
GRO 124028623	7.3	40,000,000	0.9035	23/03/2009
GRO 124031650	10.2	175,000,000	0.9893	04/03/2009
GRO124031650	10.2	1,000,000	0.9990	09/03/2009
GRO 124031650	10.2	2,000,000	1.0005	10/03/2009
GRO124031650	10.2	172,000,000	1.0014	13/03/2009
GR0110021236	3.0	25,000,000	0.99757	10/02/2009
GR0110021236	3.0	25,000,000	1.0018	11/03/2009
GR0512001356	3.9	200,000,000	0.9995	06/02/2009
GR0512001356	3.9	100,000,000	0.9907	11/03/2009
GR0512001356	3.9	172,000,000	1.0014	13/03/2009
XS0372384064	4.2	7,721,000	0.9905	17/03/2009

4.2.12 A review of the purchases and sales of GGBs during 01 2009 suggests that the Bank took part in trading activity, sometimes buying and selling on the same day to create and book profits from their GGB trades:

4.2.12.1 €65 million of ISIN GR0002069327 was purchased on 15 January 2009, and then sold two months later;

4.2.12.2 €40 million of ISIN GR0114022479 was purchased on 21 January 2009, with €17.7 million sold off between 23 January and 2 February 2009 and the remaining €22.3 million on 23 March 2009;

4.2.12.3 €40 million of ISIN GR0124028623 was purchased on 20 February 2009 and sold just over a month later on 23 March 2009;

4.2.12.4 €175 million of ISIN GR0124031650 was purchased on 4 March 2009, and sold on 9, 10 & 13 March 2009; and

4.2.12.5 €25 million of ISIN GR0110021236 was purchased on 10 February 2009 and then sold on 11 March 2009.

4.2.13 For some of these trades (i.e. purchases and sales of the same ISIN within the quarter), there is evidence that the bank changed the classification of loans to enable it to take advantage of trading gains for accounting purposes. In an email sent on 11 March 2009, Mr Alepis wrote to Dr Patsalides⁵⁹:

"We need to declassify the bonds that we sold from the Held to Maturity book and book them as available for sale...these bonds haven't been reported anywhere since these were purchases of January

⁵⁹ Document ID: 0.7.12.1194775 (Exhibit 9)

and February."

4.2.14 In addition to the trading of the bonds, the Bank also sought to take advantage of the differential between the cost of borrowing from the ECB and the yields that could be obtained in the sovereign debt market. The minutes of the Group ALCO meeting held on 10 April 2009, set out that *"a discussion took place as to the possibility of increasing the size of our bond portfolio by purchasing government and government guaranteed bonds, that could be financed through repos with the ECB. Group Treasury was requested to prepare a report to Group ALCO where the risks and rewards of such an action would be analysed."*⁶⁰

4.2.15 On 30 April 2009, Dr Patsalides presented a report to ALCO detailing the risks and benefits to the Bank of investing in Government or Government Guaranteed Bonds funded via the ECB repurchase agreements ("repos")⁶¹. This report⁸⁰ sets out the positive impact such a strategy would have on net interest income. The key elements of the report were:

4.2.15.1 BOC was expecting to have a *"strong surplus liquidity position by June 09"*⁶², and had €2.6 billion of bonds available for repoing;

4.2.15.2 BOC could use these bonds to obtain funds from the ECB at 1.25% and invest in European Government bonds at an average rate of 2.5%, generating €12.5 million of interest income for every €1 billion of repos;

4.2.15.3 The average rate of 2.5% was based on a portfolio mix of 50% of holdings in Cypriot, Greek and Irish bonds paying Euribor + 1.5% and 50% in western Eurozone bonds paying Euribor + 0.5% (i.e. a diversified portfolio);

4.2.15.4 BOC could enhance its interest income, without any impact on capital, but with a significant increase in Return on Equity;

4.2.15.5 Such a strategy would involve Eurozone government credit risk, but that this risk was perceived to be very low. It was acknowledged that in the *"unlikely event of a default"*, the impact on BOCs capital would be *"severe owing to the large amounts to be invested"*⁶³; and

4.2.15.6 There would be a risk of adversely affecting accounting reserves due to the *"marking to market"* of any bonds classified as AFS, were interest rate spreads to increase (i.e. bond prices to decrease); however, the risk of impacting accounting reserves in this way could be eliminated by classifying the bonds within HTM⁶⁴, although this would prevent the bank from being able to sell the bonds.

4.2.16 The minutes set out that Group ALCO decided to approve investments in bonds via ECB repos, up to a limit of €3 billion, with 75% of any such investments to be classified as *"Held to Maturity"* and 25% of those investments to be held as *"Available for Sale"*. The Treasury department together with Group Market Risk Management were to establish limits for investments by both country and bank⁶⁵.

4.2.17 Activity in Q2 2009 shows two periods of fluctuation; a sudden increase in holdings in May 2009, followed by a sell off; then another period of purchases in late May and the first half of June 2009, followed by a steep sell off just before the end of the half year. The chart below shows the daily purchase and sale activity during Q2 2009:

GGB Trading Activity in Q2 2009					
€1 ζη ηηηη ηηηη					
tZ UyUUU/UUU mnnn ηηηη ηηηη					
^Zuu,uuu,uuu					

⁶⁰ Minutes of Group ALCO meeting on 10 April 2009 (Exhibit 35)

⁶¹ Dr Patsalides advised in interview [page 12 of transcript/part 4] that the ECB did not monitor to which purpose it's funding was used.

⁶² Page 2 of the report entitled "Increasing our exposure to Government and/or Government-Guaranteed Bonds via ECB Repos" dated 28 April 2009 (Exhibit 36)

⁶³ Page 5 of the report entitled "Increasing our exposure to Government and/or Government-Guaranteed Bonds via ECB Repos" dated 28 April 2009 (Exhibit 36)

⁶⁴ Page 4 of report entitled "Increasing our exposure to Government and/or Government-Guaranteed Bonds via ECB Repos" dated 28 April 2009 (Exhibit 36)

GGBs by the Group and it does not appear that Group ALCO formally approved the sales. The only documentary evidence reporting the sales that we have seen is in an undated report on BOC Group Liquid Assets, prepared by Yiota Philippidou of the Group Treasury Middle Office⁶⁸, which provides details of sales and purchases of bonds during the 3rd quarter of 2009. The report stated that, *"In the period under coverage we unwounded [sic] some of our old and new positions in Greek Government bonds due to the significant tightening in spreads..."*.

43.7 In his *"Memo on the restructuring and Re-Examination of your decision concerning me"*⁶⁹ of 16 August 2012 Mr Karydas states that, *"In August and September 2009, anticipating a drop in the prices of Greek Bonds following the elections in Greece and the publication of the real deficit, it was resolved to proceed with the disposition of the Greek Bonds without any relevant reporting to the ALCO since no approval was required"*. Mr Karydas further states that *"the limit remained at €3bn since we proceeded with the disinvestment not because of an eminent risk of the Greek state not making payments upon maturity or bond-haircut, but because we believed that the current value would be reduced."*

4.3.8 Based on discussions with members of the Treasury department, it would appear that the decision to divest the GGB portfolio was made by Senior Executives and the senior members of the Treasury department, specifically by Mr Eliades, Mr Karydas and Dr Patsalides, without reference to Group ALCO or the Board of Directors. In an email dated 25 September 2009, from Dr Patsalides to Mr Koumantaris and Ms Damianou⁷⁰, Dr Patsalides requested an assessment of the profit and loss impact of disposing of the Bank's GGB portfolio, together with an analysis of the annual interest income they would lose out on were they to dispose of the entire GGB portfolio.

4.3.9 Dr Patsalides confirmed during interview that the decision to sell all of the GGBs in Q3 2009 was on his advice⁷¹, based on rumours that the budget deficit in Greece was going to be higher than expected. He advised that these rumours were circulating around banks in Greece. Dr Patsalides advised that during the first 9 months of 2009 the Treasury Department reported to Mr Kypri⁷², who did not get involved in the day to day treasury activities; from Autumn 2009 Mr Karydas was head of Treasury and he took an active interest in the department and would be in the dealing room instructing the traders on a regular basis⁷³.

4.3.10 Subsequent to this email, on 5 October 2009, Ms Kyriakidou sent an email to the Treasury department instructing them to sell the GGB portfolio⁷⁴:

"Please proceed with the sale of our GGB portfolio. For those bonds which are non-liquid please obtain prices - if you think that the prices are below market, lets [sic] discuss"

4.3.11 Based on initial interviews with Treasury staff, it was normal for them to receive either verbal or email instructions to buy and/or sell bonds^{96 97}. There appears to have been a lack of formal governance around major decisions and actions. Group ALCO was, in some instances, informed of decisions after the event.

4.3.12 As discussed, the Bank started to repurchase GGBs in early December 2009. In an email dated 11 September 2012, from Mr Alepis to Phivos Zomenis, Senior Manager of the Bank of Cyprus Legal Department, Mr Alepis provided some background to the GGB decisions in 2009. The email describes events whereby Mr Karydas was in the Treasury department every day during late November 2009. It further states that between 28 and 30 November, prices of GGBs had fallen so much that he (Mr Alepis) gave the order to purchase GGBs the following day i.e. 1 December 2009,

⁶⁸ This appears to be a report prepared on a quarterly basis to provide an overview of the Bank's foreign currency Liquid Asset portfolio (Exhibit 41)

⁶⁹ Document ID 0.7.12.2112246 - (Exhibit 42)

⁷⁰ Contained within Document ID:0.7.12.1416603 (Exhibit 43)

⁷¹ Mr Kypri in interview [page 10 of transcript/part 1] advised that the sale of GGBs was to crystallise the profit of €80 million and due to

⁷² Confirmed by Mr Kypri in interview (13 February 2013) [page 10 of transcript/part 1]

⁷³ In interview with Dr Patsalides [page 19/part 1 of transcript]. However Mr Karydas in interview (13 February 2013) [page 19 of transcript/part 1] advised that he did spend a considerable amount of time on the trading floor, although this was in late 2008 and as a result of a desire to move corporate bonds held by BoC into Government bonds as his view was that corporate bonds may default but there was little or no risk of a government default.

⁷⁴ Contained within Document ID: 0.7.12.1420037 - Email from Ms Kyriakidou to Ms Damianou and Mr Koumantaris, cc'd to Dr Patsalides and Mr Alepis (Exhibit 44)

- following which Mr Alepis obtained approval for the purchases from Dr Patsalides⁷⁵.
- 4.3.13 A significant number of events occurred in December 2009, for which the chronology of events is as follows:
- 43.13.1 30 November 2009: Mr Brian Guiney informed Mr Alepis, Dr Patsalides and Ms Kyriakidou that the BOC had received correspondence from the UK Financial Services Authority ("FSA") noting *"market concerns over Greece"*⁷⁶. This was forwarded to Ms Christofidou who confirmed that the Bank had *"significantly reduced its exposure to Greek government bonds, and now only has EUR 80 million of such issues"*⁷⁷.
- 4.3.13.2 8 and 17 December 2009: Fitch Credit Rating agency downgraded the Government of Greece from A- to BBB+⁷⁸; this was followed by Standard & Poor's downgrading Greece to BBB+ with a negative outlook. The Greek Government was downgraded to BBB+ by both Standard & Poor's and Fitch's ratings agencies, whilst spreads increased to above 250 bps over German bunds of the same maturity, reflecting the risk associated with GGBs⁷⁹. Despite a reduction of limits to €2 billion around this time, this level remained significantly higher than the less than €560 million limit BOC's internal concentration model would have recommended had the holdings been related to most countries other than Greece.
- 4.3.13.3 10 December 2009: Mr Kypri made an announcement that was reported through Stockwatch that the Bank had divested the majority of its GGB portfolio and had minimal exposure to Greek sovereign debt^{103 104}. Whilst this was correct based on the Bank's sale of GGBs, it did not reflect that the same day the Bank restarted purchases of GGBs. There is no evidence that this public statement was ever retracted or subsequently corrected by any of the Bank's Executives.
- 4.3.13.4 10 December 2009: A meeting was held with Mr Eliades and Dr Patsalides⁸⁰, where Mr Eliades instructed Treasury to purchase €400 million of GGBs⁸¹. Dr Patsalides advised in interview that the primary topic of conversation was how much funding to apply for in the upcoming ECB auction; it was also agreed to build up a bond portfolio of €6bn with additional unlimited investments permitted in AAA bonds and also to reduce the country limits for Greece and Cyprus from €3bn to €2bn⁸²;
- 4.3.13.5 On the same day €150 million of GGBs were purchased⁸³. A further €305 million of GGBs were purchased prior to the year end, bringing total holdings to c.€530 million;
- 4.3.13.6 11 December 2009: A meeting was held at 8am between Mr Karydas, Dr Patsalides, Ms Christofidou and Mr Alepis at which it was decided to revise the country limit for investing in bonds of issuers in Cyprus and Greece (sovereign and bank bonds) to €2 billion each⁸⁴; Dr Patsalides signed minutes to this meeting, only to confirm the minutes and not to agree with them. In interview he advised that he did not agree with: i) the amount which BOC was going to request at the ECB auction; ii) being able to invest an unlimited amount in AAA bonds - although he considered this irrelevant; iii) he thought €2bn was too high a limit but was not concerned as he was the one making the investment decision⁸⁵.
- 43.13.7 11 December 2009: Mr Karydas confirmed to the Board of Directors that the Bank had

⁷⁵ Document ID: 0.7.12.1795186 - this email is in Greek (Exhibit 45). In interview Dr Patsalides confirmed that the Treasury department were assessing the GGB situation in November 2009 but had made no decisions at this time as to whether or not they should repurchase GGBs [page 2 and 3 of transcript/part 2].

⁷⁶ Document ID: 0.7.12.1432667 Email from Ms Christofidou to Mr Alepis and Mr Guiney, cc'd to Dr Patsalides and Ms Kyriakidou RE: FSA

⁷⁷ Document ID: 0.7.12.1432667 Email from Ms Christofidou to Mr Alepis and Mr Guiney, cc'd to Dr Patsalides and Ms Kyriakidou RE: FSA Query (Exhibit 46)

⁷⁸ <http://www.guardian.co.uk/business/2012/mar/09/greek-debt-crisis-timeline> (Exhibit 47)

⁷⁹ http://global.factiva.com/aa/?ref=DT0Q00002Q091217e5ch0Q00r&pp=1&fcpl=en&napc=S&sa_from= (Exhibit 48)

⁸⁰ Mr Kypri in interview [page [11] of transcript/part 1] advised he did not become aware of this until late January 2010

⁸¹ Interview with Dr Patsalides, 30 August 2012 [page 3 of transcript/part 2]

⁸² Interview with Dr Patsalides, 30 August 2012 page 3 of transcript/part 3]

⁸³ Mr Kypri in interview stated that once the GGBs had been sold it was his view that the limits in respect of Greece were no longer valid, and any purchases should have been done after ALCO approved a new limit

⁸⁴ Minutes of a meeting held on Friday 11 December 2009 at 8am at the office of the Group General Manager Risk Management and

⁸⁵ Dr Patsalides in interview [page 3, 4 and 5 of transcript/part 3] stated that within BOC signing minutes meant that confirmation of decisions, not that one agreed with the decisions made

sold most of its GGBs⁸⁶ - although earlier that day, Mr Karydas was present at a meeting at which it was decided to revise the country limit for investing in bonds of issuers in Cyprus and Greece (sovereign and bank bonds) to €2 billion each⁸⁷ » The Board was not informed that the repurchase of GGBs had commenced the prior day, after the reported divestiture⁸⁸.

4.3.13.8 Mr Karydas in his *"Memo on the restructuring and Re-Examination of your decision concerning me"*⁸⁹ of 16 August 2012 states that he mentioned to the *"Programming Committee of the Board of Directors"* on 11 December 2009 that *"the risk undertaken by the Bank with respect to the Greek Government Bonds is low since the Bank of Cyprus has significantly reduced its investments in Greek Bonds". Reference to "risk" concerned the current price and not the risk of default or bond-haircut"*.

4.3.13.9 14 December 2009: The Group Wholesale Investment Committee⁹⁰ agreed to change the attitude of the Bank from "neutral to negative" to "negative" in relation to investment in sovereign bonds; but noted that 10 year GGBs with a spread of 250 bps over German bunds, represented a buying opportunity⁹¹;

4.3.13.10 16 December 2009: BOC applied for and received €3 billion of ECB funding. Dr Patsalides commented that the Greek banks obtained €3.5 billion in total as part of the same ECB liquidity offer⁹²;

4.3.13.11 21 December 2009: ALCO minutes note approval to increase the overall size of the bond portfolio to €6 billion following the €3 billion of ECB funding. At the same meeting, the limit for investments in Greek and Cypriot bonds was reduced to €2 billion each¹¹⁸. No detail was provided for the basis on which the €2 billion limit

was set. Mr Karydas in his *"Memo on the restructuring and Re-Examination of your decision concerning me"*⁹³ of 16 August 2012 states that none of the attendees to the ALCO meeting *"expressed any opinion to the contrary nor was any recommendation submitted for further decrease"*. Mr Karydas further states that *"the risk was considered acceptable because the Greek deficit was reduced and the bond prices were stabilized "*

43.13.12 22 December 2009: Dr Patsalides emailed Mr Koumadaris, Mr Damianou and Mr Alepis with instructions for the Christmas period⁹⁴:

"Christmas guidelines: -We continue our efforts to dispose of profitable bonds at reasonable bid-offer spreads up to 31/12/09; -We continue our efforts to invest in GGB inflation-linked bonds up to EUR 100 million."; and

43.13.13 24 December 2009: Dr Patsalides wrote an email to Mr Alepis highlighting the twin track investment strategy of disposing bonds where a gain could be made and purchasing ILBs⁹⁵: *"GGBs: (a) We are interested in the inflation-linked for up to EUR 70 million...(b) If there is a good buy opportunity for 5/10 year GGBs in the secondary market, please let us know. Karydas and I will be available on the phone."*

"Other bonds: (a) Continue to sell with 2009 value dates only if a good opportunity arises (i.e. if spreads are reasonable) - additional profits should not exceed EUR 5 million. In Q1 we will need to realise a profit of EUR25 million, so bear this in mind".

"The ideal scenario is that we realise EUR25 million in Q1 2010, and during this period we increase our bond portfolio to EUR 6 billion by investing in GGBs and in other bonds."

⁸⁶ BOC Group Board of Directors minutes from 11 December 2009 (Exhibit 10) - *"Ο κίνδυνος που αναλαμβάνει η Τράπεζα έναντι των ομολόγων της ελληνικής κυβέρνησης είναι χαμηλός καθώς η Τράπεζα Κύπρου μείωσε σημαντικά τις συμμετοχές της σε ελληνικά ομόλογα από την αρχή του έτους μέχρι τα τέλη Οκτωβρίου"*

⁸⁷ Minutes of a meeting held on Friday 11 December 2009 at the office of the Group General Manager Risk Management and Markets between Mr Karydas, Dr Patsalides, Ms Christofidou and Mr Alepis (Exhibit 49)

⁸⁸ Mr Kypri confirmed this in interview page 11 of transcript/part 1]

⁸⁹ Document ID 0.7.12.2112246 (Exhibit 42)

⁹⁰ The Group Wholesale Investment Committee was involved with developing investment strategies for, and investment recommendations to, customers (e.g. private wealth management customers)

⁹¹ Minutes of The Group Wholesale Investment Committee meeting on 14 December 2009 (Exhibit 28)

⁹² Document ID 0.7.12.2163717 (Exhibit 5)

⁹³ Document ID 0.7.12.2112246 (Exhibit 42)

⁹⁴ Document ID: 0.7.12.1443656 (Exhibit 51)

⁹⁵ Document ID: 0.7.12.1443992 (Exhibit 52)

43.14 The results for 2009 profit before tax saw a fall in profitability to €365 million compared to €552 million for 2008. Profit before provisions were broadly in line at €612 million in 2009, compared to €654 million in 2008. However, total provisions in 2009 increased significantly to €248 million, compared to €92 million in 2008. The table below shows the impact of provisions on profit before tax⁹⁶:

Impact of provisions on Quarterly		WffHJHM! mmmmm			
	Q1	1 ...	JL	Q4p	Full Year
Profit before provisions	113,243	145,770	194,695	158,538	612,246
Provisions for impairment of loans and advances	(34,878)	(60,785)	(60,383)	(91,889)	(247,935)
Share of losses of associates	(160)	919	1,194	(1,043)	910
Profit before tax	78,205	85,904	135,506	65,606	365,221

4.3.15 Offsetting the increase in provisions, BOC realised a €112 million gain from their bond portfolio in 2009, of which €99.4 million (89%) came from the disposal of GGBs. The table below shows the gains from disposal of bonds over the course of 2009⁹⁷:

HilMI		ppii			
		C			
Bonds Portfolio					
AFS	8.4	23.1	63.4	17.0	111.9
Trading					
HTM	0.0	0.0	0.0	0.0	0.0
Total	8.4	23.1	63.4	17.0	111.9
GGBs	5.1	21.6	57.6	15.0	99.3
GGBs as a % of bond gains	61%	94%	91%	88%	89%

4.3.16 In 2009, the Bank also benefitted from gross interest income⁹⁸ of €7.53 million from their holdings in GGBs⁹⁹.

4.4 GGB activity in HI 2010

4.4.1 The Chart below shows sales and purchases of GGBs together with the cumulative net holdings in the first half of 2010 ("HI 2010"):

GGB Trading Activity and Cumulative Holdings in HI 2010

⁹⁶ Quarterly profits and provisions sourced from financial information published on the BOC website

⁹⁷ As per financial data provided by BOC on 22 November 2012 (Exhibit 25)

⁹⁸ Gross interest income on bonds is calculated based on value date, whereas cumulative holdings have been calculated based on trade date.

300.0. 000
250.0. 000
15 200,000,000
in
| 150,000,000
JZ
u
I 100,000,000
50,000,000
0
2.500.0. 000
2.0. 000.000
fifl
c
is
1.500.0. 000 x
w
<5
e?
1.0. 000.000 | m 3
E
500,000,000 3
0
-L

Mar-10 Apr-10
ESI-j Sell, PAR, Trade Date
Jan-10 Feb-10
Buy, PAR, Trade Date
May-10 Jun-10
Cumulative buys and sells, PAR, Trade Date

4.4.2 During this period the key events in relation to the GGB portfolio were:

4.4.2.1 Within the first quarter of 2010 the Bank purchased €1.6 billion of GGBs, taking its holding to over €2 billion. Further purchases in April 2010 took cumulative holdings to €2.3 billion;

4.4.2.2 The Bank exceeded the limits approved by Group ALCO and so sought retrospective approval for the holdings from Group ALCO. Over this period the Bank changed the basis on which the limits were applied from nominal to invested value and from total Greek debt to GGB holdings only, which would enable them to gain approval for higher levels of GGBs holdings¹⁰⁰;

4.4.2.3 The Bank purchased in excess of €1 billion long dated ILBs which were amongst the highest yielding in the market. The concentration of ILBs held represented at least 7% of Greece's total ILBs. The hedging strategy pursued by the bank per Mr Alepis was: (i) a structural hedge to manage overall interest rate risk on the balance sheet;

(ii) converted fixed to floating to manage target durations; and (iii) stripped the inflation risk on the ILBs to 3 month EURIBOR plus a margin¹⁰¹. The two latter strategies would have resulted in losses associated with the GGB purchases;

4.4.2.4 Dr Patsalides in interview¹⁰² explained that Mr Eliades and Mr Karydas wanted to invest in ILBs and this was initially meant to be up to €400m. Dr Patsalides advised that he was unaware the holdings of ILBs had increased to €1.05bn until after the event. Despite ILBs being a new product with an embedded derivative and which would therefore be difficult to set up effective hedge accounting for, Dr Patsalides in interview advised that Mr Karydas stated the purchases did not have to go to Group ALCO for approval;

4.4.2.5 On 1 March 2010, the Central Bank of Cyprus wrote to Cypriot banks requesting details of the Banks' strategy in respect of GGBs¹⁰³. A report by the Cyprus Securities Exchange Commission states that this letter was not formally responded to by the BOC. However, it appears that a conversation took place between Mr Eliades and the then Governor of the CBC and from the evidence reviewed to date, the CBC did not appear to pursue the matter further¹⁰⁴. Mr Poullis confirmed¹⁰⁵ that his letter of 1 March 2010 was not responded to by BOC but that he and the

¹⁰⁰ Minutes of Group ALCO meeting held on 10 May 2010 (Exhibit 53)

¹⁰¹ Interview with Mr Alepis, 28 November 2012

¹⁰² In interview with Dr Patsalides [Page 10 and 11 of transcript/part 3]

¹⁰³ Letter from CBC to BOC -1 March 2010 - (Exhibit 11)

¹⁰⁴ Report of the Cyprus Securities and Exchange Commission dated 25 October 2012, entitled "Findings Regarding the Investment of Bank of Cyprus Public Company Ltd to Greek Government Bonds (GGB)" (ΠΟΡΙΣΜΑ ΑΝΑΦΟΡΙΚΑ ΜΕ ΤΗΝ ΕΠΕΝΔΥΣΗ ΤΗΣ ΤΡΑΠΕΖΑ ΚΥΠΡΟΥ ΔΗΜΟΣΙΑ ΕΤΑΙΡΕΙΑ ΛΤΔ ΣΕ ΟΜΟΛΟΓΑ ΕΛΛΗΝΙΚΟΥ ΔΗΜΟΣΙΟΥ (ΟΕΔ)) (Exhibit 12)

¹⁰⁵ Mr Poullis in Interview of 25 February 2013

- Governor of the Central Bank discussed this with BOC, and BOC agreed to not buy any further GGBs (albeit Mr Poullis advised that BOC continued purchasing GGBs until April 2010).; and
- 4.4.2.6 In April 2010, all the Bank's ILBs (€1.025 billion) and private placement GGBs (€528.5 million) were reclassified to Loans and Receivables ("L&R") from the AFS book¹³². This avoided the bank having to recognise mark to market losses on the GGB portfolio.
- 4.4.3 Having achieved high yields from its GGB portfolio in 2009, the Bank's investment strategy for GGBs in 2010 appears to have become more bullish. The Bank started to seek even higher yielding GGBs by investing in ILBs rather than normal bonds.
- 4.4.4 The Bank also appears to have continued to use the Treasury department to trade in bonds as a means to achieve profits. On 24 December 2009, Dr Patsalides emailed Mr Alepis in which he stated¹⁰⁶:
- "In Q1 we will need to realise a profit of EUR 25 million, so bear this in mind..."*
- "(b) You can buy anything (subject to limits) at good spreads. The objective is to gradually invest our repo proceeds. Of course at some point we will enter the GGB market."*
- "The ideal scenario is that we realise EUR 25 million in Q1 2010, and during this period we increase our bond portfolio to EUR 6 billion by investing in GGBs and in other bonds."*
- 4.4.5 In line with this, the total bond holdings increased substantially in Q1 2010 from c.€530 million to €2.1 billion, with a significant increase in the holdings of inflation-linked bonds. In an email dated 1 February 2010, Mr Alepis wrote to Ms Christofidou:
- "Maria, following Mr Eliades approval/request we purchased on Friday night another 100 million of inflation linked bond of 2030. Currently our exposure on Greece is 1.7bn EUR and we hold 375 million of I/L of 2025 and 425 million of I/L of 2030 = total 800 million of I/L bonds."*¹⁰⁷
- [I follow orders...]*^{108,1}
- 4.4.6 On 24 March 2010, an email exchange took place between Mr Larnou (Group Market Risk Manager), Mr Alepis and Ms Christofidou¹⁰⁹:
- "Regarding Greece the group ALCO's decision is to have a limit up to 2 bn EUR and to invest more only if we find any good selling opportunity [sic]. That's what we did yesterday. I have got an approval from Dr Patsalides/"*
- Christofidou responded, *"I was not aware we could go over the EUR 2 billion - do you mean buying opportunity"*
- Alepis, *"Yes, buying for us!!!"*
- 4.4.7 In April 2010, the Greek Government had been downgraded to "junk" status (i.e. non-investment grade).¹¹⁰
- 4.4.8 On 10 May 2010, Group ALCO *"ratified an increase in the limits for the Government of Greece and in [sic] the country limit for Greece, required to accommodate purchases of Greek Government bonds that were approved by the General Managers in April 2010"*. Despite the downgrade, the new limit for holdings of GGBs increased to €2.3 billion (nominal value)¹¹¹»
- 4.4.9 In May 2010, the first €110 billion bailout package for Greece was agreed under the condition that strict austerity measures were met¹¹².
- 4.4.10 During a meeting in April 2010, Group ALCO approved the reclassification of circa €1.8 billion of the GGB portfolio from AFS to L&R and HTM, meaning that the bank no longer had to mark to market these bonds, and as a result avoided recognising losses on the Bank's GGB portfolio in the Bank's financial statements.
- 4.4.11 Although the reclassification was approved in April 2010, it was not until 28 June 2010 that a memo was sent from Mr Tsolakis, Manager Finance Control Division Cyprus, to Mr Pitsillos in

¹⁰⁶ Document ID: 0.7.12.1443992 Email from Dr Patsalides to Mr Alepis dated 24 December 2009 (Exhibit 52)

¹⁰⁷ Document ID: 0.7.12.1308663 Email between Mr Alepis and Ms Christofidou dated 1 February 2010 confirming trade (Exhibit 55)

¹⁰⁸ In Greek

¹⁰⁹ Document ID: 0.7.12.1317299 Email from Mr Alepis to Ms Christofidou cc Dr Patsalides dated 24 March 2010 (Exhibit 56)

¹¹⁰ Financial Times "Interactive timeline: Greek debt crisis" from <http://www.ft.com/intl/cms/s/0/003cbb92-4e2d-11df-b48d-00144feab49a.html#axzz282F55280> (Exhibit 57)

¹¹¹ Hellenic Republic Ministry of Finance announcement dated 18 May 2010 (Exhibit 58)

relation to the reclassification of GGBs. The memo requested that the GGBs set out in the table below be sold from the AFS book and bought back to L&R using 1 April 2010 as the value date, and the market price as at 31 March 2010 for both the purchases and sale¹⁴⁰. The majority of these bonds had been purchased in Q1 2010 with some purchases taking place as late as April:

Details of GGBs reclassified				Nominal Value	Market price at Dates purchased by €'000	31.03.2010	BOC
GR0124022568	40,000	94.397	10.03.10-11.03.10				
GR0124027617	40,000	88.862	06.05.2009				
XS0289527186	108,500	96.48	14.01.10 -23.03.10				
XS0289527186	5,000	96.48	14.01.10-23.03.10				
XS0357333029	75,000	84.7004	19.01.10-09.03.10				
GR0514020172	250,000	96.1708	15.12.09				
GR0338002547	650,000	75.8539	14.01.10-07.04.10				
GRG338011531	375,000	94.5787	21.12.09-12.01.10				

4.4.12 The same memo also requested that the bond with ISIN GR0114023485, maturing in 2015, with a nominal value of €257,350,00 and a market price of 99.795 as at 31 March 2010 be sold from the AFS book and bought back to the HTM book, with a value date of 1 April 2010.

4.5 GGB Activity in H2 2010

4.5.1 During the second half of 2010 ("H2 2010"), the activity within the Bank's GGB portfolio was very limited; the total portfolio increased to €2.4 billion after which time there were no further sales or purchases of GGBs until January 2011, when Greece had already received one Eurozone bailout and was on the way to requiring another.

4.5.2 The GGB position that had been accumulated up to August 2010 was partially composed of bonds with a significantly longer maturity than the portfolio that was accumulated in the first half of 2009. The charts below compare the residual maturity for the GGBs within the Bank's portfolio at June 2009 and August 2010¹¹³:

¹¹³ Bond maturity analysis on data provided by BOC

800
700
600
500
400
300
200
100

4.53 The weighted average residual maturity of the GGB portfolio in June 2009 was 7.1 years. This had increased to 10.4 years by 31 August 2010 with 28% of the portfolio having a residual maturity greater than 15 years. The increased tenor of the portfolio required BOC to take out structural hedges to convert fixed interest to floating beyond 5 years for medium to longer term bonds.

4.5.4 In 2010, the Bank benefitted from gross interest income¹¹⁴ of €50.4 million from their holdings in GGBs¹¹⁵.

4.6 **GGB Activity** from 2011 onwards

4.6.1 Although no purchases of GGBs were made during this period, the most significant issue in relation to the GGB holding was that, despite the market sentiment in respect of Greece, the Bank did not adjust the GGB portfolio valuation prior to the finalisation of the 2010 accounts.

4.6.2 The Bank's 2010 Financial Statements were signed on 28 February 2011¹¹⁶, by which time Greece's credit rating had been downgraded to non-investment grade and the Eurozone leaders had agreed to the first bailout loan of €110 billion, all of which increased the prospects that Greece would default on its debts. The economic situation in Greece, combined with the fact that the market value of the reclassified bonds had fallen by around 30% of their carrying value, were indicators of impairment.

4.6.3 The Bank, per its policy of reviewing any bond with a fall in market value of greater than 10%¹¹⁷, conducted an impairment review of its GGB holding for the year ended 31 December 2010 (see Section 6.4 for further details).

4.6.4 There is no reference to any impairment reviews of the GGBs in the Group ALCO minutes. However, during some Group ALCO meetings there are references to other non-GGBs that were considered and reviewed for impairment. We would have expected the Group ALCO minutes to record any considerations of the impact on GGBs, had there been any such discussions, even if the ultimate decision would have been to leave the bonds unimpaired.

26 March 2013

4.6.5 Had the Bank considered the GGBs to have been impaired prior to finalising its 2010 accounts, its retained earnings and therefore equity as reported in the 31 December 2010 Financial Statements would have been €530 million lower (see Section 6.2.1).

¹¹⁴ Gross interest income on bonds is calculated based on value date, whereas cumulative holdings have been calculated based on trade date.

¹¹⁵ As per financial data provided by BOC on 22 November 2012 (Exhibit 25)

¹¹⁶ Page 60 of BOC Group Annual report for the year ended 31 December 2010 (Exhibit 60)

¹¹⁷ BOC's policy was to review all bonds with a fall in market value greater than 10% for impairment - as set out in an email from Ms

5 BOC's Losses Arising Due to GGBs to Date

5.1.1 According to an analysis of the losses BOC experienced on its GGB holdings provided by Ms Livadiotou of BOC to the Investigation team on 16 November 2012, BOC's total losses as a result of its GGB holdings stand at €1.9bn, of which¹⁴⁶:

5.1.1.1 €910m relates to the cost of restructuring due to the PSI programme;

5.1.1.2 €562m relates to mark to market adjustments on the new bonds;

5.1.1.3 €48m relates to transfers from AFS reserves; and

5.1.1.4 €399m relates to the costs of unwinding the hedges related to the inflation linked bonds.

5.1.2 As of the date of this report, we have not performed any work to verify the above calculations provided by BOC.

6 Financial Disclosures by BOC

6.1 Disclosure of GGB Portfolio

6.1.1 Based on our findings it would appear that, in some instances, the executive management of the Bank did not keep the Board of Directors adequately informed of significant investment strategies and actions.

6.1.2 On 10 December 2009, Mr Kypri informed the market that BOC had sold €1.7 billion of GGBs; stating that from the beginning of the year, the Bank had decreased its exposure of GGBs

from €1.8 billion to €0.1 billion¹¹⁸. Yet on the same day as that announcement, Mr Eliades instructed the Treasury department to purchase GGBs amounting to €400 million, of which €150 million was immediately acquired, without informing the market of this decision¹¹⁹.

6.1.3 On 11 December 2009, during the Board meeting Mr Karydas informed the Board that the Bank no longer had any significant exposure to GGBs¹²⁰. At this date, the Bank had started to repurchase GGBs and held €231 million worth of GGBs¹²¹.

6.2 Accounting treatment of GGB Holdings

6.2.1 Our review of the evidence as of 26 February 2013 would suggest that the Bank used accounting rules to reclassify substantial GGB holdings into loans and receivables in H1 2010 (see Section 6.3), thereby avoiding having to recognise substantial losses. Separately over the course of 2010 the Bank appears to have failed to adjust the reported values of its GGB portfolio to take into account the changing market sentiment (see Section 6.4). The table below shows how GGBs were treated in terms of accounting classification and the unrealised losses that existed over time¹⁵¹:

		IIKraaaMräuSi	MIEEEX7BIM	1^0232513			
30 September 2012	GREECE	708,886	147,788	147,788	147,676	0	112
30 June 2012	GREECE	707,680	105,750	106,066	105,674	0	392
31 March 2012	GREECE	760,013	152,031	269,765	536	269,230 -	0
31 December 2011	GREECE	2,083,692	558,417	623,197	1 493	620,000	1,704
30 September 2011	GREECE	2,083,742	804,365	1,161,114	167,348	993,766	0
30 June 2011	GREECE	2,093,530	1,129,155	1,624,429	237,034	1,387,395	0
31 March 2011	GREECE	2,308,131	1,590,396	1,997,053	318,998	1,678,055	0
31 December 2010	GREECE	2,357,074	1,627,499	2,048,391	336,682	1,711,709	0
30 September 2010	GREECE	2,350,060	1,682,784	2,064,265	358,920	1,705,345	0
30 June 2010	GREECE	2,250,060	1,438,466	1,952,872	352,915	1,599,957	0
31 March 2010	GREECE	2,151,850	1,946,823	1,946,823	1,946,823	0	0
31 December 2009	GREECE	600,208	595,664	595,720	595,720	0	0
30 September 2009	GREECE	674,502	664,003	663,935	663,935	0	0
30 June 2009	GREECE	1,082,612	1,096,759	1,097,965	1,097,965	0	0

Notes

The Inquiry team has profit/losses incurred

not be able to re-calculate or otherwise derive the Net Unrealised Profit/ Loss figures using the above data due to net unrealised in prior periods

6.3 Reclassification of GGB Holdings into Loans & Receivables

6.3.1 In April 2010, €1.6 billion of GGBs were reclassified into loans and receivables using IAS 39, as updated by an IASB update¹²², which permitted the reclassification of certain financial assets from AFS to L&R. In order to be eligible for reclassification, the assets need to meet the following criteria:

- (a) not to be quoted in an active market;
- (b) have fixed or determinable payments (e.g. interest payments); and
- (c) contain no features which could cause the holder to lose substantially all of its initial investment, other than due to credit deterioration.
- (d) In addition, the entity must have the intent and ability to hold the assets for the foreseeable future.

6.3.2 The date of reclassification should coincide with the date of change of intent¹²³. IAS 39 and the related IASB update did not define "foreseeable future" and this is therefore a matter of judgement. However, disclosure would normally be required as to how an entity interpreted "foreseeable future" in accordance with IAS1.

6.3.3 Of the €1.6 billion of GGBs, €1 billion related to inflation-linked bonds. On 30 March 2010, Ms Livadiotou wrote to Mr Savvas Pentaris, a Senior Manager at the Bank's auditors, Ernst & Young, for an

Stockwatch news dated 10 December 2009 (in Greek) (Exhibit 2)

¹¹⁹ Interview with Dr Patsalides, 30 August 2012 [Page 3 and 4 of transcript/part 2]

¹²⁰ BOC Group Board of Directors minutes from 11 December 2009 (A&M reference A6) - "Ο κίνδυνος που αναλαμβάνει η Τράπεζα έναντι των ομολόγων της ελληνικής κυβέρνησης είναι χαμηλός καθώς η Τράπεζα Κύπρου μείωσε σημαντικά τις συμμετοχές της σε ελληνικά ομόλογα από την αρχή του έτους μέχρι τα τέλη Οκτωβρίου" (Exhibit 10)

¹²¹ GGB purchases and sales data provided by BOC to the Investigation team in September 2012

¹²² On 13 October 2008, the IASB issued an update to IAS 39 which permitted the reclassification of certain financial assets from AFS to L&R, the purpose of which was to enable banks to recognise assets which were no longer traded in an active market at amortised cost. This, therefore, eliminated the requirement to mark these assets to market price and, as such, eliminated volatility.

¹²³ EY Supplement to IFRS outlook 0309 issue 24 (Exhibit 62)

opinion as to whether the definition for the absence of an active market for inflation linked bonds under IAS 39 and the related IASB update was met. In his response, Mr Pentaris wrote¹²⁴:

IAS 39. AG 26 states that:

...a financial asset that is quoted in an active market (such as a quoted debt instrument, see paragraph AG71) does not qualify for classification as a loan or receivable.

IAS 39. AG 71 states that:

...The existence of published price quotations in an active market is the best evidence of fair value and when they exist they are used to measure the financial asset or financial liability.

From the above, in our opinion, the classification of the Greek govt inflation linked bonds as loans and receivables is not permitted under IFRS, as an active market (as defined by IAS 39) exists."

63.4 Responding to this email, Dr Patsalides requested for a meeting to be set up with Mr Pentaris stating¹²⁵:

"Please arrange a meeting with Savvas to discuss, in order to ensure that we pursue the correct accounting treatment, it should be noted that Bloomberg prices are not reliable and there is no active trading. Live (i.e. reliable) prices are only applicable for small amounts"

63.5 We have not seen a full record of the correspondence with the Bank's auditors or documents confirming the final accounting treatment. However, the minutes of a Group ALCO meeting held on 7 April 2010¹²⁶ set out the following, which appears to be inconsistent with the earlier advice from Ernst & Young:

In the recent few weeks there are concerns by investors on the economic situation of the government [sic] of Greece and this led to a significant drop in market activity in Greek government [sic] debt. The ALCO meeting was convened in order to discuss the Group's [bond] portfolio in Greek government debt and other issues relating to the Group's debt and equity securities portfolio.

1. Reclassification of Greek government bonds

Treasury has informed the Group ALCO that the market for certain types of GGBs have a very small volume of trades as a result of the prevailing uncertainty over the Republic of Greece. Group ALCO reviewed the volumes of YD AT for the traded GGBs, which were significantly lower than previously. Group ALCO noted that no trading statistics are available for ILBs and Private placements. With respect to ILBs, Treasury informed Group ALCO that it has discussed the liquidity for these bonds with a number of dealers who have confirmed that the liquidity in these bonds was very scarce.

In light of this, Group ALCO has concluded that there is no active market for certain types of GGBs and has therefore approved their reclassification from AFS to Loans and Receivables as from 1 April 2010."

63.6 From the materials viewed, the basis on which the Bank's auditors supported the decision to reclassify into loans and receivables is not clear, in particular:

- (a) The evidence for the absence of an active market;
- (b) The purchase of €50 million (nominal value) of a GGB with ISIN GR0338002547 on 7 April 2010, the same date it was decided there was a lack of active market for bonds with this ISIN number¹⁵⁷;
- (c) The continued purchase of GGBs after the 7 April 2010; and
- (d) The determination of "foreseeable future" under IAS 39.

6.4 Decisions around the Impairment of GGB Holdings

6.4.1 For the 2010 annual accounts, it is not clear how the Bank satisfied itself, and particularly its auditors, that it did not need to impair its GGB portfolio despite the downgrades and increasing mark to market adjustment, which had to be disclosed in the accounts.

6.4.2 The IASB update required disclosure in the financial statements of the impact of any reclassifications, i.e. an entity would need to set out in the notes to the financial statements what its position would have been had the assets in question not been reclassified

¹²⁴ Contained within Document ID: 0.7.12.1467511 Email from Mr Pentaris at Ernst & Young to Ms Livadiotou, cc'd to Dr Patsalides and Mr

¹²⁵ Document ID: 0.7.12.1467511 Email from Dr Patsalides to Ms Livadiotou, cc'd to Ms Kyriakidou and Mr Alepis (Exhibit 63)

¹²⁶ Minutes of Group ALCO meeting held on 7 April 2010 (Exhibit 54)

6.43 As per the table in paragraph 6.2.1, the levels of unrealised losses were €599 million in June 2010 and €530m in December 2010. An attachment to an email from Ms Kyriakidou to Ms Christofidou, sent on 12 January 2011, detailing which bonds the Treasury Department considered to be impaired as at the 31 December 2010 year end, sets out the following in relation to GGBs (rated Baal at the time)¹²⁷:

"Fiscal consolidation is expected to take more than the three years initially planned by the EU and IMF programme. Harsh austerity measures are proving very harmful to activity which in turn is hindering the improvement in public accounts. An extension of the programme has already been agreed. At the moment we do not expect a default of the Republic and thus do not agree for bonds to be impaired."

6.4.4 The other bonds considered for impairment included, inter alia, Allied Irish Bank, Alpha Bank, the Republic of Ireland and National Bank of Greece, all rated by Moody's at Baal or lower (i.e. non-investment grade). As such, it does not appear that the Treasury department was willing to consider any of its GGBs as impaired despite the fact the bonds were no longer considered as investment grade.

6.4.5 Had the Bank considered the GGBs as impaired it would have crystallised a loss of €530 million on a portfolio of reclassified bonds with a value of €1.7 billion (i.e. had lost c 30% of their value). When this is coupled with the fact that the economic situation in Greece was deteriorating, the justification provided (i.e. that the Bank did not expect a default) does not appear to be strong. Furthermore, the argument in favour of an impairment of the GGB portfolio is strengthened by the fact that: i) the unrecognised losses were significantly material; and ii) an impairment could be reversed in later years and, therefore, was not solely dependent on expectations of a default but should be considered with a view to ensuring that the financial statements provided a materially correct view of the Bank's financial position. We have not seen a full record of the correspondence with the Bank's auditors or held discussions with them to understand the final accounting treatment.

6.4.6 The Cyprus Securities and Exchange Commission investigated this issue and concluded that the lack of impairment in the annual accounts may have been in violation of their rules¹²⁸.

6.5 Trading within Treasury

6.5.1 As noted in this report, the Treasury department ceased to operate anything more than a negligible trading book in 2008. However, as can be seen from the GGB transactions, the Bank continued to trade.

6.5.2 On 16 November 2009, Ms Christofidou informed a number of people, including Dr Patsalides and Mr Karydas, that an arbitrage trade that they had recently conducted was classified as trading, and that they currently inform regulators, rating agencies and the Board that they do not have any trading books¹⁶⁰:

"Given that our policy is not to have any trading books, and the trade below is clearly trading, if Group Treasury would like to enter into such trades in order to take advantage of market imperfections/opportunities, we need to formally set a policy relating to that type of activity. At the moment we state to regulators, rating agencies, to our Board etc. that we do not have any trading books and that all transactions take place to hedge customer positions or for ALM purposes"

6.53

It is unclear under what mandate the Treasury continued to trade in GGBs.

¹²⁷ Document ID: 0.7.12.1267280 (Exhibit 64)

¹²⁸ Page 34 & 35 Report of the Cyprus Securities and Exchange Commission dated 25 October 2012, entitled "Findings Regarding the Investment of Bank of Cyprus Public Company Ltd in Greek Government Bonds (GGB)" (ΠΟΡΙΣΜΑ ΑΝΑΦΟΡΙΚΑ ΜΕ ΤΗΝ ΕΠΕΝΔΥΣΗ ΤΗΣ

7 Management and Governance

7.1 Introduction

7.1.1 We have analysed the commonality between the management and oversight functions and noted how the lack of oversight and challenges from the Board of Directors rendered ineffective most of the supervisory and control functions which reported to it.

Management's activities were consequently able to proceed unchecked.

7.1.2 Our findings indicate that power was concentrated amongst the key executive management of the Bank, which greatly enhanced the ease with which normal risk management structures could be made ineffective thereby enabling the dominant management to direct strategy irrespective of the inherent risks.

7.1.3 This section sets out the corporate governance structures within the Bank and considers the roles played by various members of the Board and staff at the Bank in enabling the investments in GGBs.

7.2 Risk Governance Structure

7.2.1 The Bank operated a three lines of defence model as illustrated in the schematic below¹⁶¹:

7.2.2 Whilst the risk governance structure was in line with international risk management practices, the second and third lines of defence do not appear to have fulfilled their roles. We have seen little evidence that the Board was actively involved or challenged the purchase of GGBs until 2011. The Board Audit Committee does not appear to have discussed impairing the GGBs during 2010; the first discussions surrounding a potential impairment took place in the first six months of 2011, around the time of the PSI negotiations. Group internal audit only carried out a review of GGB purchases at the request of Mr Eliades in or around February 2012¹²⁹ after the losses had been experienced.

7.2.3 Although we have been unable to interview all the board members, from the interviews we have conducted there did appear to be a view within most of the board that they were inadequately informed as to key issues. In some instances board members acknowledged a lack of banking experience on their part rendering themselves unable to question or challenge the executives.

7.2.4 The Board of Directors had ultimate responsibility for the management of risk, and as such delegated responsibility for the monitoring and mitigation of risk within the Bank to the Board Risk Committee ("BRC"). The BRC in turn delegated authority to two sub committees, as follows:

7.2.4.1 The Executive Risk Committee, which had responsibility for credit and operational risk; and

7.2.4.2 Group ALCO, which had responsibility for market risk management.

7.2.5 Both the Executive Risk Committee and Group ALCO reported to the BRC, who in turn reported to the Board of Directors. Details of the dates of meetings of these three risk management committees between 2009 and 2012, and the members of these committees during this period, are set out in Exhibits 1, 2 and 3 to this report.

7.2.6 Mr Eliades, Mr Kypri, Mr Karydas and Mr Hadjimitsis were members of the Executive Risk Committee and Group ALCO. Mr Eliades was also a member of the Board Risk Committee. Although Mr Karydas was not a member of the Board Risk Committee, he attended these meetings throughout 2009 and 2010. Mr Kypri and Mr Hadjimitsis, who also were not members, only attended two BRC meetings during this period.

7.2.7 One of the pervasive weaknesses identified in the Bank's corporate governance structure, in relation to GGBs, was the dominance of the senior executives within the bank, and in particular:

7.2.7.1 Their ability to be able to issue verbal instructions to the Treasury department, without there being a requirement for written justification and evidence of these instructions prior to their enactment;

7.2.7.2 The fact that meeting minutes document only decisions reached and not the discussions and authorities surrounding those decisions; and

7.2.73 That the two most senior executives, Mr Eliades and Mr Karydas, participated in all but the audit committee meetings, ensuring they had visibility and influence in respect of this issue.

¹²⁹ Document ID 0.7.12.940169 - this email, dated 6 February 2012, refers to the letter from Mr Eliades to the Internal Auditor requesting

7.3 Risk Policy Statement in iCAAP

7.3.1 The Bank had a Risk Policy statement set out in its iCAAP reports that articulates its risk appetite. The following extract from the iCAAP report sets out the Bank's attitude to risk:

*"The Bank of Cyprus Group has a very low appetite for market risk and does not operate trading books"*¹³⁰

7A Asset and Liability Management

7.4.1 As with all commercial banks, BOC needed to maintain healthy liquidity. The management of the balance sheet and setting the parameters for managing liquidity was the responsibility of the Group ALCO.

7.4.2 Group ALCO was responsible for setting the Bank's strategy for managing its liquidity and investment strategy. The decisions made by Group ALCO were based on information and recommendations provided by Group Treasury and/or Market Risk Management ("MRM").

Group Treasury were then to carry out the specific transactions operating within the parameters set by ALCO.

7.4.3 The Bank generally had surplus US dollar liquidity due to a regulatory requirement that 70% of all foreign currency deposits have to be maintained in liquid assets; consequently any shortage of Euros could be rectified by the Bank via foreign exchange swaps from its US dollar holdings into Euros. As such, the bank did not suffer from a shortage of liquidity and did not need to rely on wholesale funding to meet liquidity needs.

7.4.4 On 6 December 2009, Dr Patsalides wrote in an email:

*"We have no reliance on ECB borrowing because (a) we borrow to invest in liquid bonds and (b) alternatively, we could have utilised our USD cash, swap them into EUR, and invest in such assets. Moreover, we could utilise undrawn (but uncommitted money-market lines) amounting to EUR500 million..."*¹³¹

7.4.5 The Bank's liquidity position meant that it did not need to rely on the ECB funding window. As such the use of the ECB funding window for the investment in GGBs would appear to be driven by commercial reasoning within the Bank to increase net interest income rather than as a policy to manage liquidity. In the above email, Dr Patsalides states, in providing input for a response to a query by a Citi analyst:

*"The reason we used repos is because the cost was lower."*¹³²

7.4.6 BOC increased its use of ECB funding from a comparatively low start of €400 million at the end of 2008 to €3.7 billion by 2012. In December 2009; it applied for €3bn of 1 year ECB repo funding just prior to the rapid accumulation of GGBs in Q1 2010. The chart below shows BOC's use of ECB funding over time¹³³:

7.4.7 The use of repos did not impact the Bank's liquidity position, as they were excluded from the ratios the CBC used. However, the leveraging of the Bank's balance sheet increased its reliance on the continuing availability of ECB funding. Initial ECB funding was 3 month rollover and although this was eventually extended to 3 year facilities through the Long Term Refinancing Operations, the weighted average residual maturity of the GGBs purchased was significantly longer than this.

7.4.8 The Bank tested the market for bank funded repos, as opposed to the ECB, in November 2009 and found that "several" other banks would not accept GGBs as repo collateral. Mr Alepis stated in an email addressed to Mr Karydas and Dr Patsalides dated 26 November 2009¹³⁴:

^Almost no bank accepts Greek Government bonds as repo collateral for 1 year. Those that do, impose very haircuts [sic]...

The cost of repoing Greek Government bonds for 3 months is around 0.70%"

7.4.9 As a consequence the ECB would have been the main provider of repo facilities for GGBs from

¹³⁰ Page 18 of iCAAP Report dated 30 June 2010 (Exhibit 16)

¹³¹ Document ID 0.7.12.2163636 Email from Dr Patsalides to Mr Pittalis dated 6 December 2009 (Exhibit 6)

¹³² ¹³³ ¹³⁴

BOC ECB Funding based on data supplied by BOC on 15 November 2012

¹³⁴ Document ID 0.7.12.1297138 Email from Mr Alepis to Dr Patsalides and Mr Karydas, cc'd to Ms Damianou dated 26 November 2009

2010 onwards. In interview¹³⁵ Dr Patsalides stated ECB funding was obtained to finance the purchases of GGBs.

7.5 Lack of Challenge from the Board of Directors

7.5.1 It is apparent from those Board members of BOC that we have interviewed, and some of the documentation reviewed, that the Board of Directors did not question the actions of the executive management in relation to the GGBs¹³⁶. The Board therefore does not appear to have fulfilled its primary role of providing a *framework of prudent and effective controls, which enables risk to be assessed and managed*¹³⁷.

7.5.2 It appears that the Chairman of the Risk Committee, Mr Georgiades, had no prior banking or risk experience and that the Chairman of the Audit Committee, Mr Sevens, had no audit experience.

7.5.3 Email correspondence would appear to suggest, that rather than provide an independent check on the actions of the executives, some of the Board of Directors seemed to support the executives in light of criticism or questions from other Board members¹³⁸.

7.6 Executive bonus structure

7.6.1 The bonus receivable by Mr Eliades and Mr Kypri was directly linked to budget achievement (70% of the bonus) and performance that compared favourably with the average of the corresponding KPIs (cost/income, return on equity and NLPs) exhibited by peers/competitors in the market (30% of the bonus)¹³⁹. The peer banks were considered to be the four largest banks in Greece and the two largest banks in Cyprus.

7.7 Key Participants involved in GGB Purchases

7.7.1 Based on our findings, the individuals discussed below were instrumental in the decisions or actions to purchase, sell and then repurchase GGBs during 2009 and 2010.

7.7.2 The Board does not appear to have been actively involved in the decisions to purchase, sell and then repurchase GGBs. Based on conversations with some members of the Board, we understand that it was not until March 2010 that the Board were informed of the purchases¹⁴⁰, by which time the GGB portfolio was €2.1 billion. However, we have not seen any evidence that the Board challenged Senior Executives in respect of the purchases of GGBs at this time. According to Mr Christofides the board were unaware of the risks to the GGB portfolio until the haircut was announced.¹⁴¹

7.7.3 It appears the three most Senior Executives involved in setting the strategy for purchasing GGBs were Mr Eliades, Mr Kypri and Mr Karydas. An email from Mr Alepis to Ms Kyriakidou, dated 12 April 2010, sets out that¹⁷⁵: *"Mr Kypri does not feel comfortable in purchasing any additional GGBs although Mr Eliades does. Therefore at the moment and because Mr Karydas is so and so we will not purchase any further*

Mr Andreas Eliades, the CEO during the period under review

7.7.4 Discussions with members of the Board and employees of the Bank indicate that Mr Eliades was a dominant character who drove the strategy and main decisions of the Bank. He sat on nearly all of the committees within the Bank, including the Board Risk Committee, Executive Risk Management Committee, and Group ALCO.

7.7.5 Outside of the minutes from the respective committees, there is limited documentary evidence of Mr Eliades' role in relation to the GGB purchases available for inspection. Therefore, our findings are limited to the interviews completed with existing Bank employees. These interviews indicate that Mr Eliades played a significant role in the decisions to purchase and sell GGBs, and in most instances

(Exhibit 68)

¹³⁶ Mr Mouskis in interview (11 February 2013) [page 2 and 3 of transcript] advised that decisions of the bank were "announced" to the board by the Executive rather than any form of brainstorming or idea generation taking place. Mr Mousakis told us he trusted the Executive and also the systems in place (Risk committee, ALCO etc) to make the right decisions. This trust was based on the positive past performance.

¹³⁷ Paragraph 1.1, page 1 of "Annual corporate governance report 2010" (Exhibit 69)

¹³⁸ Document ID 0.7.12.940080 - Email exchange between Mr. Xenophontos, Mr Constantinides and Mr. Eliades (Exhibit 70)

¹³⁹ Per the employment contracts of Mr Eliades and Mr Kypri (Exhibit 71)

¹⁴⁰ Interview with Mr Severis, 26 October 2012

¹⁴¹ Mr Christofides in interview [Page 4 of transcript/part 1]

only provided verbal instructions to buy and sell.

7.7.6 There appear to have been certain motivations for purchasing GGBs. The GGBs appear to have been used as an investment tool to improve net interest income¹⁴², profits and the growth of the Bank, combined with a desire to make sure BOCs performance compared favourably to its Greek and Cypriot peer banks. It has been suggested by Dr Patsalides that Mr Eliades was unwilling to purchase CDS protection or sell any of the bonds, whilst this was an available option¹⁴³. Purchasing CDS protection would have spot-lighted the increased risk associated with the BOC GGB portfolio and reduced returns.

7.7.7 As part of the investigation, Mr Eliades' computers were requested. A desktop apparently used by Mr Eliades in Greece was imaged in Greece on 15 November 2012. Our computer forensic technologists have confirmed that wiping software installed on the computer had been accessed. No data was found on the laptop, which would suggest that the wiping software was used to delete files or that the laptop was not used by Mr Eliades to store data. Recovery techniques have been used to establish whether any deleted data can be retrieved; however, no user data (emails, documents, etc.) was recovered

7.7.8 We were informed by Mr Isodiou from the BOCs IT department that Mr Eliades' laptop was given to Mr Eliades upon him leaving the bank. According to Mr Isodiou this is a common practice with regards to senior employees of BoC. However, on 15 January 2013 we were advised BOC was in possession of the original hard drive from that laptop. We were provided with this hard drive and forensically acquired the data on the same day.

7.7.9 After reviewing this additional data it became apparent that the hard drive was used until October 2008 and briefly accessed on 23 October 2012. The forensic recovery procedures did not indicate any mass deletions and there were only a small number of emails present on the hard drive. Mr Nicolas Karydas, Group General Manager Risk Management and Markets at the Bank during the period under **review**

7.7.10 The holding of the dual roles of Group General Manager Risk Management and Market was not in line with international best practice and posed a potential conflict of interest. Mr Karydas was a member of Group ALCO and the Executive Risk Committee, and, whilst not a member of the Board Risk committee, was present at the majority of the meetings (as evidenced by the minutes of these meetings).

7.7.11 As with Mr Eliades, there is little documentary evidence of Mr Karydas' involvement in the purchase and sale of GGBs, but interviews have also indicated that he predominantly gave instructions verbally. The interviews suggest that Mr Karydas actively participated in the purchase of GGBs and was involved in the decisions to purchase large volumes of inflation linked bonds.

7.7.12 Mr Karydas also informed the Bank's Board of Directors on 11 December 2009 that the Bank had sold the majority of its holdings of GGBs¹⁴⁴ despite apparently knowing that there was an intention to repurchase a significant amount of GGBs.

7.7.13 In interview Mr Karydas stated that he did not believe that the limit was abolished once the GGBs were sold and so no approval was required to repurchase GGBs¹⁴⁵. Furthermore, Mr Karydas stated that he did not consider the investment in government bonds to be risky and stated that the Bank's executives positive view of the Greek economy was demonstrated in that it had approved further expansions of branches in Greece¹⁴⁶.

Mr Ysannis Kypri, Group Chief General Manager

7.7.14 Mr Kypri was a member of Group ALCO and participated in the decisions to purchase GGBs. He was responsible for the statement to Stockwatch that the Bank had minimal exposure to

¹⁴² Dr Patsalides in interview [page 10 and 11 of transcript/part 3] stated purchases of GGBs, and in particular ILBs, were solely to enhance net interest income

¹⁴⁴ A&M reference A6 -"Ο κίνδυνος που αναλαμβάνει η Τράπεζα έναντι των ομολόγων της ελληνικής κυβέρνησης είναι χαμηλός καθώς η Τράπεζα Κύπρου μείωσε σημαντικά τις συμμετοχές της σε ελληνικά ομόλογα από την αρχή του έτους μέχρι τα τέλη Οκτωβρίου" (Exhibit 10)

¹⁴⁵ Page 8/part 1 of interview with Mr Karydas

¹⁴⁶ Page 8/part 1 of interview with Mr Karydas

GGBs on 10 December 2009¹⁴⁷.

Mr Hadjimitsis, Group General Manager Finance and Strategy

7.7.15 Mr Hadjimitsis was a member of Group ALCO and was present when the decisions were made to purchase GGBs. He was responsible for finance and strategy and would have had responsibility for the preparation of the Bank's financial statements.

Dr Christakis Patsalides, the Senior Manager of Group Treasury and Private Banking

7.7.16 Dr Patsalides was a member of Group ALCO and responsible for the Treasury department. Dr Patsalides was also involved in the following:

7.7.16.1 Preparation of a paper for Group ALCO in April 2009, introducing the strategy of using ECB funding to invest in sovereign bonds in order to enhance net interest income;

7.7.16.2 Instructing members of the Treasury team to invest in GGBs via email;

7.7.16.3 Through his own assertion, he was involved in the decision to divest the GGB portfolio in September 2009, due to fears that GGB prices would fall when the market found out the true state of Greece's budget deficit; and

7.7.16.4 Set out the strategy for re-investing in GGBs in December 2009 (as evidenced by contemporaneous emails to members of the Treasury Department).

7.7.17 As part of the investigation, the emails for Dr Patsalides were provided to the investigation team. On review of these emails it was noted that the period of late 2009 and most of 2010 contained significantly fewer emails than other periods, as can be seen from the chart below. We are advised that no back-up was maintained.

Monthly number of Emails- Dr Patsalides

7.7.19 Following approval to obtain forensic images of BOC computers, it was found that on 18 October 2012 over 28,000 files (including almost 1,300 documents¹⁴⁸) were deleted from Dr Patsalides' desktop using wiping software installed and executed from a portable device (e.g. a memory stick).

Ms Despina Kyriakidou, Manager, Group Treasury

7.7.20 Ms Kyriakidou, the Manager, Group Treasury, was involved in a number of the discussions about GGB trades with Dr Patsalides and Mr Alepis. She was on maternity leave in late 2009 and early 2010.

Mr Theodoros Alepis, Head Group Asset - Liability Management

7.7.21 In the absence of Ms Kyriakidou, the Manager of Group Treasury, Mr Alepis was the person directing the traders to carry out the GGBs on instructions from senior management. He participated in discussions with Mr Eliades, Mr Patsalides and Mr Karydas about the purchase of GGBs.

Ms Maria Christofidou, Manager of Market Risk Management and the Secretary of Group ALCO

7.7.22 Interviews suggest that her Group ALCO role was more administrative and that she did not exert significant influence in the decision to purchase GGBs.

¹⁴⁷ Stockwatch news dated 10 December 2009 (in Greek) -

7.7.18 When questioned about this, Dr Patsalides claimed not to know anything about this missing data, but nonetheless was able to provide some more data, which was also found to have similar data periods missing.

¹⁴⁸ Potentially there could be more than 1,300 documents deleted. However, we cannot ascertain the exact number as wiping software Ms Eliza Livadiotou, Head of Group Finance and Tax

7.7.23 Ms Livadiotou was not a member of Group ALCO; however, she did attend some meetings of Group ALCO to assist with financial or technical discussions. She was involved in discussions with the auditors around the reclassification of bond holdings, the impairments of GGBs and preparation of the financial statements.

26 March 2013

8 CBC supervision of BOC's holdings of GGBs

8.1 Summary

8.1.1 Given the broad nature of supervision, the CBCs role needs to be considered on a holistic basis. For this report our understanding is based upon interviews with staff from the banking supervision and regulation division of the CBC¹⁴⁹, review of the BOC Annual Presentations to the Supervisory College of Bank of Cyprus for 2009 and 2010 and quarterly reports submitted to the CBC.

8.1.2 It would appear that there were potential gaps at both an overall system level and at an individual supervision level. At a system wide level:

8.1.2.1 Whilst there were broad guidelines recommending holding a diverse pool of liquid assets, the CBC maintained no regulations for banks in relation to the concentration of holdings.;

8.1.2.2 Within the existing capital framework, the CBC only required additional capital to be held against GGBs in the AFS book. The CBC did not assess the risk of a haircut on sovereign debt and it may have felt constrained in its ability to "officially" consider this; and

8.1.2.3 The level of capital and in particular loss absorbing capital held was in practice too low. Basel III has introduced tougher rules for capital, both increasing Tier 1 capital and within it the level of common equity required. In addition, conservation and counter-cyclical buffers are being implemented.

8.1.3 At an individual supervision level:

8.1.3.1 The Supervision department at the CBC was potentially under-resourced and so unable to effectively monitor BOC actions;

8.1.3.2 It is unclear the extent to which the CBC identified, evaluated or investigated BOC's reliance on GGBs for net interest income and disposal profits;

8.1.3.3 The frequency of monitoring of GGB holdings and the time lag in receiving data resulted in the CBC having an incomplete picture of the BOC's GGB transaction activity, in particular as significant GGB purchases and disposals were made within short time periods inside a quarter; and

8.1.3.4 In March 2010, the CBC was starting to become aware of the substantial GGB holdings and they wrote to BOC regarding its holdings. It is not clear why no formal response was received. Mr Poullis confirmed¹⁵⁰ that his letter of 1 March 2010 was not responded to by BOC but that he and the Governor of the Central Bank

discussed this with BOC, and BOC agreed to not buy any further GGBs (albeit Mr Poullis advised that BOC continued purchasing GGBs until April 2010).

8.2 Concentration Risk

8.2.1 BOCs holdings of GGBs were highly concentrated in two ways; i) the level of holdings as a percentage of share capital and ii) the level of holdings as a percentage of the bond portfolio. These concentrations were not prevented by the Bank's internal policies.

8.2.2 The CBC noted in its 2010 Supervisory College presentation that the BOC had "*significant Greek sovereign exposure*"¹⁵¹ and that "*concentration limits need to be reassessed*"¹⁵². However, this presentation was produced after the BOC had accumulated its GGB portfolio..

8.2.3 Ms Kyriakidou has informed us that the BOC has since introduced a concentration cap of 25% of share capital¹⁵³. Had this cap been in place at the time of the purchases of GGBs in late 2009 and 2010, it would have limited BOC's holdings of GGBs to €500m.

8.3 PSISar 1 and Pillar 2 Capital Assessments

8.3.1 On site monitoring teams from CBC were responsible for the annual Supervisory Review and Evaluation Process ("SREP") for each of the banks for which they had responsibility. The key elements of the SREP are:

8.3.1.1 A risk profile assessment;

8.3.1.2 An assessment of each banks' own internal capital adequacy assessment process (iCAAP); and

¹⁴⁹ We have not met with Mr Orphanides, the former Governor of the CBC, for reasons set out in our Statement of Protocol of 26 March 2013

¹⁵¹ Page 39 of the CBC presentation dated 17 December 2010 entitled "2nd Meeting of the College of Supervisors of the Bank of Cyprus Group - Supervisory review and evaluation of the Bank of Cyprus group by the Central Bank of Cyprus" (Exhibit 74). Since 2009, the CBC has hosted a Supervisory College on all of the banks which it monitors, during which the Supervision department reports its SREP findings to the individual banks.

¹⁵² Page 45 of the CBC presentation dated 17 December 2010 entitled "2nd Meeting of the College of Supervisors of the Bank of Cyprus Group - Supervisory review and evaluation of the Bank of Cyprus group by the Central Bank of Cyprus" (Exhibit 74).

¹⁵³ We do not know when this concentration cap was introduced

83.1.3 An evaluation of the adequacy of each banks' capital.¹⁵⁴

83.2 As part of these reviews the CBC assessed whether the Bank held the minimum core tier 1 requirement of 8% of risk-weighted assets and whether any additional Pillar II capital needed to be set aside. As part of this, the CBC assessed the risk associated from (small) reductions in the market value of GGB holdings held in the AFS book and required additional capital to be held against this. However, only 16% of the total GGB holdings was held in the AFS book.

83.2.1 In 2009, the CBC assessment, based on the 30 September 2009 Balance Sheet, was that BOC should hold an additional €88 million of capital to cover losses equivalent to a potential 4% decrease in the market value of its available for sale portfolio, including €664million of GGBs.

83.2.2 In 2010, the additional capital required in relation to BOCs AFS portfolio of €258 million was calculated based on a potential loss of 10% of the market value of the portfolio which at 30 September 2010 totalled €2.58 billion, including €352 million of GGBs.

8.3.3 However, following the reclassification of GGB holdings in HI 2010, the majority of GGBs (totalling €1.79 billion) were classified as HTM or L&R. They were therefore not subject to the Pillar 2 additional capital buffer requirements. The CBC did not assess the risk associated with a haircut on these holdings. A Senior Director of the CBC advised that this risk could have been identified and assessed had the CBC analysed the reclassification through review of the monthly balance sheet and profit and loss statements.

8.3.4 An interview with Ms Procopiou has indicated that the CBC felt constrained as a member of the Eurosystem to "officially" assess or require additional capital to be held against the risk of a haircut. The EBA did not consider a haircut on Greek sovereign debt until June 2011, and the level of haircut applied in June 2011 was 25%¹⁵⁵.

8.4 CBC Supervision Department Resources

8.4.1 The Supervision department at the CBC comprised of the following: (i) three onsite regulation teams (assigned responsibility for certain banks under the CBCs jurisdiction); (ii) an off site monitoring team (to whom daily, weekly and monthly reports are submitted by all banks); and (iii) a regulation team. The reporting lines and responsibilities of the CBCs Supervision team responsible for BOC is set out below¹⁵⁶.

8.4.2 The CBC Supervision team for BOC during 2009 and 2010 consisted of four staff, two at officer 2 level (equivalent to graduate) and two at officer 3 level, all of whom reported into an Assistant Director, Ms Procopiou. The team was responsible for four large banks in Cyprus, including BOC. Ms Procopiou also had additional responsibility for EU wide stress testing, and dealing with the IMF, EC, ECB and Ratings Agencies. Given the scope of responsibility it would appear that the number and level of resources may not have been sufficient to effectively monitor BOC's actions.

8.5 CBC's Awareness of BOC's Reliance on GGB Income and Profits

8.5.1 From reports provided to us by Supervision, it would appear the CBC's perception of BOC was of a "medium-low risk"¹⁵⁷, bank. The Supervision reports highlight that the Bank had a "traditional banking" model with no "proprietary trading"¹⁹², no or a negligible trading book and did not undertake any investment banking activities.

8.5.2 The Investigation team's discussions with the CBC's Supervision department indicate that the risk profile assessment, undertaken as part of the SREP, was newly implemented in 2009, with the processes being refined in 2010 and 2011.

8.5.3 In 2009, the CBC undertook a qualitative assessment of BOC's risk profile and internal controls; from 2010 onwards an assessment of the inherent riskiness of BOC's activities was carried out with those activities then being assigned a risk rating. Following the risk assessment, the banks were assigned an overall risk rating.

8.5.4 In 2010, the CBC assigned the BOC an overall risk rating of 2, based on a rating scale of

¹⁵⁴ Page 7 of the CBC presentation dated 17 December 2010 entitled "2nd Meeting of the College of Supervisors of the Bank of Cyprus

¹⁵⁵ European stress test analysis - <http://www.moodvsanalytics.com/~media/Insight/Regulatory/Stress-Testing/2011/II-01-07-Europe-Misses-Again-on-Bank-Stress-Test.ashx> (Exhibit 75)

¹⁵⁷ Page 3 of "Central Bank of Cyprus presentation for Bank of Cyprus Supervisory College, 1st Meeting, 14 December 2009" (Exhibit 77).

between 1 and 4, with 1 being the least risky, and 4 the most. This was based on the CBC assessment as at 30 September 2010, at a time when BOC held €2.4 billion of GGBs.

8.5.5 In the 2010 presentation to the BOC Supervisory College, the CBC set out that the bank was *"focussed on the traditional banking activities of deposit taking and lending"* and that *"95% of income is generated from banking activities"*¹⁵⁸. Whilst the growth of NPLs was commented upon, there was no reference to the contribution of the Treasury department to Group profits¹⁵⁹.

8.6 CBC Monitoring of GGB Holdings

8.6.1 From June 2009 onwards, Cypriot banks falling under the CBC's jurisdiction were required, each quarter, to submit reports detailing sovereign bond holdings. The first report for June 2009 did not have to be submitted to the CBC until September 2009, with subsequent reports due a month in arrears. From March 2011, banks had to submit this data monthly.

8.6.2 These reports showed holdings as at quarter end, rather than movements in holdings over the period. Given the frequency of reporting and the time frame in which the information had to be submitted, the CBC lacked visibility as to how BOC's GGB portfolio changed within a three-month period.

8.6.3 The CBC also undertook its SREP assessments on 30 September each year; consequently on 30 September 2009 it would have received BOC's first sovereign bonds report showing holdings of €1.07 billion as at June 2009. The SREP analysis and subsequent sovereign bond report showed holdings of €664 million as of 30 September 2009, indicating that BOC had reduced its exposure. The report for 31 December 2009 showed a further decrease to €536 million, and would therefore not have shown that BOC decreased its holdings to €30 million by the end of October 2009 and then repurchased €500 million of GGBs during December.

8.6.4 The sovereign bond report for the quarter ended 31 March 2010 was submitted by BOC at the end of April 2010. This would have been the first report the CBC received which showed BOC had increased its GGB holdings to over €2 billion and, based on the reclassification of ILBs and private placement, the market for €1.79 billion of this had become illiquid. We have not seen evidence of any action being taken by the CBC in response to this submission¹⁶⁰.

8.7 Action taken by CBC

8.7.1 On 1 March 2010, a letter was sent to several Cypriot banks, including BOC, by Mr Poullis, the then head of Supervision at CBC, raising concerns about the banks' holdings of Government bonds and especially their GGB holdings¹⁶¹.

8.7.2 No formal response was received to this letter from the BOC. A report by the Cyprus Securities and Exchange Commission stated that based on the data they had obtained, they believe that this letter was not submitted to the Board of Directors of BOC until 24 April 2012¹⁶².

8.7.3 Mr Poullis confirmed¹⁶³ that BOC did not respond to his letter of 10 March 2010 but that he and the Governor of the Central Bank discussed the letter with BOC, and BOC agreed to not buy any further GGBs.

8.7.4 It is unclear why a formal response to this letter was not requested by the CBC, particularly when it would later have become apparent that the GGB portfolio had increased to over €2 billion in April 2010.

8.7.5 Mr Poullis advised that the CBC had no authority to force the bank to sell its GGBs - he made the comment at interview that even if the CBC had the authority to do this he would have been concerned about using the power if GGB prices improved and the bank lost potential profits.

¹⁵⁸ Page 17 of the CBC presentation dated 17 December 2010 entitled "2nd Meeting of the College of Supervisors of the Bank of Cyprus Group - Supervisory review and evaluation of the Bank of Cyprus group by the Central Bank of Cyprus" (Exhibit 74).

¹⁵⁹ Page 39 of the CBC presentation dated 17 December 2010 entitled "2nd Meeting of the College of Supervisors of the Bank of Cyprus

¹⁶⁰ Mr Poullis (interview of 25 February 2013) advised that the CBC became aware of the large volumes of GGBs sometime in late 2009 or early of 2010 - he could not remember the exact timing.

¹⁶¹

Letter from CBC to BOC (Exhibit 11)

¹⁶² Report of the Cyprus Securities and Exchange Commission dated 25 October 2012, entitled "Findings Regarding the Investment of Bank of Cyprus Public Company Ltd in Greek Government Bonds (GGB)" (ΠΟΡΙΣΜΑ ΑΝΑΦΟΡΙΚΑ ΜΕ ΤΗΝ ΕΠΕΝΔΥΣΗ ΤΗΣ ΤΡΑΠΕΖΑ ΚΥΠΡΟΥ ΔΗΜΟΣΙΑ ΕΤΑΙΡΕΙΑ ΛΤΔ ΣΕ ΟΜΟΛΟΓΑ ΕΛΛΗΝΙΚΟΥ ΔΗΜΟΣΙΟΥ (ΟΕΑ))(Exhibit 12)

8.8 Additional work that may be considered

8.8.1 There are further areas of work that may be performed in relation to some of the areas that the Investigation has focussed on, for example:

8.8.1.1 Undertake further interviews with other past and present employees of the BOC and CBC including:

a. Mr
Eliades, former Group Chief Executive Officer of BOC until July 2012;

b. Mr
Koumantis, an employee of the Treasury department involved in the
purchases and sales of GGBs, who left BOC in June 2010; and

c. Previous Governor of the Central Bank of Cyprus, Mr Orphanides¹⁶⁴.

8.8.1.2 Obtain audit working papers of Ernst & Young in relation to the audit of BOC to ascertain what audit work was undertaken in relation to: s) the movement of bonds between the held to maturity ("HTM") and available for sale ("AFS") books in 2009 prior to their sale; ii) the reclassification of private placement and inflation linked bonds ("ILBs") in April 2010; and iii) the impairment review of the GGB portfolio as at 31 December 2010;

8.8.1.3 Perform an in depth review of translations of the CBC's Statutory Review and Evaluation Process ("SREP") reports so as to ascertain what, if any, consideration was made of BOCs GGB holdings by CBC;

8.8.1.4 Undertake a full review of the Bank's Board of Directors, in relation to: (i) their ability to perform the role required based on previous experience of banking); (ii) the training offered to members of the Board by the Bank or CBC where their experience was deemed inadequate¹⁶⁵; and (iii) the independence of Board members - particularly in relation to the granting of loans to Board members and/or people or entities connected to them;

8.8.1.5 Listen to recordings of preserved telephone conversations of BOCs Treasury department (on or between specific dates);

8.8.1.6 Perform research on the relative holdings of GGBs by peer banks at all relevant dates; and

8.8.1.7 Obtain and review minutes of Executive Committee meetings.

APPENDIX A - Chronology in regard to electronic data collection issues

(i) As noted in the Statement of Protocol report, on 21 August 2012, the CBC issued a letter to both BOC and CPB advising that an Investigation had been commenced and that all book, records and documents, physical and electronic were to be preserved and that all routine document destruction and deletion was to be suspended. On 24 August 2012, the CBC transmitted a similar letter to the employees of the CBC. (Each or all letters cumulatively referred to as "Preservation Letter").

(ii) 5 September 2012 - Due to the sensitive nature of the electronic data imaging, the Investigation team arranged a meeting with BOC to discuss our requirements and to inform them of what will be expected so they could seek necessary approvals and legal opinions. BOC were informed that the Investigation team and the CBC were seeking an independent legal opinion regarding the electronic data and would formally request the data from the Bank once we received the appropriate approvals. The Investigation team requested that the Bank do the same.

(iii) During this BOC meeting we also discussed the set-up of the IT network and were informed by the Bank that email data was not locally stored on users' computers; all user data was saved on the network and emails were only stored on the network rather than on the users' computers

(iv) 25 September 2012 - Following the receipt of legal direction and advice, the collection of electronic evidence was approved by the CBC and a letter formally setting out the request, discussed in the 5 September meeting, was sent to the BOC requesting production within 7 days (2 October 2012).

(v) Following the letter, the investigators spoke with the BOC to confirm they had received the letter

¹⁶⁴ We have not met with Mr Orphanides and Mr Eliades for reasons set out in our Statement of Protocol of 26 March 2013

¹⁶⁵ Mr Mouskis in interview (11 February 2013) [Page 2 and 3 of transcript] advised that BoC non-executive directors received no training from either BoC or the CBC and as a result felt unable to challenge BoC executives in a number of matters as his knowledge was inferior to

and that the information would be provided to the Investigation team. No objections were raised by the Bank other than to state they would need a few more days to prepare the information.

- (vi) **8 October 2012** - In a letter dated 5 October 2012, received by the Investigation team on 8 October 2012, the BOC informed the investigation team that they had grave concerns regarding the provision of electronic data as required in the letter of 25 September 2012. Prior to the receipt of this letter, the BOC had at no point raised any concerns about the provision of the electronic data; in fact they had verbally suggested the data would be provided to the Investigation team, but that it would take a few more days.
- (vii) **9 October 2012** - Following the receipt of the letter discussions ensued with the BOC to discuss their objections. Based on this conversation it was noted that the BOC did not have any concerns in providing the emails of the requested custodians. On the basis that these emails were automatically archived by the network and would therefore contain the full date range required, it was agreed that the Bank would provide the emails and that the provision of the computers for imaging would be provided once the Bank had sought legal advice.
- (viii) **11 October 2012** - The Bank provided over 106GB of email data. However, after uploading this data it became clear that the vast predominance of the email data only started at the end of 2010 or early 2011, whereas we had requested data commencing from 1 January 2009 onwards.
- (ix) **15 October 2012** - A meeting was held with the BOC to discuss the deficiencies in the electronic data provided. During this meeting the BOC explained for the first time that the networked email system only started at the end of 2010. The investigators present at the 5 September 2012 meeting stated that the BOC had not informed them of this as it would have been critical to the investigation, which the BOC should have known, as one of the discussed critical time periods for the investigation was 2009 and 2010.
- (x) The BOC then informed us that prior to the end of 2010 all email data resided on the computers of the individuals and that any email archives would be there rather than on the network. It was therefore agreed that, subject to legal approval, the BOC would extract the email archives from the computers and provide them to us. Given the concerns surrounding our access to the hard drives we were unable to undertake this exercise ourselves.
- (xs) **16 October 2012** - The BOC started to provide the archive emails from the computers. However, on review of these emails it was apparent that some of the email files provided were extracts of the email archives rather than the untampered email archives. For example, the email archive provided to us for Mr Karydas' secretary was called "Folder for Alvarez", indicating the archive was an extraction of what the BOC considered relevant or it wished to provide.
- (xii) Further meetings were held with the IT department at the BOC to inform them of these concerns and the investigation team was informed that the IT department would extract all the email files for each custodian.
- (xiii) A review of the email data provided by the BOC to that date highlighted severe deficiencies - data for critical time periods (2009 and 2010) for a number of custodians was missing.
- (xiv) **23 October 2012** - Following further requests for clarification from the BOC, a letter was sent to the BOC setting out the powers under which the electronic information was being requested. In addition a meeting was arranged for that evening with the BOC and its external legal advisor.
- (xv) During the meeting it became apparent that the BOC's legal advisor had not seen any of the correspondence in relation to the provision of the hard drives, despite the fact the first meeting that took place in relation to this was held almost two months prior to this date and formal letters had been sent over one month previously. The BOC was requested to provide the correspondence in relation to the requests for electronic information so that a legal opinion in respect of the provision of this data could be provided.
- (xvi) **25 October 2012** - The BOC's external counsel informed the investigation team that he had reviewed the correspondence, and although not enamoured with the idea of providing the data, he was going to inform the BOC that they should do so, whilst still maintaining its rights.
- (xvii) **30 October 2012** - The BOC sent a letter, received on 1 November 2012, stating that they would

allow the imaging of the computers, but reserved their rights in respect of any loss or damage suffered by the BOC.

- (xviii) 8 November 2012 - Following approval from the Investigation team's legal advisors and the CBC, the computers at BOC were forensically imaged, with those in Greece being completed on site on 15 November 2012. An initial forensic review of the computers provided has highlighted a number of concerns regarding the integrity of the data:
- a. Some of the computers imaged had deletion software installed. This software removes traces of any deletions that have taken place and also permanently deletes the files, making forensic recovery impossible.
 - i. The computer belonging to Mr Eliades had deletion software installed on it, which had been accessed one hour before the computer was provided to A&M for forensic imaging. Although we could not verify that the software had been used to wipe data, the computer appeared to be cleaned with no user data on the computer except for standard system files.
 - ii. Similarly for Dr Patsalides, we identified traces of the deletion software on the computer, but we could not verify that it had been used to wipe data from his computer. The email archives provided in respect of the Patsalides computer had little or no email data between August 2009 and January 2011 but had a significant amount of email data either side of these dates, suggesting that emails may have been deleted. Our forensic analysis indicates that on 18 October 2012 (2 days after providing us with deficient email data) over 28,000 files (including almost 1,300 user created files) were deleted from the Dr Patsalides computer. Review of the reconstructed file names suggests that some of the deleted documents are relevant to the investigation.
- (xix) 15 December 2012 - We received email data for 8 additional BOC custodians that we had requested to be secured by BOC in early December 2012. The email server mailboxes and email archives from employee's PCs were collected by BOC's IT personnel and provided to us on 15 December 2012.
- (xx) 15 January 2013 - BOC IT provided the investigation team with physical access to computers of those 8 additional employees, and between 15 and 30 January 2013 we forensically acquired the data from a total of 15 computers related to those 8 custodians.



INVESTIGATION REPORT BANK OF CYPRUS - BANCA TRANSILVANIA INVESTMENT PREPARED FOR THE CENTRAL BANK OF CYPRUS

26 MARCH 2013

ALVAREZ & MARSAL GLOBAL FORENSIC AND DISPUTE SERVICES, LLP

STRICTLY PRIVATE & CONFIDENTIAL

Table of Contents

DRAMATIS PERSONAE.....	3
1. INSTRUCTIONS	4
1.1 INSTRUCTIONS	4
2. EXECUTIVE SUMMARY	5
2.1 BANCA TRANSILVANIA	5
2.2 INVESTMENT IN BANCA TRANSILVANIA	6
2.3 ALLEGED MARKET MANIPULATION	7

3.	RELATIONSHIP BETWEEN BT'S FOUNDING SHAREHOLDER AND BOC.....	10
3.1	BOC LOANS PROVIDED TO BT FOUNDER	10
3.2	PERFORMANCE OF THE CIOROLa GROUP LOANS	12
3.3	ADDITIONAL€17 MILLION LOAN FACILITY	14
3.4	THE REFINANCING OF CIORCILS GROUP LOANS AND BOCs ACQUISITION OF BT INTEREST	15
4.	ACQUISITION OF SHARES IN BANCA TRANSILVANIA	18
4.1	INTRODUCTION	18
4.2	OPTIONS CONSIDERED FOR THE ACQUISITION OF BT SHARES BY BOC.....	18
4.3	AGREEMENTS REACHED BETWEEN BOC, Mr CIORCILS AND MrSILAGHI..	19
4.4	ACQUISITION OF BANCA TRANSILVANIA SHARES	23
5.	USE OF PROCEEDS TO PURCHASE BOC SHARES.....	36
6.	APPROVAL FROM THE BOARD OF DIRECTORS	38
7.	DISCLOSURE IN ROMANIA.....	39
8.	CBCs INVOLVEMENT	40
9.	FORMAL INTERVIEWS WITH SENIOR EXECUTIVES.....	41
10.	RECOMMENDATIONS FOR FURTHER INVESTIGATION..	42

DRAMATIS PERSONAE

Defined name		
BANK OF CYPRUS		
Mr Andreas Eliades	Mr Eliades	Group Chief Executive Officer until 10 July 2012
Mr Nicolas Karydas	Mr Karydas	Group General Manager Risk Management and Markets
Mr Yiannis Kypri	Mr Kypri	Group Chief General Manager, now Group Chief Executive Officer
Mr Christis Hadjimitsis	Mr Hadjimitsis	Group General Manager Finance and Strategy
Mr Vassos Shiaryl	Mr Shiaryl	Senior Group General Manager until 22 March 2012
Mr Georgios Christoforou	Mr Christoforou	General Manager, BOC Romania
Mr Yiannis Pehlivanidis	Mr Pehlivanidis	First Deputy Group Chief Executive Officer
Mr Anastasios Isaakidis	Mr Isaakidis	Credit Risk Manager, BOC Romania
Ms Marianna Pantelidou	Ms Pantelidou	Manager, M&A and Competition Monitoring
Mr Kyriacos Tsolakis	Mr Tsolakis	Manager, BOC Financial Control Division
Ms Anna Sofroniou	Ms Sofroniou	General Manager, CISCO
Mr Panicos Nicolaou	Mr Nicolaou	Head, Project Finance & Loan Syndication Unit
1 EXTERNAL TO BANK OF CYPRUS		
Mr Horia Ciorcila	Mr Ciorcila	Chairman & founding shareholder of Banca Transilvania
Mr Claudiu Silaghi	Mr Silaghi	Founding shareholder of Banca Transilvania
Mr Octavian Radu	Mr Radu	Alleged beneficial owner of Dodworth Ltd
Mr Lefkios Joannides	Mr Joannides	Managing Director, Joannides & Co

¹ Job titles taken from contemporaneous documentation, including BOC 2009 Annual report, Central Bank of

1. Instructions

1.1 Instructions

1.1.1. Alvarez & Marsal ("A&M") was instructed by the Central Bank of Cyprus ("CBC") on 21 August 2012 to conduct an Investigation as independent persons, appointed in accordance with Section 24 of the Central Bank of Cyprus Laws of 2002 to 2007, to assist the CBC in accordance with the Mandate¹⁶⁶ (the "Investigation").

1.1.2. Specifically, the Investigation was tasked with assisting "the Governor to take all necessary legal and regulatory remedies, whether they concern the conduct of supervision by the Bank, the

¹⁶⁶ All capitalized terms herein shall have the meanings set forth in the Statement of Protocol, which is fully

procedures followed by some systemically important local banks (hereinafter referred to as "the Cypriot banks") to acquire Greek Government Bonds and / or investing abroad in the form of a branch network and/or subsidiaries banks, having regard to the requirements specified by the provisions of the Banking Laws of 1997 to (No. 2) 2011 and the Central Bank of Cyprus Laws of 2002 to 2007 and the Regulations / Directives/ Guidelines issued under these Laws, or otherwise at the discretion of the Governor".

- 1.1.3. This report sets out the findings and conclusions based on work conducted up to 26 February 2013 in relation to the purchase of a 9.7% interest in Banca Transilvania, a Romanian listed company, by the Bank of Cyprus Public Company Limited ("BOC" or "the Bank").
- 1.1.4. This report has been prepared for the CBC solely for use in relation to the Investigation and must be read in conjunction with our Statement of Protocol dated 26 March 2013. It may not be used for any other purpose, reproduced or disclosed to any other party in whole or in part without our prior notice. In no event, regardless of whether notice has been provided, will we assume any liability or responsibility to any third party to which this report is disclosed or otherwise made available.

2. Executive Summary

2.1 Banca Transilvania

- 2.1.1 Banca Transilvania is a Romanian company listed on the Bucharest Stock Exchange ("BSE"). BT was established in 1994 as a local bank and has grown to be ranked one of the top 5 banks in Romania. Significant shareholders include the European Bank for Reconstruction and Development ("EBRD"), IFC (the investment division of the World Bank) and BOC¹⁶⁷, with effect from the end of 2009.
- 2.1.2 Mr Georgios Christoforou ("Mr Christoforou"), the General Manager of BOC Romania, has stated that the Bank's relationship with BT commenced on or around the date BOC opened its branch in Romania in 2006.
- 2.1.3 The Bank has also had commercial relationships with one of the founders of Banca Transilvania, Mr Horia Ciorcila ("Mr Ciorcila"), since January 2007, by virtue of the Bank being a lender to Cypriot companies beneficially owned by Mr Ciorcila.
- 2.1.4 In the latter half of 2008, BT needed to obtain additional funding and therefore publicly sought a possible capital injection from a strategic investor. To this end, in October 2008, BT engaged Merrill Lynch to find potential investors, of which six were identified, including BOC¹⁶⁸. BOC's Mergers and Acquisitions ("M&A") team undertook due diligence on BT, in April 2009, with a view to investing¹⁶⁹.
- 2.1.5 On 23 April 2009 Mr Christoforou¹⁷⁰, received a call from Mr Andreas Eliades ("Mr Eliades") (Chief Executive Officer of BOC in 2009) informing him that he, Mr Yiannis Kypri ("Mr Kypri") (Group Chief General Manager) and Mr Lefkios Joannides ("Mr Joannides") (Managing Director at Joannides & CO, Cyprus) had met with BT representatives and had signed a nondisclosure agreement granting the Bank access to the information in the data room that had been set up by BT for the potential investors. This opportunity was referred to within BOC as "Project Beatrice".
- 2.1.6 Only one of the six potential investors, Marfin Investment Group, submitted a non binding purchase offer, subject to approval from the National Bank of Romania. This approval was not obtained. It is understood that BOC withdrew from the process due to the limitations placed on investors in BT by BT's Articles of Association; specifically that no foreign investor could hold more than a 10% stake in BT¹⁷¹.
- 2.1.7 On 23 September 2009, in conjunction with the EBRD a 15%¹⁷² shareholder in BT¹⁷³, BT decided

¹⁶⁷ Exhibit 1: http://www.bancatransilvania.ro/bt/despre_noi_en.html

¹⁶⁸ Exhibit 2: Translation of Sentence following the public hearing of case no 33454/3/2010 on 4 July 2010 in the Bucharest Court, page 7

¹⁶⁹ Exhibit 3: Witness Statement of Mr Karydas, presented to the Romanian Court on 18 May 2011

¹⁷⁰ Per a meeting between Alvarez & Marsal and Mr Christoforou, on 19 December 2012 in Romania

¹⁷¹ Exhibit 2: Translation of Sentence following the public hearing of case no 33454/3/2010 on 4 July 2010 in the

¹⁷² EBRD was permitted to obtain a greater than 10% shareholding in BT

¹⁷³ Exhibit 1: <http://www.bancatransilvania.ro/index/43.html>

to stop its search for a strategic investor¹⁷⁴.

2.2 Investment in Banca Transilvania

2.2.1 According to Mr Christoforou, during August and September 2009, Mr Claudiu Silaghi ("Mr Silaghi"), a founding shareholder in BT and a member of the Board of Directors, commenced purchasing additional BT shares in the market. Following the receipt of a non-binding offer from MIG these shares were subsequently sold to MIG.

2.2.2 From the documents reviewed, it appears that in August 2009 conversations had already taken place between Mr Christoforou from BOC and Mr Ciorcila, a founding shareholder of BT and Chairman of the Board of Directors, regarding the potential to purchase an interest in BT.¹⁷⁵

2.2.3 The review of electronic communications has identified that the possibility of obtaining a shareholding of up to 20% of BT was still under consideration by BOC in June 2009, despite BOC having formally withdrawn from the process following the April due diligence.

2.2.4 A document titled "*Draft Non-Paper on a possible Structure and Consideration for the acquisition of 20% strategic interest in Beatrice and subsequent Call Options*"¹⁷⁶ ("Draft Non- Paper") and circulated amongst BOCs internal M&A department and external advisors on 29 June 2009¹⁷⁷, outlined a mechanism via which BOC could obtain a 20% shareholding in collaboration with one or more of the founding shareholders, and the "relevant investor"¹⁷⁸. The Draft Non-Paper also sets out that BOC would require changes to BT's Articles of Association (i.e. to permit BOC to hold more than 10% of BT) in order to proceed with the proposed acquisition of 20% of BT.

2.2.5 On 16 December 2009, BOC made an announcement that it had acquired 102,862,785 BT shares, a 9.7% shareholding, for €58 million¹⁷⁹. BOC paid an average of RON 2.38¹⁸⁰ per share, the price at which they were initially recognised in the Bank's financial statements.

23 Alleged Market Manipulation

2.3.1 In making its investment in BT, the Bank sought to do so through various structures that disguised the true beneficial ownership of the shares (see Section 4 below), a possible consequence of which was to limit the impact on the share price, as the market was not aware of the Bank's interest in purchasing a significant shareholding in BT. The structures used by the bank to obfuscate the true ownership included:

2.3.1.1 Reaching an agreement with one of the founding shareholders to purchase BT shares in the market knowing that he had a guaranteed purchaser (i.e. BOC) at an already agreed premium;

2.3.1.2 Providing a bank loan to a BOC employee as a proxy who was used to purchase shares in the market on behalf of the Bank; and

2.3.1.3 Providing loans on favourable terms to companies beneficially owned by the founding shareholders of BT in return for agreements to sell their shareholdings in BT at a later date.

2.3.2 BOC's original intention was to acquire a 10% stake in BT, which would be further increased to 20% during 2010¹⁸¹. However, following BOC's initial acquisition of 9.7% of BT, an investigation into market manipulation and insider trading was instigated by DIICOT, the Romanian Directorate for Investigating Organised Crime and Terrorism. The investigation named, amongst others, two

¹⁷⁴ Exhibit 2: Translation of Sentence following the public hearing of case no 33545/3/2010 on 4 July 2010 in the Bucharest Court, page 7

¹⁷⁵ Exhibit 4: Doc I.D: 0.7.12.2186833 with attachment "Memo regarding Mr C's Loans and Beatrice"

¹⁷⁶ Exhibit 5: Doc I.D: 0.7.13.445383, E-mail from Ms Pantelidou to Mr Polys Polyviou & Michalis Kramvis (both of CP Law), Todd Robinson & Simon Dayes (both of CMS Cameron McKenna) and Mr Aristidis Vourakis of JP Morgan. The Draft Non-Paper is referred to as having been drafted by Ms Pantelidou's Romanian colleagues, which is assumed to refer to employees of BOC Romania.

¹⁷⁷ Exhibit 5: Draft Non-Paper

¹⁷⁸ This is believed to refer to the European Bank of Reconstruction and Development as it was the only shareholder other than the founding members to hold more than 10% of BT's share capital

¹⁷⁹ Exhibit 6:

<http://www.bankofcyprus.com/Documents/Investor%20Relations/Press%20Releases/ENG/AnnouncementBT-Final-ENG.pdf>

¹⁸⁰ . . .

¹⁸¹ Exhibit 5: Draft Non-Paper

founders of BT and two BOC Romania employees.

2.3.3 There is an on-going criminal case in Romania¹⁸² in which the General Manager for BOC Romania is one of the defendants. It is apparent from evidence submitted in the course of the criminal trial¹⁸³ that the actions taken by individuals from the Bank in Romania were done on the basis of instructions from the Head Office of BOC.

2.3.4 The criminal aspects of market manipulation vary between different jurisdictions and the merits of any criminal case are a matter for legal opinion. However, JP Morgan stated in an e-mail dated 30 June 2009, that they were concerned that the proposed structure for the acquisition of BT shares as proposed in the Draft Non-Paper was potentially not compliant with the spirit Romanian regulations (see paragraph 4.4.11 below).

2.3.5 Despite this advice from JP Morgan, BOC continued with its plans to purchase shares in Banca Transilvania through various mechanisms apparently designed to conceal BOC being the ultimate beneficial owner of the shares acquired, until such time as all of the transactions were completed with BOC owning just under 10% of the share capital and BOC having in place agreements to secure a 20% shareholding (subject to approval from National Bank of Romania).

23.6 It is noted that in relation to the case against its employees in Romania the Bank has, so far, been successful in dismissing the allegations put forward by the prosecution. In this regard, as described herein, our investigation has identified that *some of the evidence and statements provided to the courts in Romania are inconsistent with the evidence found*. Consideration should be given as to whether their potentially contradictory statements should be brought to the attention of the Cypriot and Romanian legal authorities.

23.7 As set out above, whether or not the agreements reached between BOC and the founding shareholders and their consequent execution to acquire BT shares constitutes market abuse, is a legal matter. However, we have concerns surrounding the manner in which BOC secured the 9.7% shareholding and these concerns may require further investigation and/or review by the relevant authorities. The areas of concern are:

23.7.1 Facilitating one of the founding shareholders, Mr Silaghi, to buy up a 3% stake in BT, for onward sale to BOC at a pre agreed premium to the market price, thereby enabling Mr Silaghi to profit from information not publicly available (i.e. the precise number of BT shares BOC was intending to purchase, and the price

for which they were intending to acquire the shares);

23.7.2 Entering into an Agreement with Mr Ciorcila whereby Non Performing Loans held by companies under his beneficial ownership were restructured on favourable terms, in exchange for Mr Ciorcila i) agreeing to sell approximately 5% of BT shares under his beneficial ownership to BOC at a pre agreed premium to the market price; ii) agreeing to ensure that BT would undertake a rights issue during 2010 and that BOC would be guaranteed a certain percentage of unsubscribed shares so as to facilitate an increase in BOCs stake to c20%; and iii) signing an exclusivity agreement whereby neither Mr Ciorcila, nor Mr Silaghi, could sell any shares under their beneficial ownership to any party other than BOC until 30 June 2010 (see Section 3 below);

23.7.3 On 7 December 2009, via the various mechanisms employed to purchase shares, BOC was the beneficial owner of 9.1% of BT (see Section 7); however, only on 8 December 2009 did BOC approach the Romanian regulator to notify their intent to purchase more than 5% of BT¹⁸⁴, and only on 16 December 2009 was an announcement made of a significant investment, when such a disclosure was required to be made within 3 days of the acquisition per Romanian National Securities

¹⁸² Following the acquisition of 9.7% of BT by BOC, DIICOT launched an investigation into the share purchases due to suspicions that the Chairman and founding shareholder (Mr Ciorcila), another founding shareholder (Mr Silaghi) and two BOC Romania employees, Mr Christoforou and Mr Isaakidis, had traded on the back of inside information (Case no 191D/P/2010 - Exhibit 7)

¹⁸³ Exhibit 2: Translation of Sentence following the public hearing of case no 33545/3/2010 on 4 July 2010 in

¹⁸⁴ Exhibit 3: The witness statement of Mr Nicolas Karydas, General Director of BOC, presented to the

Commission ("CNVM")¹⁸⁵ resolution 1/2006 (see Section 7).

23.7.4 The sequence of events leading up to the purchase of BT shares by BOC, and the nature of the agreements reached between BOC and the founding shareholders, were not disclosed to the Romanian Court. Instead an alternative description of events has been presented which creates the impression that BOC executives were not aware that the BT shares they acquired were purchased, indirectly, from Mr Silaghi and Mr Ciorcila. Further, evidence has been discovered and detailed herein that directly contradicts the statements made to the court by Mr Nicolas Karydas ("Mr Karydas") in his witness statement²².

3. Relationship between BT's Founding Shareholder and BOC

3.1 BOC Loans provided to BT Founder

3.1.1 One of the founding shareholders of BT, Mr Ciorcila, is also the beneficial owner of the Ciorcila Group of companies. This group comprises various Cypriot registered entities. The principal activities of these companies are to act as the vehicles for Mr Ciorcila's equity and property investments and to manage his various business interests in Romania, including telecommunications and construction companies¹⁸⁶.

3.1.3 Per a memorandum prepared by BOC Romania dated 6 August 2009 ("6 August 2009 memo") companies beneficially owned by Mr Ciorcila had outstanding loans with BOC totalling €59 million, as set out below.

Castorius Limited ("Castorius") - €22 million loan

3.1.4 This loan was granted on 22 January 2007 by the BOC for the purpose of financing various corporate investments in Romania¹⁸⁷. The loan was subsequently restructured in such a way as to apportion the €22 million across Castorius and two other of the Group companies, Dodworth Limited ("Dodworth") and Dericom Limited ("Dericom"). As set out in Section 3.2 from 2008 the customer was struggling to make interest payments on these loans.

3.1.5 The collateral taken against the loan to Castorius was comprised of a Corporate Guarantee from Powerax for €22 million, 196,399,513 shares of BT owned by Castorius and €3.5 million held in a blocked cash guarantee account that was to be charged semi-annually with the loan interest¹⁸⁸.

3.1.6 In relation to the BT shares, should the market value of the shares fall below 200% of the loan facility, Castorius would be obliged to provide the Bank with additional security and, further, if the market value of the shares fell below 170% of the loan facility, BOC would have the right to sell the shares, without any reference or consent from Castorius (the "selling condition")²⁶.

Casternet Limited ("Casternet") - €25 million loan

3.1.7 This loan was granted on 12 June 2007¹⁸⁹. The purpose of the loan was to enable €17.5 million to be used to refinance a Casternet loan of an equivalent amount with Alpha Bank and the remaining amount was to finance purchases of shares of Romanian public companies.

3.1.8 The collateral pledged against the loan to Casternet comprised a floating charge on the assets of Casternet for an amount of €25 million, 196,255,077 BT shares owned by Casternet and its subsidiary and a blocked cash guarantee account of €783,000 to be used as a reserve account for the payment of the last interest payment¹⁹⁰.

3.1.9 If the market value of the BT shares fell below 200% of the loan facility, then Casternet would be required to pledge additional security; whilst a fall in the market value of the shares below 170% of the amount of the loan facility would give BOC the right, after giving Casternet 30 days' notice, to sell the shares immediately without any reference or consent from Casternet¹⁹¹.

Powerax Limited ("Powerax") - €12 million loan

3.1.10 This loan was granted on 12 June 2007 for the purpose of acquiring a 15% share in a Romanian Limited Company that owned a 50% interest in the Hilton Hotel Romania¹⁹².

3.1.11 The security pledged against the Powerax loan comprised of 24,290,204 shares of SIF Banat-Crisana ("SIF I")¹⁹³. Were the market value of the shares to fall below 180% of the amount of the

¹⁸⁶ Exhibit 9: 6 August 2009 memorandum on the Ciorcila Group, produced by Corporate Department, BOC Romania ("6 August 2009 memo")

¹⁸⁷ Exhibit 10: Confirmation of loan granted by BOC to Castorius Ltd, dated 22 January 2007

¹⁸⁸ Exhibit 10: Confirmation of loan granted by BOC to Castorius Ltd, dated 22 January 2007

¹⁸⁹ Exhibit 11: Confirmation of loan granted by BOC to Casternet Ltd, dated 12 June 2007

¹⁹⁰ Exhibit 11: Confirmation of loan granted by BOC to Casternet Ltd, dated 12 June 2007

¹⁹¹ Exhibit 11: Confirmation of loan granted by BOC to Casternet Ltd, dated 12 June 2007

¹⁹² Exhibit 12: Confirmation of loan granted by BOC to Powerax Ltd, dated 12 June 2007

¹⁹³ SIF 1 is a closed-end investment company listed on BSE; the company holds shares in banks (including BT), and

loan facility, then Powerax would be obliged to provide additional security, whilst a fall in the market value below 140% of the amount of the loan facility would invoke BOC's right to enforce the selling condition¹⁹⁴.

- 3.1.12 Since Powerax had also provided cross guarantees in respect of other group companies¹⁹⁵, further security was taken in the form of personal guarantees of the Ciorcila family, as follows:

Guarantor	Amount
Mr Horia Ciorcila	€12 million
Mrs Simona Ciocila	€5 million
Mrs Maria Mates	€5.5 million
Mr Ioan Ciorcila	€2.5 million
	€25 million

- 3.1.13 The terms of all three loans were the same, being priced at 6 months Euribor + 2%¹⁹⁶, with payment of the interest semi-annually on 30 June and 31 December and the principal repayable in balloon payments at the end of the three year anniversary of the drawdown of the loans.
- 3.1.14 On 24 September 2008, a memorandum was provided to the Board of Directors of BOC from the Executive Loans Committee ("ELC")¹⁹⁷ recommending the granting of an additional loan to the Ciorcila Group. This memorandum noted that the existing pricing of the loans to the Group was low. The reason for the preferential pricing of the loans is not clear, however, the same memorandum referred to the *"special relationship"* between the Ciorcila Group and BOC (their emphasis)¹⁹⁸.
- 3.2 Performance of the **Ciorcila** Group Loans
- 3.2.1 A number of memorandums regarding these loans were sent from BOC Romania to Senior Executives, during 2008 and 2009, from which it is apparent that the customer (i.e. the Ciorcila Group) was struggling to cover the interest payments thereon¹⁹⁹.
- 3.2.2 One such memorandum, dated 18 December 2008 ("18 December 2008 memo")²⁰⁰, commented that the loans were in default as the share coverage ratio, which had fallen to between 75% and 129% of the loan facilities granted to the various group companies, was considerably below the selling conditions per the original loan agreements (see paragraphs 3.1.4 to 3.1.11 above). The reason for the considerable decline in the share coverage ratio was a combination of the RON depreciating against the Euro and a decrease in the performance of shares on the Bucharest Stock Exchange²⁰¹.
- 3.2.3 The 18 December 2008 memo also commented that the customer had requested that the interest on all of the Group's loans due on 31 December 2008 be paid out of the *"Casternet and Castorius cash guarantee accounts"*²⁰ (see paragraphs 3.1.5 and 3.1.8 above). The reason for which was that there were *"no other revenues...for the payment of the interest"* and therefore it was *"extremely important to use the cash collateral to avoid some of the loans"* being in arrears. The memorandum further sets out that *"the situation seems to be very serious and requires immediate action"*.

companies in the chemicals, metallurgy and pharmaceutical industries

¹⁹⁴ Exhibit 12: Confirmation of loan granted by BOC to Powerax Ltd, dated 12 June 2007

¹⁹⁵ E.L.C. memo to the Board of Directors, dated 24 September 2008

¹⁹⁶ Exhibits 10, 11 & 12

¹⁹⁷ The Executive Loans Committee at BOC was comprised, inter alia, of Mr Karydas, Mr Eliades and Mr Vassos Shiarly ("Mr Shiarly").

¹⁹⁸ Exhibit 13: Executive Loans Committee Recommendation to the Board of Directors, dated 24 September 2008

¹⁹⁹ Exhibit 14: Memorandum on Ciorcila Group, dated 25 September 2009, produced by Corporate Department, BOC Romania ("25 September 2009 Memo")

²⁰⁰ Exhibit 15: Memorandum on Ciorcila Group, dated 18 December 2008, produced by Corporate Department, BOC Romania ("18 December 2008 Memo")

²⁰¹ Whether or not the exchange rate risks inherent in the original loan agreements were considered at the time the loans were granted is unclear from the documentation reviewed.

3.2.4 In relation to 18 December 2008 memo, the ELC decided, inter alia, the following²⁰²:

3.2.4.1 Additional security would be taken against the Ciorcila Group Loans in the form of 46.21% of the share capital of Technofrig Imobiliare S.A (a subsidiary of Powerax) with an estimated market value of €19 million; the shares were to be transferred to a new Cypriot SPV fully controlled by BOC with the intention being to liquidate the collateral and use the proceeds to repay the loans;

3.2.4.2 The cash guarantee accounts of Casternet and Castorious could be used to pay the interest due on 31 December 2008; and

3.2.4.3 The interest for the next funding period was to be set at 8.25% and reassessed at every rollover.

3.2.5 The 6 August 2009 Memo²⁰³, produced by the Corporate Department of BOC Romania, provided an analysis of the contemporaneous value of the pledged collateral (excluding the personal guarantees of Mr Ciorcila and associates). That analysis is summarised in the table below:

3.2.6 By August 2009 the collateral for these loans had fallen far below the percentage coverage required. The loan agreements required coverage of 200% of the loan amounts, or 180% in the case of Powerax, however, by August 2009 the coverage had fallen to an average of 63%. Per the loan agreements the Bank had selling conditions that it could have enforced once the

coverage fell below 170%, or 140% in the case of Powerax. However, BOC did not enforce the sale of the collateral at this time.

3.2.7 In 2008, BJ's capital structure was consolidated, with one share of nominal value 1 RON being exchanged for 10 existing shares with a nominal value of 0.1 RON⁴³. Consequently, in August 2009 this collateral included the following Romanian Listed company shares⁴⁴:

33 Additional €17 million loan facility

3.3.1 The purpose of the 6 August 2009 Memo was to:

3.3.1.1 Inform how the customer was intending to pay unpaid interest on its existing loans; and

3.3.1.2 To evaluate the customer's request for an additional loan of €17 million for Dodworth, another company of which Mr Ciorcila was a beneficial owner, to repay loans it held with Alpha Bank.

3.3.2 According to the memorandum, if BOC granted the additional €17 million loan to Dodworth, repayment would be made from the €11 million of proceeds of the sale of one of Dodworth's subsidiaries, Valserial Limited. Valserial Limited's sale and purchase agreement ("SPA") was due to be signed on 15 August 2009⁴⁵ (9 days after the memo) and provided that the €11 million price would be paid to Dodworth in two tranches: €3 million in September 2009; and €8 million in March 2010. As such, there would be two corresponding balloon payments made against the proposed €17 million loan, with a final balloon payment of €6 million in July 2011.

3.3.3 In relation to the final balloon payment, the 6 August memo notes that, *"The repayment ability for the remaining EUR 6.000.000 is not certain. Basically the repayment will emerge from the revenues that will be generated from the additional income that the investments of HC Group will generate (telecommunication, real estate, construction companies) or from their disposals. As a second way out the repayment will be done through the sale of the TLV & SIF 1 shares that are going to be pledged in favour of our Bank"*.

3.3.4 Mr Ciorcila offered an additional 11,788,961 BT shares owned by Casternet Ltd, and 8,918,671 BT shares owned by Dodworth as collateral against the €17 million loan (i.e. in addition to the 8.52% shareholding in BT already held as collateral in relation to existing loans); 16,441,000 SIF 1 shares owned by various group companies were also proposed as collateral. According to the memo, the contemporaneous value of the shares was in the

region of €14 million, i.e. already below the coverage value required under the terms of the original loans and therefore further exposing BOC to potentially unrecoverable losses. However, it is stressed in the memo, in relation to the collateral that *"...with the additional shares of BT, Bank of Cyprus will have pledge over 10.47% of the share capital of BT."* (emphasis in original)

The extension of the maturity date for the existing facilities until 30 June 2010;

²⁰² Exhibit 16: Executive Loans Committee ratification of actions taken by BOC Romania pursuant to 18 December 2008 Memo, dated 21 January 2009 ("21 January 2009 Ratification")

Utilisation of the remaining cash collateral to pay interest arrears for Castorius and a related company, Dericom; Capitalisation of the interest payable for the 6 months to 30 June 2009 on the loans to Casternet and Dodworth; and

Capitalisation of the future interest due for the period to 30 June 2010. September 2009 Memo sets out the following in relation to the potential

3.3.5 A later memorandum, dated 25 September 2009 ("25 September 2009 Memo")²⁰⁴, proposed the following rescheduling of the existing loans which included, inter alia,:

3.3.5.1

33.5.2

33.53

33.5.4

33.6 The 25

enforcement of loans granted by Alpha Bank to Dodworth, and other Ciorcila Group companies:

"The loan of the Group with Alpha, reaches maturity at the end of October As it is noted in many previous memos, the loan at Alpha often jeopardises the stability of the client Group - and hence indirectly affects our loans position - mainly because Alpha's stance is not in line with our somewhat lenient stance on this client This in effect makes the two-Bank debt structure of the Group, non-workable at present."

3.3.7 The ultimate recommendation per the 25 September 2009 memo was that *"In order to effect a workable solution for the existing financing facilities that HC Group has with our bank and taking into consideration the special relationship of the client with the Bank, we exceptionally recommend the approval"*²⁰⁵ of Mr Ciorcila's request for the rescheduling of the existing facilities and the granting of an additional €17 million loan. The copy of this memorandum shows that these recommendations were approved by Messrs Karydas, Kypri, Shiarly and Eliades. The Bank's approach in respect of the Ciorcila Group loans was thus very much in favour of the borrower and more lenient than the approach of Alpha Bank.

3.4 The refinancing of Ciorcila Group loans and BOC's acquisition of BT interest

3.4.1 From our review of the documents and interviews it appears that the refinancing of the Ciorcila Group loans was directly connected to the ultimate goal of BOC to purchase a significant interest in BT.

3.4.2 During discussions surrounding the acquisition of a 20% strategic interest in BT in June 2009, concerns were raised both internally and externally about the association between the refinancing of the loans and the purchase of BT shares. For example:

3.4.2.1 In an e-mail dated 30 June 2009²⁰⁶, Ms Marianna Pantelidou ("Ms Pantelidou") informed Mr Christoforou that she had *"....sent..a credit memo for Mr. C's loans. If u [sic] want to have a look, let me know (I don't think you are not entitled to). I see the transaction interconnected with the Loans position and I share CMS' opinion that these loans are giving us certain leverage."* and

3.4.2.2 A later e-mail from JP Morgan, dated 15 July 2009²⁰⁷ sets out that with respect to the overall agreement (i.e. the acquisition of a strategic interest in Banca Transilvania), that they (JP Morgan) assumed *"...the restructuring of the loans are on an arm's length basis so that they do not affect the value of the transaction"*.

3.4.3 Whether or not these loans were being dealt with on an arms' length (i.e. commercial) basis could be considered against the following background context:

3.4.3.1 BOC was willing to capitalise interest arrears and future interest payments that were payable under the terms of the original loans;

3.4.3.2 BOC did not rigorously enforce the requirement for the Ciorcila Group to provide additional collateral despite the fact that the existing collateral value was well below the selling conditions (meaning the loans were technically in default);

3.4.3.3 BOC granted the Group an additional €17 million loan despite the existing loans being in

²⁰⁴ Exhibit 14: 25 September 2009 Memo

²⁰⁶ Exhibit 5: Doc I.D: 0.7.13.445383

default; and

3.43.4 BOC's desire to own a 20% equity interest in BT.

3.4.4 The favourable treatment provided to the Ciorcila Group is further evident from the repeated references to the Ciorcila Group's "special relationship" with BOC and the Bank's "somewhat lenient stance" on the customer (when compared to Alpha Bank - see paragraph

3.3.6 above).

3.4.5 The link between the refinancing of the Ciorcila Group loans and the desire by BOC to purchase an interest in BT was raised in August 2009. An email from Mr Christoforou to Mr Eliades, via his secretary Tina Stefanou, dated 27 August 2009 included a memorandum ("27 August 2009 Memo") providing an update on the situation with the Ciorcila Group loans. The memorandum stated that the planned sale of Valserial had been put on hold, but that the customer (i.e. Mr Ciorcila) was "*confident that a deal will be reached soon for a value of 8 -10 mln*"²⁰⁸. The memorandum discussed various options including comments that Mr Ciorcila would be willing to sell BOC shares in BT especially if that was combined "*with a parallel solution for his loans*".

3.4.6 This memorandum also included an assessment of possible options for refinancing Dodworth's loan with Alpha Bank, given the uncertainty over the sale of Valserial. Mr Christoforou concluded that these "*...options "buy" us time till December to determine our position on how to handle the existing loans. The client has repeatedly expressed his wish to reschedule all existing facilities for 3 years with capitalisation of interest... As discussed in the past such rescheduling could occur simultaneously with a possible arrangement for a strategic participation in Beatrice.*"²⁰⁹

3.4.7 Mr Christoforou also relayed the following in the memorandum, in relation to a possible participation in BT²¹⁰:

" - Mr.C asked me if I had any talks with the H/O (CEO level) and if we have an interest in Beatrice. I replied in the usual diplomatic way that it is my belief that under certain conditions we would be interested.

We shared the common view that trying to buy around 5% in the market would be far fetched (without causing more increase in the price of the stock); still buying bits and pieces cautiously would likely not harm.

I asked him if he would be willing to sell us 2-3% of his own stake and he replied that this would be possible "especially if we combine it with a parallel solution for his loans"

He also said that he could explore the intentions of another major shareholder who holds around 4% in Beatrice, who previously was looking for partial exit

In any case he looked confident enough that he can secure for us around 5% stake.

I assume that he would expect around 10% - 15% premium over the current price levels for these transactions.

He pointed out that he considers as a relevant stake in Beatrice, the level of 13% which is the hurdle-level for EBRD to maintain its "relevant investor" status. Therefore he believes that through a VPO - once we have secured around 5% from his "circles" - we could reach this point pretty safely."

3.4.8 It is clear that BOCs consideration of refinancing the Ciorcila Group's loans was driven, at least in part, by its desire to reach an arrangement with Mr Ciorcila whereby the Bank would have the option to purchase BT shares from Mr Ciorcila, and individuals associated with him, rather than having to acquire BT shares more expensively through the market.

4. Acquisition of Shares in Banca Transilvania

4.1 Introduction

4.1.1 Documentation evidences that BOC considered that purchasing shares in the market would increase the market price. In order to limit the impact of the share purchases on the share price of the BT shares, BOC structured its purchases in such a way as to conceal the true beneficial ownership of the shares until all transactions had been put in place. During his interview Mr Kypri confirmed that these mechanisms were

²⁰⁸ Exhibit 4: Email containing attachment: "Memo regarding Mr C's Loans and Beatrice", produced by Mr Christoforou. Doc I.D.: 0.7.12.2186833

²⁰⁹ Ibid

²¹⁰ Mr C refers to Mr Ciorcila; EBRD is the European Bank of Reconstruction and Development, a 15%

used to limit price movements²¹¹.

4.1.2 The use of these structures was only possible through the various parties involved working in concert with the ultimate goal of BOC obtaining a 10% interest in BT by the end of 2009.

4.1.3 The table below sets out the various mechanisms via which BOC acquired a total of 102,862,785 BT shares during December 2009²¹². Of these 102,862,785, only 7% of the BT shares were purchased directly by BOC from the market, the remaining 93% were purchased through other structures.

Date	Method of Acquisition	Number of Shares	Price per share paid by BOC (RON)	Total Cost (RON)
07.12.2009	Acquisition via DEALS market	33,600,000	2.40	80,640,000
07.12.2009	Purchase of shares from Dodworth Ltd	8,918,671	2.40	21,404,810
07.12.2009	Purchase of Salecom Ltd	52,106,614	2.40	125,055,874
15.12.2009	Purchase of shares on DEALS market via proxies	3,541,500	2.23	7,862,420
11.12.2009 - 18.12.2009	Purchased by BOC direct from market	4,696,000	2.09-2.40	10,327,530
Total		102,862,785		245,290,634

4.1.4 It has been commented that the increase of BOCs shareholding in BT from 10% to 20% was planned to occur through a rights issue. However, due to the investigation into market manipulation and insider dealing this did not occur.

4.2 Options considered for the acquisition of BT shares by BOC

4.2.1 It is clear from the documents reviewed that BOC considered a number of alternative mechanisms through which it could acquire BT shares indirectly and thereby not alert the market to its interest. These documents included:

4.2.1.1 The Draft Non-Paper²¹³, prepared by BOC Romania, and circulated internally and to external consultants including JP Morgan and CMS Cameron McKenna ("CMS"), in June 2009 (see paragraph 4.3.16 below);

4.2.1.2 A document titled "Project Beatrice Agreement- Main Terms" (see paragraph 4.3 below), obtained from hard copy files maintained by Ms Pantelidou, an employee in BOCs Mergers and Acquisition ("M&A") department, and subsequent revised versions of this agreement (see paragraph 4.3.3 below); and

4.2.1.3 A document titled "Beatrice - acquiring steps up to 9.9%" dated 1 November 2009, and subsequent revisions dated 2 and 4 November 2009 (see paragraphs

4.4.5 to 4.4.10).

4.2.2 BOC did not ultimately use all of the methods identified in the different versions set out above to acquire shares (for details of the options considered see paragraphs 4.4.5 to 4.4.12 below). For example, BOC only funded one Proxy, Mr Anastasios Isaakidis ("Mr Isaakidis") (see paragraph 4.4.44 below), to purchase shares on its behalf. However, the various versions of options considered demonstrate the intention of the Bank to acquire the shares in a disguised manner.

4.3 Agreements reached between BOC, Mr Ciorcila and Mr Silaghi

4.3.1 Files containing hard copy documents related to Project Beatrice were maintained by Ms Pantelidou. Included in these files is a document titled "Project Beatrice Agreement - Main Terms"²¹⁴, which contains a hand written note in the top right hand corner: "9/10 Athens", this has been confirmed in interviews as relating to discussions from a meeting in Athens on 9 October 2009²¹⁵.

4.3.2 This document sets out the terms of the agreement reached between Mr Ciorcila, Mr Silaghi and BOC under which BOC would restructure the Ciorcila Group loans and release pledges over some of the existing collateral, in exchange for a shareholding of at least 15% of BT which would be purchased indirectly from Mr Silaghi and Mr Ciorcila. It further provides for

²¹¹ Per interview with Mr Kypri

²¹² Exhibit 18: Attachment to e-mail from Maro Klerides to Tina Stefanou, dated 16 December 2009 (Doc ID: 0.7.12.2193354)

²¹⁴ Exhibit 19: 9 October 2009 Agreement

²¹⁵ Per Interview with Mr Hadjimitsis

exclusivity of rights over any remaining BT shares beneficially owned by Mr Silaghi and Mr Ciorcila up to 30 June 2010.

4.3.3 Subsequent revised versions of this document refer back to the "9 October 2009 agreement". These revised versions are titled:

4.3.3.1 "Project Beatrice Understanding between parties involved as of 9 October 2009 and as amended on 25 November 2009" ("Revised 25 November 2009 Agreement")²¹⁶;

4.3.3.2 "Project Beatrice Understanding between parties involved as of 9 October 2009 and as amended on 26 November 2009" ("Revised 26 November 2009 Agreement")⁵⁹; and

4.3.3.3 "Project Beatrice Understanding between parties involved as of 9 October 2009 and as amended on 28 November 2009" ("Revised 28 November 2009 Agreement")²¹⁷.

4.3.4 The Revised 28 November 2009 Agreement also contains a hand written note which sets out that this was a *"Revised document following the discussion we had on Saturday afternoon (28/11/09)"*. Initials are also annotated on the document: AE, YK, VS, ChH and NK. It is understood that these are the initials of the BOC Senior Executives in attendance at the 28 November 2009 meeting, and therefore were involved in agreeing the terms of the agreement reached with Mr Ciorciia and Mr Silaghi. The initials stand for Mr Andreas Eliades, Mr Yiannis Kypri, Mr Vassos Shiarly, Mr Christis Hadjimitsis and Mr Nicolas Karydas, respectively.

4.3.5 In interview²¹⁸ Mr Kypri confirmed that he had seen this document and that following receipt of the document he had concerns relating to the structures proposed and stated that he refused to be involved in the transaction any further, such that he refused to sign the Sale and Purchase Agreement with Salecom Limited (see paragraphs 4.4.41 to 4.4.43). The lack of detailed knowledge claimed, in interview, by Mr Kypri prior to this date would appear to be inconsistent with the fact that two days earlier he, along with Mr Eliades, signed a power of attorney in favour of Mr Christoforou to enable him to authorise some of the planned transactions.

Phase One of the Agreement

4.3.6 The first phase of the agreement involved the restructuring of the Ciorciia Group loans and the purchase by BOC of its interest in BT, equalling no less than 8.7% of the issued share capital.

4.3.7 Under the terms of the Revised 28 November 2009 Agreement, BOC agreed to reschedule the Ciorciia Group loans up to 30 June 2010, as follows:⁶²

4.3.7.1 The personal guarantees provided by Mr Ciorciia and associates as security against the loans would be released;

4.3.7.2 The interest rate on the loans as from the 1 July 2009 to 30 June 2010 would be Euribor (3 month) plus 3% (initially priced at Euribor (3 month) plus 2%);

4.3.7.3 The collateral selling conditions, top up clauses and "other relevant covenants" would be waived up until 30 June 2010;

4.3.7.4 BOC would waive strict controls over the way the investments and subsidiaries of Powerax Ltd (one of the Ciorciia Group companies) were managed; and

4.3.7.5 An additional loan would be granted to enable the loans from Alpha Bank to be paid off, subject to, inter alia, the collateral held by Alpha Bank (namely 20,707,632 BT shares, amongst others) being transferred to BOC²¹⁹.

4.3.8 As per the agreement the above rescheduling of the Ciorcila Group loans was predicated upon the subsequent sale of BT shares to BOC and consequently was subject to the signing of:

"...an exclusivity agreement between Bank of Cyprus and Horia Ciorcila that he will not be in discussions as from today until 30 June 2010 with any other party for the purposes of selling any of the shares he beneficially owns

²¹⁶ Exhibit 20: Revised 25 November 2009 Agreement

²¹⁷ Exhibit 21: Revised 28 November 2009 Agreement

²¹⁸ Per interview with Mr Kypri

²¹⁹ Exhibit 14: 25 September 2009 Memo

and/or controls to a beneficial owner other than Bank of Cyprus"; and
"an exclusivity agreement between Bank of Cyprus and Claudiu Silaghi that he will not be in discussions as from today until 30 June 2010 with any other party for the purposes of selling any of the shares he beneficially owns and/or controls to a beneficial owner other than Bank of Cyprus."

4.3.9 This exclusivity agreement was signed on 12 October 2009 by Mr Hadjimitsis on behalf of BOC, and both Mr Silaghi and Mr Ciorcila²²⁰.

4.3.10 The Ciorcila Group loans were then to be rescheduled on 30 June 2010, as follows⁶⁵:

"(1) The loans will be rescheduled for a period of 10 years. In the first three years no capital installment and no interest will fall due and accrued interest will be capitalised. Capital installments plus interest will be payable on the loans for the remaining term of the loan (i.e. seven years).

(2) The applicable interest rate for the period starting on 1 July 2010 will be Euribor (3 month) plus 3.00%. At that time, the parties will examine the possibility of a fixed interest rate scheme instead of the floating rate scheme.

(3) Bank of Cyprus will examine the possibility of releasing further collateral held, in view of the prevailing market conditions at the time, including but not limited to the positive evolution of the collateral coverage of the loans. Otherwise, the existing collateral structure will be considered sufficient for the purposes of this rescheduling..."

4.3.11 The rescheduling of the loans was subject to Mr Ciorcila and Mr Silaghi ensuring that a number of conditions were met, including that "A shareholding of no less than 92.625.285 shares of Banca Transylvania (approx. 8.7% of total share capital) will be sold to Bank of Cyprus...". The way in which this 8.7% was to be sold to BOC is set out in Section 4.4 below.

Phase Two of the Agreement

43.12 The second phase of the agreement envisaged that following the purchase of 8.7% of the share capital of BT, Mr Ciorciia and Mr Silaghi would ensure that the required changes to the Articles of Association were made and would also facilitate a means by which BOC could increase its holding in BT.

43.13 The agreement stated that in addition to the acquisition of an 8.7% stake in BT, it was agreed that Mr Ciorciia and Mr Silaghi would ensure that:

"By 30 June 2010, Bank of Cyprus

i. Enjoys the same shareholder rights in Banca Transylvania as the Founding shareholders and the Relevant Investor,

ii. Will be allowed by Banca Transylvania's Articles of Association to exceed the 10% level of Banca Transylvania's share capital (i.e. the existing maximum level of 10% imposed on investors will not be applicable to Bank of Cyprus).

iii. Appoints one member of Banca Transylvania's Board of Directors."

4.3.14 The requirement for BOC to be able to exceed the 10% shareholding threshold was driven by BOCs desire to build up a 20% stake in BT, as evidenced by the Draft Non-Paper²²¹.

43.15 An increase in the shareholding from 10% to 20% was to be achieved (in part) via a share capital increase and this was another condition for the rescheduling of the Ciorciia Group loans on 30 June 2010:

"Horia Ciorciia and Claudiu Silaghi will ensure that:

i. Banca Transylvania will proceed to a share capital increase of no less than the RON equivalent of approx. €50 mn (and preferably €60mn) at nominal value ...and no later than 31 May 2010.

ii. 60% of any unsubscribed shares from the share capital increase mentioned above will be allocated and subscribed by Bank of Cyprus. Such subscription should occur at a price not to exceed 10% of the nominal value (RON 1.00) per share."

²²⁰ Exhibit 22: Signed exclusivity agreement dated 12 October 2009

²²¹ Exhibit 5: Draft Non-Paper

4.3.16 The increase in BOCs shareholding via a share capital increase appears to have first been suggested in the Draft Non-Paper. This document sets out a four stage process via which a 20% stake in BT would be obtained; under stages 1 and 2, BOC would acquire a 15% stake in BT, whilst stage 3 involved acquiring *"...an additional stake of around 5.1% through a share capital increase"*¹⁶⁷. Stage 4 involved a potential call option on further BT shares.

43.17 This document refers to "AcqCo", which is defined as the "offeror" and is therefore assumed to represent BOC. Per the Draft Non-Paper the suggestion was that:

"AcqCo will subscribe for shares in the EUR 60 mln (RON 250 mln approx.) share capital increase of the Beatrice to occur during 2009. AcqCo shall subscribe for both (i) newly issued shares pro rata with the number of shares AcqCo shall own at such date and (ii) for additional newly issued shares, not subscribed by the other existing shareholders...

*...The Founding Partners and the Relevant Investor ("RI"), will have agreed a proportional subscription mechanism together with the AcqCo in such a manner that will allow AcqCo to acquire the targeted 5.1% holding (i.e., Founding Partners may seek 0% of the unsubscribed shares. RI may seek 40% and the AcqCo the remaining 60%).*¹⁶⁸

4.3.18 It is unclear from the Revised 28 November 2009 Agreement the total shareholding BOC was intending to acquire following the 2010 share capital increase, nor how they were confident of ensuring they would achieve this shareholding following the rights issue.

4.3.19 The loans were not rescheduled on 30 June 2010 as per the Revised 28 November 2009 Agreement. It is not clear why this rescheduling did not happen. It may be that following the initiation of the investigation by DIICOT, BOC did not pursue the increase in its shareholding of BT to 20%, or it may be due to other unknown reasons. It is understood that as at the date of this report, these loans remain under review²²².

4.4 Acquisition of Banca Transilvania Shares

Shares purchased from Mr Silaghi

4.4.1 This transaction involved the purchase of 33.6 million BT shares on 7 December 2009, via the DEALS market, at a price of 2.40 RON per share²²³. Although these shares were purchased on the DEALS market, the ultimate owner of the shares at the time of the purchase was Mr Silaghi. The various draft documents obtained indicate that BOC had informed Mr Silaghi of its intention to acquire shares, and further, that BOC had proposed to provide a loan to Mr Silaghi to facilitate his purchase of shares in the market for onward sale to BOC at a profit.

4.4.2 The Revised 28 November 2009 Agreement outlines the details of the transaction, as follows:

"31.600.000 shares of Banca Transilvania (approx.. 3.0% of total share capital) will be acquired by Bank of Cyprus through a maximum of four block market trades

(through the DEALS market of the Bucharest Stock Exchange) to be sold by persons friendly to Claudiu Silaghi at a price per share (gross of any commissions, charges or other fees) not to exceed RON 2.40 per Banca Transilvania share.

Such block market trades should take place concurrently and in no circumstances should the last trade take place later than five minutes away from the first trade...

> The price to be reported to the DEALS market will be RON 2.40 per share, provided that this price per share falls within the allowable price range of the share as per the regulations of the Bucharest Stock Exchange. In the case that the price does not fall within the allowable price range as per the regulations of the Bucharest Stock Exchange, then the closest allowable price per share to RON 2.40 will be reported and any price difference, i.e. between RON 2.40 per share and the price to be reported' will be compensated to

■ *either Claudiu Silaghi, if the price per share to be reported is lower than RON 2.40,*

■ *or Bank of Cyprus, if the price per share to be reported is higher than RON 2.40,*

as brokerage fee for the transaction through the issuance of an invoice by a Cypriot registered entity to be specified by the party to be compensated (i.e. by either Claudiu Silaghi or Bank of Cyprus)".

4.43 Although the agreement envisaged the purchase of 31.6 million shares, an additional 2

²²² Exhibit 23 : Minutes of BOD meeting held on 3 August 2012, during which the Casternet Group Loans were discussed

million shares were purchased by BOC from Mr Silaghi on the 7 December 2009²²⁴.

4.4.4 The rules of the BSE are such that the price paid for any given security cannot fall outside of +/- 15% of the closing share price of that security on the day preceding the trade²²⁵. BOC agreed to pay a price that may have fallen outside of this permitted price range and in order not to raise any issues with the market agreed to report a price different to the 2.40 RON

agreed²²⁶. Any difference between the reported price and the agreed 2.40 RON was to be paid to Mr Silaghi via the payment of an invoice for services.

Evolution of acquisition steps

4.4.5 It is apparent that Mr Silaghi's involvement in the acquisition of shares in BT by BOC dated back to at least 12 October 2009 when he signed an exclusivity letter with BOC⁷⁴. From November 2009 three different documents have been obtained, dated 1, 2 and 4 November and from which it is clear that the initial plan had been for Mr Silaghi to acquire BT shares for onward sale to BOC, at a premium to that which he acquired them for. Ultimately BOC purchased shares from Mr Ciorcila, in exchange for BOC refinancing the Ciorcila Group loan portfolio, reducing the volume required from Mr Silaghi.

4.4.6 The 1 November 2009 document titled "Beatrice - Acquiring shares up to 9.9%", set out possible steps for BOC acquiring 9.9% of BT's shares with the help of an individual referred to as "CL". It is understood that CL refers to Mr Silaghi. The 2 and 4 November 2009 documents contain revisions to the method of acquisition outlined in the 1 November 2009 document. An individual "CS" is referred to in these documents which is also understood to refer to Mr Silaghi.

4.4.7 The process by which it was suggested the purchase of BT shares could happen in the 4 November 2009 version of the memo ("4 November 2009 Steps Memo") was as follows²²⁷:

4.4.7.1 Step 1: Around a 2% stake had been acquired as at the date of the memo, by an individual related to Mr Silaghi. This was to remain in the name of that individual until step 4 (see below). It was noted that were Mr Silaghi to experience liquidity problems from having to hold onto these shares, then BOC would pay a *"premium/interest on the funds used for the acquiring stake...starting on 1 November 2009 until the occurrence of events described in 4th step below"*²²⁸;

4.4.7.2 Step 2: Three Romanian tax residents of Greek nationality were to acquire a 4.9% stake in BT between them, funded by loans granted by BOC to the individuals. These individuals would sell their BT shares to BOC via the DEALS market, as per step 4 (see below). The loans would be repaid via the sale proceeds;

4.4.7.3 Step 3: Following completion of step 2, Mr Silaghi would find another individual to buy a sufficient number of BT shares to take the overall stake to 9.5% - 9.9%; the funding for the purchases of these shares would be provided via a loan from BOC to Mr Silaghi, who would in turn fund the individual in question. The individual would then sell these shares to BOC on the DEALS market; and

4.4.7.4 Step 4: All individuals involved in steps 1 to 3 would sell their BT shares to BOC via the DEALS market concurrently or over two consecutive days.

4.4.8 In the 1 November 2009 version of the document ("1 November 2009 Steps Memo"), the mechanism for acquiring BT shares for onward sale to BOC differed²²⁹. However, the 1 November 2009 version of the document sets out the price BOC would pay Mr Silaghi for the BT shares he secured for them. This price is referred to in the document as the "Actual" price, which would be comprised of the "Transaction" price plus the "Difference".

4.4.9 This would appear to be similar to the arrangement in the Revised 28 November 2009 Agreement, in so far as the "Transaction" price would be the day's stock market price, "Actual" price related to the pre agreed price per share to be paid by BOC to Mr Silaghi, and the "Difference" being the difference between the pre agreed price and the stock market price on the day of the transaction, paid *"through invoicing between*

²²⁴ Exhibit 24: Doc I.D: 0.7,12.450140

²²⁵ Exhibit 25: Bucharest Stock Exchange Investor Guide

²²⁶ Exhibit 21: Revised 28 November 2009 Agreement

²²⁷ Exhibit 26: 4 November 2009 Steps Memo

²²⁸ Exhibit 26: 4 November 2009 Steps Memo

²²⁹ Exhibit 27: 1 November 2009 Steps Memo

entities controlled by CL and the Sellers"⁷⁸.

4.4.10 Further to this, the 4 November 2009 Steps Memo sets out that there was *"Authority to offer overall premium on transactions of 15% (i.e. increase from previously agreed 12%). Such increased premium will apply if and only if all transactions are completed by 18 December 2009"*. One of the reasons given for the "importance of completing all transactions before

18 December 2003" (emphasis in original) was that *"BOC cannot straddle the year-end without completing the transactions, as loans to be provided...will be audited by the external auditors. Substance of transactions may be unveiled"*²³⁰.

4.4.11 The agreement with Mr Silaghi was such that he was able to acquire BT shares on the market which he knew he would then be able to sell onto BOC at a pre agreed price of 2.40 RON per share; a price that was guaranteed to generate a profit for Mr Silaghi. This was contrary to concerns raised by JP Morgan, in relation to the Draft Non Paper circulated in June 2009:

"...As previously discussed we are not sure that this proposed transaction is compliant with the spirit of the Romanian regulations as we understood them from CMS, requiring that somebody that has intention to purchase significant shares of a listed entity does this via a voluntary tender offer. The essentially silent agreement

for the collection of shares up to 4.99% of Beatrice to be then onsold at a premium might not be compliant with this and could ultimately lead to repricing of share sales or a penalty/'

4.4.12 Despite these concerns BOC still entered into an agreement whereby Mr Silaghi 'collected' shares in the market and then sold them onto BOC at a premium, via his mother in law²³¹.

Actual method of acquisition of 33.6 million BT shares

4.4.13 Mr Christoforou was in contact with Mr Silaghi during November 2009, monitoring the number of BT shares he had been able to acquire and the price he had paid for these. An email from Mr Christoforou to Mr Eliades, Mr Hadjimitsis and Ms Pantelidou, dated 16 November 2009²³², sets out the following:

"In the morning CL closed a DEALS transaction of approx. 2 mln pieces at RON 2.1.

This brought the total so far at 31.6 mln pieces which concludes step 1 (of 3%)...

...Following the specific transaction, speculators entered the market and the price fluctuated between 2.1 and 2.2. Now we are in the market though [sic] Tasos with orders at 2.04- 2.05 [sic]. CL will seek to close big deals off the floor this week."

4.4.14 The indictment dated 9 July 2010, in which the case for market manipulation of a number of individuals (including BOC employees Mr Christoforou and Mr Isaakidis) is presented, sets out that 33.6 million BT shares were sold to Mr Christoforou on 7 December 2009, at a price of 2.40 RON per share, on the deals market by Ms Doina-Marioara Cojocaru ("Ms Cojocaru"), Mr Silaghi's mother in law²³³. The shares were sold by Ms Cojocaru through S.S.I.F IFB Finwest S.A., a brokerage firm, and purchased by Mr Christoforou via S.S.I.F Raiffeisen Capital & Investment S.A. ("Raiffeisen"), also a brokerage firm

4.4.15 Mr Christoforou purchased the 33.6 million BT shares in four separate transactions, as

The details of these transactions are set out in

evidenced by the Raiffeisen order forms the table below:

²³⁰ Exhibit 26: 4 November 2009 Steps Memo

²³¹ Exhibit 7: 9 July 2010 Indictment, page 14

²³² Exhibit 28: Doc I.D: 0.7.13.449501 (N.B. CL refers to Mr Silaghi; the relevance of "Tasos" is explained in paragraphs 4.4.44 to 4.4.56)

QO

07.12.09	
07.12.09	
07.12.9	07.12.09^
Time	Price per Share, RON
15:43:18	?
15:43:18	2.4
15:43:18	2.4
15:43:18	2.4;
wm>	■
8,600,000	
2,000,000	
11,000,000	
12,000,000	
33,600,000	

- 4.4.16 As per the Revised 28 November 2009 Agreement, these share purchases were made at the pre agreed price of 2.4 RON per share and were also transacted concurrently.
- 4.4.17 In order for Mr Christoforou to purchase the 33.6 million BT shares on behalf of BOC a Power of Attorney ("PoA") was granted to him on 26 November 2009 by BOC, under which he was given authority to *"represent the Grantor's interests as he may deem necessary or desirous while conducting and managing the Grantor's business and affairs with conducting business with Raiffeisen Capital & Investment, including but not limited to hold negotiations, finalise and sign any contracts, agreements and deeds for and under the authority of the Grantor and any such document thus properly signed shall be considered a legally binding undertaking assumed by the Grantor."*²³⁴ The POA was signed by Mr Eliades and Mr Kypri.
- 4.4.18 Funds totalling RON 100,100,000 for the BT share purchases (including those acquired from Dodworth - see below) were transferred by BOC to Raiffeissen's account at Raiffeissen Bank SMB, on 7 December 2009²³⁵.
- 4.4.19 The Revised 28 November 2009 Agreement indicates that Executives from BOC had pre agreed to acquire shares from Mr Silaghi, at a pre agreed price, and in such a way as to attempt to conceal the identity of both the buyer and seller (i.e. BOC and Mr Silaghi). The structure of this transaction was developed with input from CMS in Romania. An email from Mr Simon Dayes ("Mr Dayes") of CMS to Ms Pantelidou, dated 2 December 2009²³⁶ contained an attachment titled "Preparatory Steps"²³⁷
- 4.4.20 This document refers to Deals 1, 2 and 3 and outlines the steps to be taken in order to complete these deals.⁸⁸ There is also reference to "D-Day", which is presumably meant to represent the day on which the purchase of shares was to be undertaken. In this instance, "Deal V is believed to refer to the purchase of shares from Mr Silaghi.
- 4.4.21 According to the document, on "D-Day", and in relation to Deal 2, the seller was to instruct *"his broker that he can sell Deal 2 shares at a certain price to a certain individual at the relevant brokerage house only"*²³⁸ (emphasis in original) and further, that BOC was to instruct its *"broker that broker can buy all... Deal 2 shares at certain prices from certain individuals at relevant brokerage houses only, or none at all"*²³⁹.

²³⁴ Exhibit 29: Power of Attorney date 26 November 2009, signed by Mr Eliades and Mr Kypri

²³⁵ Exhibit 30: SWIFT (MT103) message dated 7 December 2009

²³⁶ Exhibit 31: Doc I.D: 0.7.13.449719 with the Preparatory Steps Memo prepared by CMS attached

²³⁷ Exhibit 31: Preparatory Steps Memo prepared by CMS

Exhibit 31: Preparatory Steps Memo prepared by CMS

²³⁹ Exhibit 31: Preparatory Steps Memo prepared by CMS

4.4.22 Although the structure of the acquisition was created with the assistance of CMS it is not clear if CMS had any knowledge of the agreement reached between Mr Ciorciia, Mr Silaghi and BOC executives as set out in the Revised 28 November 2009 memo, or if they were aware of the exclusivity agreements and concurrent loan refinancing²⁴⁰.

Shares Purchased from Dodworth

4.4.23 This transaction envisaged the purchase of 8,918,671 BT shares from Dodworth, at a price of 2.40 RON per share. These were shares that were originally going to be offered as collateral against the loan BOC was providing to enable Dodworth to repay its loans to Alpha Bank⁹².

4.4.24 The Revised 28 November 2009 Agreement, outlined the following in relation to this transaction:

"8.918.671 shares of Banca Transylvania (approx. 0.8% of total share capital) will be acquired by Bank of Cyprus through one block market trade (through the DEALS market of the Bucharest Stock Exchange) to be sold by the Cypriot- registered entity Dodworth Ltd, which is controlled by Horia Ciorciia, at a price per share (gross of any commissions, charges or other fees) not to exceed RON 2.40 per Banca Transylvania share.

- > *Such a block market trade should take place no later than December 10, 2009 (and preferably earlier).*
- > *The price to be reported to the DEALS market will be the lowest of the following:*
 - *RON 2A0 per share*
 - *The closing price of the share on the Bucharest Stock Exchange on the day immediately preceding the date on which the block market trade will take place*
- > *In case that a price less than RON 2.40 is reported to the DEALS market, the difference will be compensated to Horia Ciorciia as brokerage fee for the transaction through the issuance of an invoice by Dodworth Ltd to Bank of Cyprus."*

4.4.25 The purchase of shares from Dodworth was also undertaken by Mr Christoforou on BOCs behalf, under the 26 November 2009 POA granted to him by BOC. As with the shares purchased from Mr Silaghi, this transaction was conducted via the DEALS market and was carried out via Raifeissen, utilising the funds transferred by BOC (see paragraph 4.4.18 above).

4.4.26 It appears from the various agreements that BOC had pre agreed a price for the purchase of shares from Mr Ciorcila, and that BOC Executives had agreed to ensure that Mr Ciorcila was able to provide evidence for any additional money received by Dodworth by issuing an invoice to cover any difference between the 2.40 Ron per share agreed and the price to be reported to the Deals Market.

4.4.27 One of the terms of the Revised 28 November 2009 Agreement was that *"an additional loan facility will be granted to pay off the loans that are due to Alpha Bank, subject to the collateral held at Alpha Bank to be transferred to Bank of Cyprus..... The pay off of the loan due to Alpha Bank will take place no later than 31 October 2009"*²⁴¹.

4.4.28 The loans in question included an amount from Alpha Bank to Dodworth, against which its holding of BT shares had been posted as collateral. As such, BOCs refinancing of this loan enabled the pledge over these shares to be released, thereby facilitating their ultimate purchase by BOC.

4.4.29 Essentially, this transaction involved: BOC repaying Dodworth's loan from Alpha Bank thereby releasing the associated pledge over Dodworth's 8,918,671 BT shares; releasing the pledge over the BT shares in turn pledged to BOC following the refinancing of the Alpha Bank loan; and ensuring the sales proceeds paid to Dodworth by BOC were paid into a blocked account at the BOC. It is understood that the purpose of the blocked account was to enable the cash paid for the BT shares to be used as collateral against the Ciorcila Group's loans.

4.4.30 One of the main attributes of market manipulation, as conveyed by Mr Gabriel Sidere ("Mr Sidere"), of CMS to Mr Polyviou, in an email dated 30 April 2010 is *"fixing the purchase price by acting in collaboration with others to secure a dominant position over the supply/demand of BT*

²⁴⁰ Alvarez & Marsal has contacted CMS but as at the date of the report had received no response

²⁴¹ Exhibit 21: The Revised 28 November Agreement was based on the original agreement dated 9 October

shares"²⁴².

4.4.31 The terms of the Revised 28 November 2009 Agreement were such that BOC agreed to purchase, indirectly, 61,025,825 shares in BT from Mr Ciorcila at a pre agreed price of 2.40 RON per share, and further, obtained exclusivity of rights over any additional BT shares held by Mr Ciorcila and Mr Silaghi, in exchange for refinancing existing loans of the Ciorcila Group on favourable terms.

4.4.32 We recommend that a legal opinion be sought to establish whether BOC, using the Bank's position as a provider of loans to the Ciorcila Group to secure a dominant position over the BT shares held by Mr Ciorcila, could be construed as "acting in collaboration".

Ownership of Dodworth

4.4.33 BOC documentation shows that Horia Ciorciia was originally the beneficial owner of Dodworth²⁴³, a fact that we understand the Romanian Courts were trying to prove as part of their investigation. However, additional documentation in the Dodworth files show the beneficial owner changing to be a Mr Octavian Radu, an individual with whom BOC Romania had no contact in relation to the Ciorciia Group loans during 2009.

4.4.34 Documents obtained from the Dodworth Know-your-customer ("KYC") files show Mr Ciorciia as the beneficial owner of Dodworth as at 3 February 2009²⁴⁴ and Mr Radu as the beneficial owner as at 30 October 2009²⁴⁵. The latter document has been certified by Joannides & Co, a Cypriot based accountancy firm. The documents in question are stamped as having been received by BOC's International business unit on 20 January 2011, subsequent to the commencement of the criminal investigation. The reason for the delay in the receipt of the KYC documentation is unclear and no contemporaneous documentation was located in the Dodworth files.

4.4.35 We consider that a review of the documentation held by Joannides & Co, whom we understand to be the accountants for the Ciorciia Group of companies, should be undertaken in order to confirm the ultimate beneficial owner of Dodworth during 2009, and the nature of any changes in this ownership in October 2009, as indicated by the documents maintained by BOC. We were not granted access to this documentation when we met with Mr Joannides.

4.4.36 A recent internal audit report into the large non-performing loans at BOC between 2006 and 2011 lists Mr Ciorciia as having outstanding loans of €84 million (against which a provision of €46 million had been made). Included in this amount is €22 million in relation to a loan to Dodworth²⁴⁶.

4.4.37 During interview Mr Kypri stated that he believed Mr Ciorciia to be the beneficial owner of the company. When questioned as to the validity of this Mr Kypri informed us that he had recently met with Mr Ciorciia to discuss the loans from BOC, including those to Dodworth²⁴⁷.

4.4.38 Since the interview with Mr Kypri, we have received a letter from BOC stating that the beneficial owner of Dodworth is Mr Octavian Radu²⁴⁸, although no-one at the Bank appears to have met with this person, and the Bank, despite what its KYC documents state, continues to regard the company as related to Mr Ciorciia.

4.4.39 As a consequence, it would presently appear that the change in beneficial ownership is an attempt for the purposes of the Romanian court case, to distance Mr Ciorcila from the company and therefore from the beneficial ownership of the BT Shares held by Dodworth that were sold to BOC.

4.4.40 In his witness statement Mr Karydas stated that the beneficial owner of Dodworth was no longer Mr Ciorcila. We note that he failed to mention that, at the date of this report, the Bank

2009, hence the requirement for the Alpha Bank loan to be repaid by 31 October 2009

²⁴³ Exhibit 33: Documentation obtained from Dodworth's KYC file

²⁴⁴ Exhibit 33: Documentation obtained from Dodworth's KYC file

²⁴⁵ Exhibit 33: Documentation obtained from Dodworth's KYC file

²⁴⁶ Exhibit 34: Report on Non - Performing Loans, produced in December 2012. This report is in Greek and has not been formally translated

²⁴⁷ As per interview with Mr Kypri

²⁴⁸ Exhibit 35: Letter to Alvarez & Marsal from Mr Kypri, dated 15 February 2013 (the day after the formal

regards Dodworth "os related to Horia Ciorgilla [sic] and Casternet Ltd"²⁴⁹.

Shares purchased from Salecom Limited

4.4.41 The final transaction outlined in the Revised 28 November 2009 Agreement involved the purchase, by BOC, of a newly created Cypriot registered SPV by BOC as follows:

"52.106.614 shares of Banca Transylvania (approx. 4.9% of total share capital) will be acquired by Bank of Cyprus through the purchase of the shares of a Cypriot SPV; owned by Casternet Ltd (which is controlled by Horia Ciorgila), and whose only assets will be the 52.106.614 Banca Transylvania shares. The purchase consideration of the shares of the Cypriot SPV will be RON 125.055.873,60 and the amount will be payable in Euro, the Euro equivalent to be calculated based on the BNR FX rate of the business day immediately preceding the acquisition date. For the purposes of clarity it is stated that the purchase consideration will not exceed the product of the number of Banca Transylvania shares held by the SPV times RON 2.40 per share (gross of any commissions, charges or other fees)..."

- > *The acquisition of the shares of the SPV will be subject to clearance of financial and legal due diligence to be obtained prior to the transaction date...*
- > *The consideration to be paid for the acquisition of the shares of the Cypriot SPV will be deposited in an account to be opened in the name of the seller with the Bank of Cyprus in Cyprus and the funds in that account will be blocked in favour of the Bank of Cyprus as collateral against the loans that currently exist. Such funds can be used, at the sole discretion of Horia Ciorgila as the ultimate beneficiary to purchase Bank of Cyprus shares, that can then be pledged as collateral against the existing loans..."*

4.4.42 A table obtained from the hard copy files of Ms Pantelidou, titled "BT Transactions", sets out that 52,106,614 shares in BT were acquired by BOC via the purchase of Salecom Ltd, which was purchased from Casternet Ltd under an SPA dated 7 December 2009²⁵⁰.

4.4.43 In an email dated 17 December 2009¹⁰³, Ms Eliza Livadiotou informed members of her finance team that *"some of the Transylvania shares were bought through Salecom Ltd (a Cyprus registered company). I am looking for the details of this company"*. Consequently, as at the 2009 year end, Salecom Ltd had been acquired by BOC, together with its 52,106,614 BT shares.

Proxies

4.4.44 This transaction relates to the purchase of 3,541,500 shares through a brokerage account in the name of a BOC Romania employee, MrIsaakidis. A copy of an undated letter from Mr Yiannis Pehlivanidis to the Chief Prosecutor of the Romanian Public Ministry, explains that:

"Mr. Isaakidis was expressly authorized by the Bank to open a brokerage account with SSIPIFB FINWEST and to acquire 3,541,500 shares in Banca Transylvania on the open market in late November and early December 2009, through funds provided to him by the Bank, with a view to selling such shares to the Bank on 15 December

2009

4.4.45 As can be seen from this transaction, a consequence of using proxies, funded entirely by the Bank with all the risks and benefits assumed by the Bank, was that the market was not made aware of the true purchaser under the transactions. Further, the 4 November 2009 memo sets out that it was important that all transactions be completed by 18 December 2009, as:

"BOC cannot straddle the year-end without completing the transactions, as loans to be provided...will be audited by the external auditors. Substance of transaction may be unveiled/"²⁵¹

This suggests that individuals within BOC were aware that using proxies to buy shares on behalf of BOC, with loans provided by BOC, was not necessarily acceptable practice for the Bank.

4.4.46 A loan account, with account number 0292-13-001386 ("The Loan Account")²⁵², was opened in the name of Demetriou Tasos. Mr Karydas explains in his witness statement that Demetriou Tasos is Mr Isaakidis, and that there was an error made with the name assigned to the account (Demetriou is

²⁴⁹ Exhibit 3: Witness Statement of Mr Karydas

²⁵⁰ Exhibit 36: Signed Salecom SPA dated 7 December 2009

²⁵¹ Exhibit 26: 4 November 2009 Memo

²⁵² Exhibit 38: Mr Isaakidis' loan account statement ("The Loan Account Statement")

Mr Isaakidis' middle name)²⁵³. It is possible that Mr Isaakidis's middle name coupled with his shortened first name (Tasos) may have been used so as to ensure that the loan account was not directly linked to Mr Isaakidis.

- 4.4.47 The request for this account to be opened, dated 12 November 2009, was sent from Mr Christoforou to Mr Panicos Nicolaou ("Mr Nicolaou"), at the time an employee of BOC Romania. In turn Mr Nicolaou received authorisation to open The Loan Account from Mr Shiarylly and Mr Karydas, as evidenced by the signatures on the memorandum sent by Mr Nicolaou to Mr Karydas and Mr Shiarylly on 13 November 2009²⁵⁴. The Loan Account was administered by BOC Cyprus.
- 4.4.48 The Loan Account Statement shows that the total loan facility was for an amount of €10 million, as per the request sent from Mr Christoforou to Mr Nicolaou²⁵⁵.
- 4.4.49 The Loan Account file does not contain any KYC documentation, nor is there any evidence of any consideration of the magnitude of the loan compared with the salary of Mr Isaakidis, or of any collateral taken against the loan. Consequently, this loan was granted without following the procedures set out in the BQC's credit risk manual; specifically an e-mail chain in August 2012, between two BOC employees, indicates that there was an internal search for the KYC documentation (such as a passport, identity card or utility bill) as this was not in the file and nor was there any indication of the individual's profession²⁵⁶.
- 4.4.50 The authorisation for The Loan Account was provided by Senior Executives (namely, Mr Karydas and Mr Shiarylly) overriding internal controls and disregarding anti money laundering procedures, in order to facilitate the granting of a loan that (it is presumed) would not normally be granted to a customer with Mr Isaakidis's profile.
- 4.4.51 The Loan Account statement shows that an advance of €1,500,612 was drawn down on 17 November 2009²⁵⁷. On the same date, a transfer of RON 6,427,500 was made into a brokerage account with IFB Finwest S.A. in the name of Anastasios Isaakidis²⁵⁸ ("The Brokerage Account"). A memo authorising a transfer, shows that €1,500,000 was to be transferred from account number 0292-13-001386 with BOC, to an account of SSIB IFB Finwest S.A on 16 November 2009²⁵⁹.
- 4.4.52 A second advance of €1,500,612 was drawn down against The Loan Account on 10 December 2009²⁶⁰, with a corresponding amount in RON also being received into the Brokerage Account, as authorised by a second memo²⁶¹.
- 4.4.53 The money transferred into the Brokerage Account was used to purchase shares on the Bucharest Stock Exchange, including a total of 3,541,500 BT shares which were sold to BOC on 15 December 2009, at a price of 2.23 RON per share²⁶², a total of RON 7,858,057.
- 4.4.54 The 1 November 2009 Steps Memo, which outlined possible steps via which BOC could build up a 9.9% shareholding in BT, included a mechanism whereby BOC would designate:
"...a trusted person (Indiv 2) to whom CL will channel shares through the market (such transactions will be normally pursued on the floor and/or through pre-agreed pockets with willingful sellers that were identified by CL)...funding should come from a loan"
- 4.4.55 The 1 November 2009 Steps Memo sets out that the above step would be repeated twice, using individuals 3 and 4. The memo concludes with certain requests, which included the approval of three

²⁵³ Exhibit 3: Witness Statement of Mr Karydas

²⁵⁴ Exhibit 39: Request from Panicos Nicolaou, Manager Global Banking & Loan Syndication Unit to Mr Karydas

²⁵⁵ Exhibit 39: Request from Mr Christoforou to the BOC Romania Banking Centre, C/O Mr Panicos Nicolaou, dated 12 November 2009. Greek with English translation

²⁵⁶ Exhibit 40: E-Mail chain regarding Mr isaakidis' KYC documentation

²⁵⁷ Exhibit 38: The Loan Account Statement

²⁵⁸ Exhibit 41: Mr Isaakidis' Brokerage Account Statement

²⁵⁹ Exhibit 42: Authorisation to transfer €1.5 million from the Loan Account to the Brokerage Account, dated 16 November 2009

²⁶⁰ Exhibit 38: The Loan Account Statement

²⁶¹ Exhibit 42: Authorisation from Mr Karydas to transfer €1.5 million from the Loan Account to the Brokerage Account, dated 10 December 2009

loans (to individuals 2, 3 and 4) with:

"The GM (BoC Rom) to be empowered to increase these Loans' amount up to a maximum EUR 12,75 mln per case, in order to accommodate for higher purchase prices than those currently anticipated (if needed). Each of these loans will accommodate:

- a. *The purchase of approx, 2,3% of Beatrice, estimated at around EUR 11 mln*
- b. *The purchase/trading of other top-20 titles for an aggregate amount of EUR 1 mln. The Trading strategy will be setup and carried out by CL, The purpose of this step is to avoid (as much as possible) attracting the eyes of the authorities on the transactions made on Indiv 2, 3 & 4, since these persons will be perceived as building a broader investment portfolio.*

The Individuals [sic] 1,2,3 & 4 have been proposed in a different memo."

4.4.56 This separate memo was sent from Mr Christoforou to Ms Pantelidou via an e-mail on 29 October 2009²⁶³ and included Mr Isaakidis as one of the four individuals, of whom Mr Christoforou says *"He is the most loyal of existing colleagues and I trust him entirely"*¹ (as translated).

4.4.57 Despite the fact that the quantity of BT Shares purchased by IFB FINWEST on Mr Isaakidis's behalf represented a 0.33% shareholding, considerably less than a 2.3% stake, the following is consistent with the process outlined in 1 November 2009 Steps Memo:

4.4.57.1 The total amount of the loan facility granted to Mr Isaakidis was €10 million (although only €3 million was actually utilised);

4.4.57.2 Although the vast majority of purchases were BT Shares which were subsequently sold to BOC, a mix of Romanian listed company shares were also purchased by the broker IFB FINWEST on behalf of Mr Isaakidis, in line with the comments above that this would serve to avoid the attention of the authorities; and

4.4.57.3 The 9 July 2010 Indictment claims that an offer of 1 million BT shares at a price of 2.2 RON per share was refused by Mr Silaghi, but that Mr Silaghi provided a contact who purchased the stake on behalf of Mr Isaakidis¹¹⁷ (if true this may be evidence that Mr Silaghi was 'channeling' BT shares to Mr Isaakidis).

Profit generated from Brokerage account

4.4.58 A profit of RON 168,713 was generated from the trading activity on The Brokerage Account, RON 118,512 of which was due to the purchase, and subsequent sale to BOC, of BT Shares.

4.4.59 A copy of a SWIFT message²⁶⁴, provided to the Romanian Court by BOC, shows a transfer of €3,144,265 on 22 January 2010 from an account in the name of IFB FINWEST SA with Banca Transilvania to an account with Tasos Demetriou with IBAN number CY6900200292000000138600. This transfer amounted to the cash generated from liquidating the brokerage account.

4.4.60 The accounting entries related to this SWIFT transfer show that this amount was automatically posted to the suspense account. Following instructions from Mr Christoforou, an amount of €3,021,033.19 was transferred to close The Loan Account, with the remaining profit generated from the trading account of €123,234.45 posted to "arrangement fees", which is a profit and loss account²⁶⁵.

4.4.61 The Loan Account statement shows three transfers into the account on 25 January 2010: a "payoff" of €3,009,914.41; an "interest" payment of €6,72933; and an expense of €4,389.45, totalling €3,021,033.19.

4.4.62 As such, it would appear that all of the profit generated from The Brokerage Account was transferred back to BOC. However, this profit was recorded as "arrangement fees" rather than profit from investments and foreign exchange gains.

5. Use of proceeds to purchase BOC Shares

5.1.1 Some of the proceeds of the BT shares were invested by Mr Ciorciia and Mr Silaghi in BOC shares. It is not clear as to why some of the proceeds were invested in BOC. In an interview we were

²⁶³ Exhibit 43: Doc I.D: 0.7.13.449205

²⁶⁴ Exhibit 44: SWIFT message 21 January 2010

²⁶⁵ Exhibit 45: Journal entry from BOCs General ledger provided to Alvarez & Marsal, by Mr Kyriacos Tsolakis,

informed by Mr Karydas and Mr Hadjimitsis that the decision to purchase these shares was made by Mr Ciorciia and Mr Silaghi. However, in interview Mr Kypri stated that during a recent meeting with Mr Ciorciia he was informed that Mr Ciorciia only purchased the BOC shares at the request of Mr Eliades²⁶⁶.

Weilane Limited

5.1.2 The 9 July 2010 Indictment sets out how Mr Silaghi allegedly disbursed the RON 80,640,000 received for the 33.6 million BT shares. The proceeds of the sale of BT shares were initially deposited in an account in the name of Mr Silaghi's mother in law with IFB FINWEST SA. Various disbursements were made out of the RON 80,640,000 including a transfer of RON 60,000,000 on 11 December 2009 to an account with Citibank Europe in Mr Silaghi's name.

5.1.3 The RON 60 million was exchanged into euros at an exchange rate of RON 4.258/C resulting in a deposit of €14,091,122.59. A subsequent transfer of €10,000,000 was then made to an account in the name of a Cypriot registered entity, Weilane Limited, at the BOC with IBAN CY 63 BTRL 0020 0155 0000 0001 1336 5200²⁶⁷.

5.1.4 This account was a CISCO customer account²⁶⁸, from which a total of 2,241,845 BOC shares were purchased on Wellane Limited's behalf, at a total cost of €10 million. The CISCO transaction report shows that these shares were purchased in small increments, on an almost daily basis, between 12 February 2010 and 5 May 2010²⁶⁹.

5.1.5 The KYC documents associated with Wellane Limited identifies Mr Silaghi as the beneficial owner of Wellane Limited²⁷⁰.

5.1.6 If the nature of the way in which BOC structured the acquisition of BT shares from Mr Silaghi could be considered to be market manipulation, market abuse or insider dealing, then a legal opinion should be sought on whether BOC knowingly facilitated money laundering by permitting the proceeds from criminal activity to be invested in its own shares, via CISCO.

Peramant Limited

5.1.7 An amount of €29,415,914 was paid to Casternet Limited by BOC, following the purchase by BOC of Salecom Limited on 7 December 2009²⁷¹.

5.1.8 A Cypriot registered company called Peramant Limited ("Peramant") was incorporated on 27 October 2009²⁷². Documentation in the Peramant KYC file indicates that, as at 2 December 2009, Casternet held 100% of the share capital of Peramant as trustees on behalf of Mr Octavian Radu²⁷³. There is also letter dated 10 December 2009 from Mr Radu stating that he is the beneficial owner of Peramant²⁷⁴.

5.1.9 Peramant acquired 7,358,800 BOC shares via CISCO between 17 December 2009 and 1 June 2010, at a total cost of €34 million²⁷⁵, payment of which came from an account in Peramant's name at the BOC with account number 0292-04-000113²⁷⁶. This was an account administered from Cyprus but associated with a customer of BOC Romania (as denoted by the numbers "0292" in the account number).

5.1.10 Consequently it would appear that the Ciorcila Group loans were restructured on favourable terms, in exchange for Mr Ciorcila selling a significant investment in BT at above market price to BOC. The proceeds were then used to purchase BOC shares which were placed as collateral against

²⁶⁶ Per interview with Mr Kypri

²⁶⁷ Exhibit 7: 9 July 2010 Indictment, Page 69

²⁶⁸ Exhibit 46: E-Mail from Anna Sofroniou, General Manager CISCO, to Alvarez & Marsal, dated 25 January 2013

²⁶⁹ Exhibit 47: Wellane Ltd Transaction Report, provided to Alvarez & Marsal by CISCO

²⁷⁰ Exhibit 48: Wellane Ltd KYC documentation, provided to Alvarez & Marsal by CISCO

²⁷¹ Exhibit 49: Memo dated 16 December 2009 from Mr Tsolakis and Mr Hadjimitsis to Mr Kyriacos Iacovides

²⁷² Exhibit 50: Peramant Ltd Certificate of incorporation

²⁷³ Exhibit 51: Declaration of Octavian Claudiu Radu, dated 2 December 2009

²⁷⁴ Exhibit 52: Letter from Mr Radu confirming he was the beneficial owner of Peramant Ltd, dated 10 December 2009

²⁷⁵ Exhibit 53: Peramant Ltd transaction report provided to Alvarez & Marsal by CISCO

²⁷⁶ Exhibit 46: E-Mail from Anna Sofroniou, General Manager, CISCO, to Alvarez & Marsal, dated 25 January

the existing loans.

- 5.1.11 A memorandum dated 10 March 2010²⁷⁷ on the Ciorcila Group, prepared by BOC Romania and sent to the Credit Risk department, sets out, inter alia, that the 60,263,108 BT shares originally posted as collateral against the Casternet and Dodworth loans was in the process of being swapped for BOC shares and a corporate guarantee of Peramant for €60 million. The purpose of the memo was to request ratification for the action taken by BOC Romania; the issues set out in the memo were ratified by, amongst others, Mr Eliades, Mr Shiaryl and Mr Karydas. The memo does not mention that BOC had purchased the BT shares in question, for a premium, and had therefore been instrumental in increasing the value of the collateral whilst simultaneously ensuring it was able to secure a strategic investment in BT and a significant investment in its own share capital.

6. Approval from the Board of Directors

- 6.1.1 An extract from the minutes of the Board of Directors ("BOD") meeting held on 10 December 2009, sets out that Mr Hadjimitsis informed the BOD that BOC had acquired 4 - 5% of BT and had the opportunity to increase this to 9% for a total consideration of €54.7 million²⁷⁸. The benefits of such an investment to BOC were presented to the BOD.
- 6.1.2 The minutes further note that on the basis of the strong recommendation of the Executive Managers of BOC and the benefits and low risk of the transaction, the BOD authorised the Executives to proceed with negotiations with the shareholders of BT to secure more than 10%, but less than 20% of the share capital BT²⁷⁹.
- 6.1.3 The facts presented to the BOD on 10 December 2009 do not appear to be entirely consistent with the reality of the negotiations surrounding the acquisition of BT shares. As of 10 December 2009, BOC was already the beneficial owner of 9.1% of BT²⁸⁰, which had been secured prior to obtaining authorisation to proceed with negotiations from the BOD.
- 6.1.4 There is no mention in the BOD meeting minutes of the association between restructuring of the Ciorcila Group loans and the acquisition of BT shares, nor the fact that BOC had paid, and was intending to pay, a premium of c15% above the market price for the shares.
- 6.1.5 It appears that the Senior Executives of BOC had concluded negotiations to secure a shareholding in excess of 5% prior to obtaining BOD approval for the investment, and as such essentially overrode both the authority, and purpose, of the BOD.
- 6.1.6 Further, there appears to have been a lack of transparency over the structure of the acquisition as presented to the BOD, which may have been due to the fact that the Senior Executives had negotiated a deal that potentially went against the 'spirit' of the Romanian Capital Markets legislation.
- 6.1.7 The board members that have been interviewed all denied any detailed knowledge of the transaction prior to the announcement of the criminal investigation, and confirmed that they were first aware of the purchase of shares in BT at the 10 December 2009 BOD meeting in which approval was sought to purchase an increased holding.
- 6.1.8 Mr Eliades and Mr Hadjimitsis were both recipients of the e-mail sent by Mr Christoforou on 7 December 2009, setting out that, at that time, BOC was the beneficial owner of 9.1% of BT. Three days later, both executives informed the Board that only 4% of BT had been acquired, and that there were agreements in place to acquire up to 10% when in fact both were aware that the Bank had already acquired almost 10%.

7. Disclosure in Romania

Failure to adhere to Romanian Securities Regulator's requirement to disclose shareholding in excess of 5%

- 7.1.1 According to the witness statement of Mr Karydas²⁸¹, he approached Mr Cinteza, the head of

2013

²⁷⁸

²⁷⁹ Exhibit 55: Translation of extract from minutes of BOC meeting held on 10 December 2009

²⁷⁹ Exhibit 55: Translation of extract from minutes of BOC meeting held on 10 December 2009

13A

²⁸¹ Exhibit 3: Witness Statement of Mr Karydas

the National Bank of Romania Surveillance department, on 8 December 2009 to inform him that BOC had acquired 4% of BT, and was intending to acquire up to 10%. However, the email from Mr Christoforou to Mr Eliades, Mr Hadjimitsis and others, on 7 December 2009 indicates that BOC already had 9.1% BT under its beneficial ownership²⁸². A formal announcement to the market was not made until 16 December 2009²⁸³.

- 7.1.2 Consequently, it appears that BOC did not disclose the fact that it held more than 5% of the share capital of BT within 3 days of acquiring the shareholding to the CNVM, the company, the BSE and the market, as required under Article 228 of Law no. 297/2004 as set out in CNVM Regulation 1/2006¹³⁸.

Disclosures to the Romanian Court

- 7.1.3 As indicated in paragraph 2.3.7.4 above, documentation reviewed during this investigation appears to contradict some of the claims made by Mr Karydas in the witness statement he submitted to the Romanian Court in relation to the on-going capital markets case. These specific statements, and the associated contradictory evidence, have been set out in Appendix 1 to this report.

8. CBC's involvement

- 8.1.1 As per the Banking Laws of 1997 to 2012, Section 13 (1) states that a bank may not acquire or hold, either directly or indirectly, more than ten percent of the share capital of any other company without the written approval of the CBC.
- 8.1.2 BOC obtained the approval to invest in over 10%, and up to 20%, of BT from CBC in a letter to Mr Eliades from Mr Athanasios Orphanides (the then Governor of CBC) dated 31 March 2010. This was a reply to a letter from Mr Eliades, dated 19 January 2010, requesting this approval²⁸⁴.
- 8.1.3 We have not investigated whether CBC had any additional involvement in the purchase of BT shares, either at the time of the purchase, or in relation to the on-going court case in Romania. However, from a regulatory perspective, there was no requirement for CBC to actively supervise the investment.
- 8.1.4 Keyword searches undertaken on electronic communications obtained from key employees at CBC have not identified any communication indicating that CBC employees or Governor Orphanides had any contemporaneous knowledge of the mechanisms employed by BOC to purchase shares in BT.

9. Formal Interviews with Senior Executives

- 9.1.1 Formal interviews were undertaken with Mr Karydas, Mr Kypri, Mr Hadjimitsis and Mr Shiarly during which, inter alia, their involvement in the acquisition of BT shares during 2009 was discussed. The general response received from all four current and former senior executives was that they were not involved in the negotiation of the deals. This appears inconsistent; particularly for Mr Hadjimitsis, to whom the M&A department reported¹⁴⁰.
- 9.1.2 Appendix 2 to this report sets out specific documentation, e-mails and meetings associated with the acquisition that these four executives received and/or attended and which therefore contradict the assertions made during formal interviews that they had no direct involvement in the acquisition.

²⁸² Exhibit 24: Doc ID: 0.7.13.450140

²⁸³ **Exhibit 6: Announcement on BOC Website**

²⁸⁴ Fvhihit çβ· I pttty frnm ΓΚΓ tn Mr Fliadp*; riatpri 31 March 2010

10. Recommendations for further investigation

- 10.1.1 It appears from the Investigation that BOC sought to acquire an interest in BT through various structures that were intended to initially disguise the true beneficial ownership of the shares.
- 10.1.2 Based on suspicions of market manipulation the Romanian authorities instigated a criminal investigation, which included the General Manager of BOC Romania as one of the defendants. As part of this legal case Mr Karydas, as Group General Manager Risk Management and Markets at BOC, provided evidence to the Romanian court which contradicts some of the documentary evidence found during the investigation.
- 10.1.3 Based on the findings of the Investigation, legal advice should be sought to establish whether the alleged market manipulation in Romania is relevant to the Cypriot authorities and whether the findings from the Investigation should be presented to the Attorney General.

4i

INVESTIGATION REPORT

BANK OF CYPRUS - BANK OF CYPRUS'S ACQUISITION OF UNIASTRUM BANK

PREPARED FOR THE CENTRAL BANK OF CYPRUS

26 MARCH 2013

ALVAREZ & MARSAL GLOBAL FORENSIC AND DISPUTE SERVICES, LLP

STRICTLY PRIVATE & CONFIDENTIAL

Table of Contents

1.	INSTRUCTIONS.....	3
1.1	INSTRUCTIONS.....	3
2.	EXECUTIVE SUMMARY	4
3.	PURCHASE OF UNIASTRUM-OUR FINDINGS	6
3.1	STRUCTURE.....	6
4.	BACKGROUND TO BOC'S EXPANSION INTO RUSSIA	7
4.1	BOC'S RUSSIAN EXPANSION	7
4.2	RUSSIAN MARKET	7
4.3	RUSSIAN BANKING AND M&A MARKET	9
4.4	BACKGROUND TO UNIASTRUSVI	10
5.	BACKGROUND AND TIMELINE TO ACQUISITION	11
5.1	SELECTION OF UNIASTRUM	11
5.2	SUMMARY OF SIGNIFICANT ACQUISITION EVENTS	12
6.	ADVISORY/ DUE DILIGENCE FINDINGS	13
6.1	JP MORGAN	13
6.2	SUMMARY OF DUE DILIGENCE - ERNST & YOUNG	13
6.3	MUTUAL FUNDS	15
6.4	ESCROW ACCOUNT.....	16
7.	BOARD APPROVAL OF THE ACQUISITION	17
7.1	SUMMARY OF BOARD OF DIRECTORS' INVOLVEMENT	17
7.2	BOARD OF DIRECTORS-CONSIDERATION OF ACQUISITION	18
8.	BOC'S ABILITY TO RENEGOTIATE / WITHDRAW	19
8.2	BOARD OF DIRECTORS OPINION ON BOC WITHDRAWAL FROM THE DEAL	20
8.3	MATERIAL ADVERSE CHANGE.....	21
8.4	CAPITAL INJECTION.....	21
9.	CBC APPROVAL OF THE ACQUISITION.....	23
9.1	SUMMARY OF CBC CONSIDERATION AND APPROVAL	23
9.2	CENTRAL BANK APPROVAL OF UNIASTRUM ACQUISITION	24
10.	ALLEGATION OF CORRUPT PAYMENTS	26
11.	RECOMMENDATIONS FOR FURTHER WORK	27

Exhibits

- A. Bank of Cyprus Non-binding offer letter dated 28 February 2008
- B. Extracts of Ernst & Young due diligence reports of 23 May 2008 and 22 October 2008
- C. Board of Directors' meeting minutes of 26 June 2008 and 30 October 2008 (Translated)
- D. White & Case legal advice in regard to potential clauses to enable negotiaton/ withdrawal from acquisition dated 8 October 2008
- E. Central Bank of Cyprus letter of recommendation from Mr Poullis to the Governor dated 29 September 2008 (Translated)
- F. Letter from the Central Bank of Cyprus to Bank of Cyprus approving the acquisition of Uniastrum Bank dated 30 September 2008 (Translated)
- G. Bank of Cyprus announcement regarding the acquisition of Uniastrum Bank dated 26 June 2008

1. Instructions

1.1 Instructions

1.1.1. Alvarez & Marsal ("A&M") was instructed by the Central Bank of Cyprus ("CBC") on 21 August 2012 to conduct an Investigation as independent persons, appointed in accordance with Section 24 of the Central Bank of Cyprus Laws of 2002 to 2007, to assist the CBC in accordance with the Mandate (the "Investigation").

1.1.2.

Specifically, the Investigation was tasked with assisting "the Governor to take all necessary legal and regulatory remedies, whether they concern the conduct of supervision by the Bank, the procedures followed by some systemically important local banks (hereinafter referred to as "the Cypriot banks") to acquire Greek Government Bonds and / or investing abroad in the form of a branch network and/or subsidiaries banks, having regard to the requirements specified by the provisions of the Banking Laws of 1997 to (No. 2) 2011 and the Central Bank of Cyprus Laws of 2002 to 2007 and the Regulations / Directives/ Guidelines issued under these Laws, or otherwise at the discretion of the Governor".

1.1.3. This report sets out findings, conclusions and recommendations based on our work conducted up to 26 February 2013 in relation to the acquisition of 80% of the share capital of Uniastrum Bank in Russia.

1.1.4. This report has been prepared for the CBC solely for use in relation to the Investigation and must be read in conjunction with our Statement of Protocol of 26 March 2013. It may not be used for any other purpose, reproduced or disclosed to any other party in whole or in part without our prior notice. In no event, regardless of whether notice has been provided, will we assume any liability or responsibility to any third party to which this report is disclosed or otherwise made available.

2. Executive Summary

2.1.1 BOC signed a non-binding offer to acquire 80% of Uniastrum in February 2008, executed a Sale and Purchase Agreement ("SPA") in June 2008 and completed the purchase on 3 November 2008, less than two months after Lehman Brothers filed for bankruptcy.

2.1.2 BOC Executives proceeded with the acquisition of Uniastrum in late 2008 despite deteriorating economic conditions in Russia and beyond, the collapse of Lehman Brothers and Uniastrum's need for capital injections from BOC pre-acquisition, based on their view that:

2.1.2.1 The changes to the economic environment did not constitute a good cause for termination of the agreement since no material changes occurred in Uniastrum;

2.1.2.2 Any attempt to withdraw from the agreement could implicate BOC in long-term legal procedures;

2.1.2.3 The terms of the acquisition were favourable;

2.1.2.4 Further negotiations may *"cut the rope linking [BOC] with the previous owners"*;

2.1.2.5 The transaction was of strategic importance for BOC and BOC anticipated negative market reaction if the acquisition was not completed; and

2.1.2.6 BOCs reputation in the Russian market could suffer and it would become extremely difficult to re-attempt an acquisition or other activity in the Russian market in the near future.

2.1.3 BOC considered, but did not act upon, legal advice they received on the provisions of the SPA that may have been available to them as an opportunity to either:

2.1.3.1 renegotiate the purchase price; or

2.1.3.2 withdraw from the acquisition. **(Section 8)**

2.1.4 An escrow account mechanism, integral to the acquisition, only adjusted for 1x bad debts and the impact of issues relating to mutual funds, when the deal multiplier would have been appropriate to protect BOCs entity value. **(Section 6)**

2.1.5 Some members of the BOC Board of Directors ("BoD") felt they did not have sufficient time to adequately scrutinise the due diligence findings prior to Board approval of the transaction.

(Section 7)

- 2.1.6 Some due diligence findings appear not to have been included/clearly reported in the BoD presentation of 26 June 2008. **(Section 7)**
- 2.1.7 BOC lent funds to and purchased loan assets from Uniastrum prior to acquisition, effectively to prop up the bank. It is not clear that the BoD was aware of this funding. (Section 8)
- 2.1.8 The CBC's licensing department prepared an internal report dated 4 September 2008. It was reviewed by Mr Poullis from the CBC who subsequently recommended approval of the deal to the CBC Governor on 29 September 2008, two weeks after the collapse of Lehman Brothers:
 - 2.1.8.1 The CBC considered detrimental market conditions and the collapse of Lehman Brothers in the intervening period not to be particularly relevant;
 - 2.1.8.2 The CBC approved the transaction before Ernst & Young ("E&Y") prepared their closing due diligence report; and
 - 2.1.8.3 The CBC did not apply any conditions to their approval to enable the CBC to reevaluate the application if there were significant adverse events between approval (on 30 September 2008) and acquisition completion (on 30 October 2008). (Section 9)
- 2.1.9 We have found no evidence to substantiate rumours of corrupt payments in relation to the transaction. (Section 10)

Purchase of Uniastrum - Our Findings

3.

3.1

3.1.1

Structure

Our findings are structured as follows:

Section 4) Background to BOCs expansion in Russia

Section 5) Background and timeline to acquisition

Section 6) Advisory / due diligence findings Section 7)

Board approval of the acquisition Section 8) BOCs

ability to renegotiate / withdraw Section 9) CBC

approval of the acquisition Section 10) Allegation of

corrupt payments Section 11) Issues identified for

potential follow up

4. Background to BOC's Expansion into Russia

4.1 BOC's Russian Expansion

- 4.1.1 BOC decided to expand into emerging markets (such as Russia, Romania and Ukraine) in 2007. This formed part of their "*3 year plan*" (dated 12 December 2007) communicated to shareholders.
- 4.1.2 Russian banking law required a bank to be acquired in order to obtain a banking licence. BOC commenced due diligence work into acquiring Moscow National Investment Bank in June 2007. The idea was later abandoned due to changes in Russian law.
- 4.1.3 BOC opened a branch in Moscow in 2007 - the first Cypriot bank to have operations in Russia.
- 4.1.4 In September 2008, Laiki Bank Group entered the Russian market by acquiring the majority shareholding of CB Rosprombank LLC and was the first banking organisation in Cyprus and Greece to proceed with the acquisition of a Russian bank.
- 4.1.5 Barclays completed the purchase of Expobank for a value of US\$745m (cash funded) on 1 July 2008 (announced 3 March 2008) at a price to book value (P/BV) multiple of 4 (postcapital increase).
- 4.1.6 With a desire to build its network of branches in Russia, BOC commenced due diligence work

to find a Russian bank with an established branch network, as the Russian branch licence application process was cumbersome and required a separate licence for each location within Russia.

4.2 **Russian Market**

4.2.1 The Russian banking sector continued to demonstrate dynamic growth in 2007 and developed a functional role in the Russian economy.

4.2.2 The Central Bank of Russia noted this was a result of measures taken by the Bank of Russia to strengthen the banking sector's capital base, improve the quality of banking risk management and upgrade the deposit insurance system.

4.2.3 The Russian economy experienced growth of an average of 7% per year during 1999 to 2007, and 8% in the first half of 2008.

4.2.4 Standard & Poor's ("S&P") revised Russia's credit rating outlook to Negative on 23 October 2008.

4.2.5 According to a report by the World Bank dated 1 November 2008 the Russian economy was undergoing a slowdown:

4.2.6 *^After a decade of high growth, the Russian economy is experiencing a slowdown in the wake of the global financial crisis. While Russia's strong short-term macroeconomic fundamentals make it better prepared than many emerging economies to deal with the crisis, its underlying structural weaknesses and high dependence on the price of a single commodity make its impact more pronounced than otherwise..."*

4.2.7 Fitch Ratings in a report on 3 November 2008 discussed *"the severe deterioration in the Russian capital markets*

3 Russian Banking and **M&A** Market

Mergers and Acquisitions, Russia, Commercial Banks (Primary) OR Thrifts and Mortgage Finance (Primary)

M&A Bank activity in Russia did not decline significantly post the Lehman Brothers failure, although the number of cancelled deals increased in Q4 2008

Lehman Brothers filed for bankruptcy on 15 September 2008

Jan-08 Mar-07 May-07 Jul-07 Sep-07 Nov-07 Jan-08 Mar-03 May-08 Jul-08 Sep-08 Nov-03

■ **Sum of Cancelled B Sum of Completed or Effective**

Implied Equity to Book Value of Russian M&A Transactions during

7.0
6.0
5.0
4.0
3.0
2.0 1.0
0

July 2006-July 2009

Uniastrum

JCF FPK and Starr Foundation purchase of 39.98% of O JSC Investtradebank at implied multiple of 4.26x

Oct-06 Jan-07 Apr-07 Aug-07 Nov-07 Feb-08 Jun-08 Sep-03 Dec-08 Mar-09 Jul-05

4.4 Background to Uniastrum

4.4.1 Uniastrum Bank was established in 1994, and obtained a Russian banking licence in May 2005.

4.4.2 The bank was formed by former graduates of the Moscow Aviation Institute, Mr Zakaryan and Mr Piskov, and the Belousov family (who sold their minority shareholding prior to acquisition by the BOC).

4.4.3 As of 31 December 2007, Uniastrum had 209 offices with 43 branches in 41 regions across Russia, operated out of a head office in Moscow, and employed 3,413 staff (1,050 in the head office),. Uniastrum had the ninth largest branch network in Russia in 2007 although some of the branches are reportedly little more than small offices or kiosks.

4.4.4 In 2008, the principal activities of Uniastrum were deposit taking, lending and issuing guarantees. Uniastrum also had foreign exchange and securities functions.

4.4.5

Unistream is a money transfer business which was launched in 2001 by Uniastrum. In 2006, it formed a separate legal company with a separate banking licence. Assets to run the business including 200 staff, 75 cash desks, 145 service points and agency agreements, were transferred to Unistream in 2007. Unistream was not owned by Uniastrum and consequently did not form part of the acquisition by BOC.

4.4.6 Post transfer, Unistream profits were no longer consolidated in Uniastrum, only commission income was received by Uniastrum, which continued to provide Unistream services from its network of branches.

5. Background and Timeline to Acquisition

5.1 Selection of Uniastrum

5.1.1 Mr Piskov and Mr Zakaryan engaged Rothschilds in late 2006 to find a potential investor in Uniastrum prior to the approach by BOC. This search had ended unsuccessfully with one potential suitor buying outside Russia and another buying a less costly Russian bank. It is unknown whether BOC was on this initial list, but we understand there were no serious discussions with BOC at that stage.

5.1.2 Mr Ergatoudes (BOC Russia) was instructed by BOC Head Office to research six different Russian banks for which the BOC Group had intelligence that they may be willing to sell. The six banks he was asked to research were Uniastrum, BIN Bank, Masterbank, Transcapitalbank, Avangard Bank and National Trust Bank.

5.1.3 Mr Ergatoudes researched the banks from public record sources and prepared (with the assistance of BOC staff) a summary of the key statistics relating to the six banks. This summary was provided to Head Office.

5.1.4 Uniastrum was selected by BOC as the favoured acquisition target because of its:

5.1.4.1 Established Russian branch network;

5.1.4.2 Simple ownership structure (other banks had complex structures and Uniastrum was deemed

ideal as it had two shareholders with a majority stake);

5.1.4.3 Profitability potential;

5.1.4.4 Likelihood to retain Russian banking knowledge using the ongoing support of the two shareholders (BOC was unfamiliar with the Russian market and practices and it was deemed beneficial that the two shareholders could remain in the business in the short term).

5.1.5 The key team from BOC in almost all discussions consisted of Messrs. Eliades, Kypri and Hadjimitsis.

Summary of Significant Acquisition Events

26/6

BOC BoD approves the acquisition at US\$1576m (loss escrow recount)

Mid Feb - 2nd meeting with **Uniastrum sellers**

Market announcement

7/1 - 31/1

UB financial data **circulated** to **BOC**

2.008

Jan 8/2

JPM compare **financials** of **3 / >anks** including **JJB**

27/10

White & Case **pro-closing**

legal DD

12/2 JPM sign **lon-disclosure**

agreement

Feb **'Initial** meeting with Uniastrum sellers re: likelihood of acquisition

at multiple of 4x 8.V.

BOC = Bank of Cyprus UB = Uniastrum Bank BOG (Russia) = BOC (Russia) Holdings Ltd CBC = Central Bank of Cyprus CBR = Central Bank of Russia BoD = Board of Directors DD = Due Diligence NBO = Non-binding Offer letter SHA = Shareholders' Agreement ; SPA - Participatory Share Purchase .Aanmmgot _

ge 12

3»

A

6. Advisory / Due Diligence Findings

6.1 JP Morgan

6.1.1 BOC retained JP Morgan ("JPM") for ongoing advisory work.

6.1.2 BOC compiled a shortlist of potential targets, and contacted JPM in February 2008 with the name of three Russian banks; TransCredit Bank, Master Bank and Uniastrum Bank, and inquired as to whether JPM had any potential conflicts acting in relation to these entities. JPM was subsequently asked to assist with initial due diligence work on Uniastrum Bank.

6.1.3 JPM commenced initial due diligence work immediately, although their engagement letter *"to act as its financial adviser, in connection with a possible transaction... involving the acquisition of shares in "UNIASTRUM BANK" (LLC)"* was only signed on 26 May 2008.

6.1.4 JPM engaged its Russian team for due diligence work, the managers of which met with BOC personnel including Messrs Eliades, Kypri and Hadjimitsis. JPM was involved in a number of key BoD meetings, including presenting on Russian market opportunities and later at part of the BoD meeting of 26 June 2008.

6.1.5 JPM prepared valuation models based on audited financial statements and management accounts provided by Uniastrum, using key assumptions which evolved over time with the deal.

6.2 Summary of Due Diligence - Ernst & Young

6.2.1 E&Y was engaged in March 2008 to perform financial and tax due diligence. The Appendix to E&Y's engagement letter states their remit *"is to provide Bank of Cyprus with enough information to decide whether to proceed with the acquisition and/or renegotiate the deal."*

6.2.2 Their scope included:

6.2.2.1 General procedures; analysis of activity of Uniastrum, its structure, shareholders and main operations, licences, personnel review, review of BoD, etc;

6.2.2.2 Review of financial statements and management accounts, review of auditors reports;

6.2.2.3 Analysis of branch network, its structure, income and expenses, staff, property, etc;

6.2.2.4 Analysis of ratios and banking indicators, review of asset quality and profitability;

6.2.2.5 Review of securities and loan portfolio, including related party loans; and

6.2.2.6 Other general reviews (a detailed scope can be found at Appendix II to their engagement letter).

6.23 Their initial due diligence work was based upon financial statements for the year ended 31 December 2005 (audited), 2006 (audited), and unaudited draft financial statements for 2007 (**Exhibit B**).

6.2.4 E&Y's May 2008 due diligence report (**Exhibit B**) highlighted a number of significant issues that should have raised concerns, including:

6.2.4.1 The shareholders of Uniastrum own and/or control many other companies including *"the money transfer business executed through OJSC CB Unistream"*, which was *"started in 2001"*. They note that *"Unistream was established in May 2006 and segregated from the Bank into the separate legal entity"*. E&Y states that the 2007 profits of Uniastrum include a gain from sale of shares of *"LLC Unistream Properties"* of €43.6m.

6.2.4.2 The shareholders are executives of Uniastrum and have the opportunity and power to influence the day to day operations, including the granting of loans.

6.2.43 The exposure of related party transactions is unclear.

6.2.4.4 Uniastrum's corporate loan portfolio (at 31/12/07) includes significant concentrations of loans to clients' SPEs with an unclear or undisclosed purpose, Armenian entities and related parties - warranties for the completeness of balances with related parties needs to be sought.

6.2.4.5 Based on the 2006 financial statements, *"there is a significant gap in short-term liquidity (up to 3 months) in the amount of EUR 42 million"*. The gap at 31 December 2007 is €177 million. (See capital injection on pages 34 and 35).

- 6.2.4.6 Significant weaknesses in the loan process, including inadequate analysis of borrowers' financial information.
- 6.2.4.7 At the end of 2007, 25 out of 43 branches were loss-making (pre-tax).
- 6.2.4.8 Based on the 2006 audited accounts, an increase in equity of €64 million was due to a revaluation of buildings purchased by a related party.
- 6.2.4.9 Before FY07, up to 40% of employee compensation was paid unofficially so Uniastrum could avoid tax.
- 6.2.5 Aside from the unidentified related loans issues, E&Y does not appear to have performed any due diligence in relation to the Uniastrum shareholders despite the concerns raised in due diligence report as to the unclear situation in relation to the related party transactions.

63 Mutual Funds

- 6.3.1 As part of their due diligence, E&Y reviewed mutual funds in which Uniastrum were trustees. Mutual funds are professionally managed collective investment vehicles that pool money from multiple investors to purchase securities.
 - 6.3.2 E&Y's initial due diligence highlighted that the *"mutual fund business is supported by the London based company Uniastrum Capital Limited which is ultimately owned by one of the shareholders of the bank. It is important to formalize the arrangements with these companies."*
 - 6.3.3 A number of areas of concern were highlighted by E&Y in their closing due diligence in relation to the mutual funds (Exhibit B):
 - 6.3.3.1 A significant decrease of Net Asset Value of mutual funds and its impact upon Uniastrum. Total Net Asset Value of Uniastrum mutual funds declined from €100.244m in December 2007 to €13.195 million in September 2008 (659% fall);
 - 6.3.3.2 The price per unit of 14 of the most significant mutual funds decreased more than 85%. The net asset value of these funds dropped €80 million. The explanation by management was due to an overall drop on the securities market and liquidity crisis on the Russian market.
 - 6.3.3.3 Negative publicity in regard to mutual funds - E&Y highlighted negative press articles in regard to mutual funds run by Uniastrum, including protests outside the headquarters of Uniastrum. Press reports indicate that Uniastrum's securities licence was suspended for 2 weeks in December 2008;
 - 6.3.3.4 Outstanding REPO transactions; and
 - 6.3.3.5 The liquidity of the promissory notes of Utrade LLC.
 - 6.3.4 In an E&Y memo dated 17 October 2008 to Ms Pantelidou (forwarded to BOC executives), titled *"Memorandum regarding the legal framework with respect to mutual funds of LLC "Uniastrum Bank" and valuation of legal risks with respect to purchase of such mutual funds"*, E&Y opined: *"...the Target [Uniastrum] has violated and/or has failed to comply with the requirements to the form of the General Terms and the Investment Declaration as well as with the requirements to managing OFBUs, established in the General Terms and the Investment Declaration as well as determined in applicable legislation. In this connection the Target may be subject to administrative sanctions by the Bank of Russia..."*
 - 6.3.5 The memo described the negative effects of the issues identified and the potential fiscal and legal repercussions of such negative events.
 - 6.3.6 The Joint Instructions document set out that \$67,095,992 was placed in Escrow in respect of potential losses resulting from the impairment of the assets attributed to the mutual funds managed by Uniastrum.
 - 6.3.7 Any amount remaining in Escrow after the "Escrow release date V (31 October 2011) was to be released to the Sellers as per the ratio detailed in the SPA.
- ### **6.4 Escrow Account**
- 6.4.1 Upon acquisition of Uniastrum, BOC was to pay consideration in return for 80% of the share capital. A portion of the purchase price was to be paid up front to the sellers and another portion placed in Escrow awaiting release on the fulfilment of certain criteria.

6.4.2 The Escrow account was devised to provide protection to BOC from selected non-performing loans ("NPL") and losses relating to the mutual funds (see pages 23 and 24). Funds that were formulaically linked to the NPLs and the mutual funds were deposited in an escrow account with a corresponding amount being deducted from consideration paid for Uniastrum. This amount was to be held in "Escrow" with an agent and released to either the buyer or the seller upon fulfilment of certain conditions.

6.4.3 We note that the escrow account mechanism only adjusts for lx bad debts and the impact of the mutual fund issues when the transaction multiple would be appropriate to protect BQC's entity value.

6.4.4 If performance of the loans was agreed, BOC directors notified the Escrow agent to release the relevant amount to the sellers of Uniastrum. If it was confirmed that the loans had not performed, then BOC was entitled to instruct the agent to release the relevant amount to BOC. Attached to the Escrow Agreement were "Joint Instructions" ("JI") , which were provided to the external agent who administered the Escrow account. This document governed the way in which the funds were to be disbursed and what approvals were required before disbursement.

6.4.5 The JI shows that a sum of US\$226,615,884 was to be paid into Escrow Account 1 and US\$67,095,92 was to be paid into Escrow Account 2 (a total of US\$293,711,876).

6.4.6 The sum paid into Escrow Account 1 was equivalent to 60% of the total value of the "Reviewed Loans list", and was withheld from the initial payment of consideration as per the SPA. The Reviewed Loan list included the name of the holder of the loan, maturity date, balance and applicable interest rate, the advisers' determined total value of all loans. Loans were to be reviewed periodically by the advisor and after each loan review a report was to be provided to the BoD by the adviser confirming any loans which had been repaid in full for the period of the loan review, and those that had not been repaid having matured during the period of the Loan review.

Board Approval of the Acquisition

1 Summary of Board of Directors' Involvement

1/3

Commencement of **Financial &**

Legal **DD 11/6**

Presentation of acquisition proposal to BoD - BoD supported acquisition

\

\

Apr

¥

KEY:

BOC = Bank of Cyprus UB * Uniastrum Bank BOC (Russia) * BOC (Russia) Holdings Ltd
CBC = Central Bank of Cyprus CBR = Central Bank of Russia BoD = Board of Directors DD - Due Diligence NBO « Non-binding Offer letter SHA = Shareholders' Agreement SPA = Participation

Share Purchase Agreement 29/5

Executive Committee presentation

26/6 BoD resolution to proceed with acquisition for 80% at US\$576

Signing of Agreements (SPA, SHA, etc) 30/10

BoD meeting discussing closing DD & approved completion

22/10 Pre-closing DD reports received

—T~----- 7T

Sep /Oct

/

/
23/6 - 26/6 DD reports available to BoD
9/10 BoD meeting
discussing global financial crises &
DD findings
27/8 Presentation to investors
29/10 DD reports available to BoD

A

7.2 Board of Directors - Consideration of Acquisition

7.2.1 At the 26 June 2008 BoD meeting, a detailed presentation was given consisting of background to the strategic rationale; due diligence scope and findings, valuation and transaction structure (Exhibit C).

7.2.2 Although full due diligence documents were made available to the BoD from 23 to 26 June 2008, select due diligence findings appear not to have been included or adequately reported in the BoD presentation such as the following (which were identified in BOCs Internal Audit review of August 2012):

7.2.3 Unistream:

7.2.3.1 The BoD presentation states "*Operations related to Unistream accounted for approximately a third of all fee and commission income in 2007¹ and that "Uniastrum's most important fee generating activities are its money transfer agreement with Unistream [as well as fees for retail and corporate cash settlements]"/*"

7.2.3.2 E&Y's due diligence report advised that Unistream is ultimately owned by one of the shareholders of Uniastrum and recommended formalising arrangements with Unistream. This was not included in the BoD presentation.

7.2.4 Related party transactions:

7.2.4.1 E&Y's finding that the shareholders/ultimate owners own and/or control many other companies

and they have the opportunity and power to influence the bank decisions, including the granting of loans, was not disclosed in the BoD presentation.

7.2.5 25 out of 43 Uniastrum branches were loss making - this was not included in BoD presentation.

7.2.6 In addition, the 30 October 2008 BoD minutes note that closing due diligence documents were made available to the BoD the day before the meeting (available from 9.30 am to 6.00 pm) in which they were asked to approve the transaction (Exhibit C). Some members of the BoD felt that this was not sufficient time for them to adequately scrutinise the findings. In interview, Mr Xenephontos stated that he did not feel that the BoD was provided with enough time to review the documents properly.

8. BOC's Ability to Renegotiate / Withdraw

- 8.1.1 BOC sought legal advice from White & Case on the provisions of the SPA that could allow BOC to withdraw from the transaction or re-negotiate the purchase price with Uniastrum, in the light of *"the current crisis in the banking sector"*, and potential adverse affects on the future prospects of Uniastrum.
- 8.1.2 The White & Case memo stated that they understand the deal *"may now represent o bod or unacceptable bargain for the Bank of Cyprus"* (Exhibit D).
- 8.1.3 While the SPA had been signed in June 2008 and did not specifically allow for a retraction, the legal advice from White & Case stated that BOC may be able to withdraw from the agreement or re-negotiate price using a number of limited sections of the SPA, including:
- 8.1.3.1 Proving a material adverse change ("MAC") in net assets; or
- 8.1.3.2 A misleading warranty by the sellers.
- 8.1.4 The legal advice stated that retraction from the SPA due to general market conditions is not specifically provided for and that the law is unclear in some areas (such as relying on a "MAC" clause). White & Case recommended seeking English law Counsel opinion on these matters but it appears that no such opinion was sought.
- 8.1.5 The email attached to the memo from White & Case stated the advice was discussed between external legal advisors (Chryssafinis and Polyviou), Messrs Eliades, Kypri and Hadjimitsis. Mr Hadjimitsis could not remember receiving the legal advice and stated that at the BoD meeting on 30 October 2008, the option of withdrawing was never realistically pursued (although there was discussion of re-negotiating the purchase price). He said *"we never discussed what ammunition we have to withdraw from the agreement"*.
- 8.1.6 BOC acknowledged the impact that *"unfavourable financial developments"* may have on the deal, but wanted to continue with the acquisition as a *"strategically important decision"* for fear of losing respect of BOC shareholders and investors. The Board minutes state that *"if the effort was abandoned, there would be negative consequences on the reputation and image of the [BOC], which would be very hard to manage"*.
- 8.1.7 Mr Kypri stated that the question arose of whether BOC should renegotiate the acquisition price, *"given that Russia [was] starting a phase of recession"*. He stated that the option to renegotiate was not *"officially put on the table"*. The question of whether BOC could pull out of the deal if things were bad or going to get worse was discussed. Mr Kypri said the BoD discussed whether this was a legal option, and the impact this would have on *"our reputation in the Russian market image, given that we have a very large number of Russian clients."*, such that withdrawing may be seen as a *"vote of no confidence in Russia"*.
- 8.1.8 Chryssafinis & Polyviou stated at the BoD meeting that *"any external factors referring to the changes of the economic environment do not constitute a good cause for the termination of the agreement since no material changes have occurred in Uniastrum. Thus, any attempt to withdraw from the agreement would implicate the Group in long-term legal procedures."*
- 8.1.9 There was discussion whether to proceed with the acquisition in light of the financial crisis. Mr Eliades stated that *"if something material comes up we can withdraw"*, but noted *"there is no*

material change (i.e. the d.d. has not revealed any material change)."

- 8.1.10 The executive management were very determined to proceed with the purchase and, even in light of the deterioration in the economy, thought it was a good investment and a good price for BOC.
- 8.2 Board of Directors Opinion on BOC Withdrawal from the Deal
- 8.2.1 Mr Piskov and Mr Zakaryan respected BOC for sticking to their deal and also felt at the time that Uniastrum was no less an attractive proposition and that the market would turn around in a short timeframe (Russia was used to stock market volatility).
- 8.2.2 Mr Karydas believed if BOC wanted to pull out of the deal they would have found an adverse change. The only person who Mr Karydas remembers expressing a view about pulling out was Mr Xenophontos.
- 8.2.3 With reference to renegotiating the price, the minutes state the Executives thought the price agreed was still favourable and as they would be paying 3.1x net asset value rather than 3.8x as previously agreed (or 4x as per initial discussions), *"we are getting a better deal"*.
- 8.2.4 Mr Eliades stated that *"further negotiating pressure may cut the rope linking us [BOC] with the previous owners"*. The owners of Uniastrum, Mr Piskov and Mr Zakaryan, remained as Chairman and President respectively, retaining a 10% holding each.
- 8.2.5 Mr Xenophontos's notes of the BoD meeting state that he mentioned *"the due diligence report brings to the surface enough material to enable us to reduce the price significantly, if not abandon the deal altogether"*, and notes that although the escrow account provides some protection, *"it diverted our attention away from the price which is 3.1 times BV [book value] and not 1:1"*.
- 8.2.6 Fitch Rating on 3 November 2008, downgraded BOCs Long-term Issuer Default rating ("IDR") to BBB+ from A- and s stated that *"the recent acquisition of UB [Uniastrum] has an adverse impact on the group's risk profile. The agency views the pricing and timing of the acquisition as unfavourable, after the severe deterioration in the Russian capital markets has impacted the value and prospects of UB"*.
- 8.2.7 Despite the worsening economic situation and the Russian economy showing signs of deceleration (e.g. on 23 October 2008, S&P revised Russia's credit rating outlook to Negative), the BOC did not act upon the legal advice or the provisions of the SPA that may have been available to them as an opportunity to re-negotiate the purchase price or withdraw from the deal with Uniastrum.
- 83 Material Adverse Change
- 83.1 "Material Adverse Effect" is defined in Paragraph 10.2 of Schedule 2 of the SPA as any material adverse change in or effect on any of the following:
- 8.3.1.1 the business (including ability to conduct business), assets (including ability to acquire assets), liabilities, financial condition, trading position, future prospects and/or results of operations of the Bank or any of the Sellers; and/or
- 8.3.1.2 the ability of any of the Sellers to perform its/his/her respective obligations under any of the Transaction Agreements.
- 8.3.2 White & Case advised it is additionally a condition precedent to Closing under the SPA (Clause 7.2(i)) that:
- 8.3.2.1 *The Purchaser in its sole discretion shall be satisfied with the results of the closing financial and legal review that it and his appointed financial and legal advisers have undertaken in respect of the Bank and Uniastrum Leasing, within four (4) weeks prior to the date of the Closing. Such a review will include, but not be limited to ... analytical review of the Bank's performance in the period between 1 January 2008 and the date of the review, review of the loan portfolio of the Bank....*
- 8.3.3 White & Case advised that *"to the extent that difficulties in the banking market have a material effect on the Bank's loan and other assets, and such effect is capable of being measured in accounting terms in the course of the financial review, this clause should allow the Purchaser not to proceed with Closing" [our emphasis]*.
- 8.3.4 E&Y was instructed by BOC to perform closing due diligence work (based on IFRS unaudited

management accounts for the 9 months to 30 September 2008). E&Y identified adjustments to net assets decreasing the draft unadjusted net assets from €148.6 million to €119.1 million (including tax) as at 30 September 2008. They also identified additional nonperforming loans amounting to €57 million and the total exposure of loans secured only by guarantees increased to €301m (€230m at FY07).

8.4 Capital Injection

8.4.1 It appears that one of the attractions of purchasing Uniastrum from both BOC and the sellers' perspective was Uniastrum's need for capital. BoD minutes for 26 June 2008 state that *"Uniastrum has reached a point where it cannot further develop on its own, mainly due to lack of funds"* (Exhibit C).

8.4.2 A capital increase of US\$50 million in Uniastrum was to be completed at closing as noted at the 26 June 2008 BoD meeting and as set out in the SPA, *"to further strengthen the capital adequacy of Uniastrum Bank"*. Uniastrum financial statements for 2009 indicate that *"BOC agreed to upsize Uniastrum's charter capital by 50mn USD"*

8.4.3

However, we have identified that BOC lent funds to Uniastrum prior to acquisition as follows:

8.4.4 Group ALCO ratified the lending of US\$15 million for three months by BOC (Russia) to Uniastrum Bank on 26 August 2008, committing to placing funds (RUB 360 million) with Uniastrum Bank until 25 November 2008; and

8.4.5 BOC Russia placed RUB 740 million for three months (equivalent of c.US\$30 million) (12% for three months) on 17 September 2008, to be retrospectively ratified at ALCO meeting on 29 September 2008 (the minutes of the ALCO meeting make no reference to such ratification).

8.4.6 There appears to have been further provision of liquidity support to Uniastrum before the deal was completed. We are advised that Bank Kypra (BOC's existing Russian bank) purchased loans from Uniastrum for c€60-80 million, and that these loans were eventually sold back to Uniastrum for profit before Bank Kypra merged into Uniastrum. Mr Ergatoudes (BOC Russia) was instructed by BOC Head Office (Mr Hadjimitsis) to purchase the loans and these were approved by the BOC Executive Loans Committee on 30 October 2008.

8.4.7 In interview, a former Uniastrum employee was *"horrified"* that the BOC was purchasing assets from Uniastrum prior to acquisition to *"prop it up"*. He found this to be very unusual and raised this concern with Mr Hadjimitsis; however the response was that if BOC did not buy these assets the deal to purchase Uniastrum would fall through.

8.4.8 Mr Karydas advised that Uniastrum required funds to *"survive"* pre acquisition and that *"all the Russian banks had liquidity problems"*. The liquidity crisis was caused by a run on all Russian banks (following the collapse of two banks) and with an aggressive expansion of lending in anticipation of the completion of the acquisition.

8.4.9 Although it is noted in the BoD meeting of 26 June 2008 that *"Uniastrum has reached a point where it cannot further develop on its own, mainly due to lack of funds"*, it is not clear that the full extent of loans and financial support to Uniastrum prior to acquisition was disclosed to the BOD. It is not clear whether the required financial support prior to acquisition could be construed as a material adverse change for purposes of rescission or termination of the deal.

CBC Approval of the Acquisition

1 Summary of CBC Consideration and Approval
2/7

BOC requests approval for US\$576m + \$50m capital increase to be paid by BOC Russia. Requests BOC (Russia) is considered liquid for monthly reporting

KEY:
BOC = Bank of Cyprus UB - Uniastrium Bank BOC (Russia) = BOC (Russia) Holdings Ltd CBC - Central Bank of Cyprus CBR = Central Bank of Russia BoD = Board of Directors
4/7

CBC asks CBR for objections or concerns
3/9

CBC request confirmation of
adequate risk procedures
& copy of BoD approval
minutes from BOC

. .

11/9
BOC responds to CBC with BoD minutes &
10/7 confirmations
CBC approves transfer to BOC (Russia) & capital increase solely for UB acquisition
26/6 BoD approve acquisition proposal

4/9
CBC Licensing prepare internal report on acquisition
29/9
Mr Poullis (CBC) writes to Governor summarising CBC licensing report of 4/9 & recommending approval

9.2 Central Bank Approval of Uniastrum Acquisition

9.2.1 BOC (and Uniastrum) requested approval of the transaction by the Central Banks of Cyprus and Russia following the announcement to the market on 26 June 2008 (Exhibit G).

9.2.2 The CBC contacted the CBR on 11 July 2008 asking whether they had any queries with the transaction and stating that BOCs *"financial standing is considered sound"*. The CBR responded on 5 September 2008 (received stamped by CBC on 19 September 2008), raising no major issues.

9.2.3 Mr Poullis went to Russia twice (15-17 July 2008 and 24-26 August 2008) to meet with the CBR prior to the acquisition - he said that he agreed with BOCs purchase of Uniastrum and did not see any regulatory issues suggesting the CBC should not give its approval.

9.2.4 The CBC approval was based upon BOCs submitted application and additional documents requested (such as BoD minutes, BoD presentation, due diligence etc)

9.2.5 When reviewing the application, the CBC noted initial due diligence reports highlighted issues, including:

9.2.5.1 General challenges; poor corporate governance, difficulties in determining shareholders' indirect beneficial ownerships, high proportion of loans with unclear substance, poor profitability, etc;

9.2.5.2 Due to recent asset growth but poor internal capital generation, capital adequacy is a constraint;

9.2.5.3 Before 2007, employee compensation (up to 40% of staff costs) was paid unofficially (unrecorded cash payments) to reduce Uniastrum's tax obligations.

9.2.6 CBC's licensing department evaluated the information (including initial due diligence findings) and prepared a report to Mr Poullis (Senior Director Banking and Supervision and Regulation department). Mr Poullis reviewed this report and summarised it with a recommendation to the Governor of the CBC.

9.2.7 Mr Poullis wrote to the Governor of the CBC on 29 September 2008 (Exhibit E) summarising the report prepared by CBC licensing dated 4 September 2008 and recommending approval of the transaction.

9.2.8 With reference to the agreed price of US\$576m (EUR371m), Mr Poullis stated it was *"not exceedingly high as compared to other similar acquisitions"* and that: *"According to international analysts, the acquisition multiplier (price to book value - P/BV), amounts to 3.1, which is very attractive. It should be noted that other recent acquisitions - that of Expobank by Barclays and that of Investtorgbank by pension funds - amounted to 4.1."*

9.2.9 Mr Poullis stated that it was not the CBC's job to assess the valuations applied to purchases. He stated that although they do not assess these, they would consider appointing an expert to do so if they thought the values were unreasonable. In terms of Uniastrum, he said that the multiplier was less than Barclays and so did not think that the value was unrealistic.

9.2.10 Mr Poullis stated *"7η conclusion and taking into account (a) the developing Russian market, (b) the relatively low cost of acquisition of Uniastrum, (c) the fact that the majority of the problems of Uniastrum have been identified and sufficient safeguards have been introduced, (d) that the Central Bank of Russia has not reported anything negative in relation to Uniastrum and/or its shareholders and (e) that the cost of the proposed acquisition does not negatively affect the share capital of the Bank of Cyprus, I recommend that we give our approval to the Bank of Cyprus regarding the proposed acquisition."* (Exhibit E)

9.2.11 The CBC wrote to BOC on 30 September 2008 approving the transaction (Exhibit F).

9.2.12 CBC approved the transaction prior to E&Y's closing due diligence report of 22 October 2008.

9.2.13 Mr Poullis could not remember if E&Y had conducted closing due diligence. In terms of whether the CBC approval decision could change before the final completion, Mr Poullis accepted that this could be the case if there was a fundamental change, but this was not the case with Uniastrum.

9.2.14 In his letter of recommendation to the Governor of the CBC of 29 September 2008, Mr Poullis does not reference the developing economic downturn (including Lehman Brother's bankruptcy) or

any impact this may have on the price agreed between the parties in June 2008.

9.2.15 In terms of the changes in the market post Lehman, Mr Poullis stated that the CBC did not consider the Lehman collapse as particularly relevant as during the 2007 banking crisis in the US, the Cypriot banks were largely unaffected and so the CBC saw no reason why the Lehman collapse would impact the Russian acquisition.

9.2.16 We note, however, that Fitch Rating on 3 November 2008, downgraded BOC's Long-term Issuer Default rating ("IDR") to BBB+ from A-. Fitch's stated that *"the recent acquisition of UB [Uniastrum] has an adverse impact on the group's risk profile. The agency views the pricing and timing of the acquisition as unfavourable, after the severe deterioration in the Russian capital markets has impacted the value and prospects of UB ... If net deposit outflow continues, Fitch would expect BOC to support its 80%-owned subsidiary, in turn putting funding pressure on the group [BOC]"*.

9.2.17 We have seen no evidence to suggest that the acquisition was re-evaluated in-between the CBC licensing department's report of 4 September 2008 and Mr Poullis' letter to the Governor of the CBC on 29 September 2008.

10. Allegation of Corrupt Payments

10.1.1 During our Investigation, we have received confidential statements that we construe as rumours that corrupt payments were made in relation to the Uniastrum acquisition. The rumours were similar and related to a total amount of €50 million being distributed from the sale proceeds to five separate individuals.

10.1.2 We have been unable to substantiate these allegations to date despite interviews with numerous individuals including the sellers of Uniastrum and BOC officers.

10.1.3 Personal bank statements of the two Uniastrum shareholders were requested but have not been provided. These were requested to understand where sale proceeds were received by each shareholder, to confirm amounts were in accordance with the SPA and to confirm that no inappropriate payments were made out of these accounts to individuals involved in the deal. Mr Piskov and Mr Zakaryan refused to provide personal bank statements stating:

10.1.3.1 *"We are involved in a number of businesses outside Uniastrum and Bank of Cyprus Group, and we are not comfortable to divulge the information about these business projects to the third parties."*

10.1.4 With reference to the allegation of corrupt payments, Mr Zakaryan stated:

10.1.4.1 *"...the allegations of bribery and corruption in the Uniastrum transaction are completely unfounded. As far as our personal accounts are concerned, we confirm, that no payments have ever been made to any of the Bank of Cyprus Group officials."*

10.1.5 Accounting documentation of Bank Kypra was passed to the new owners when purchased in 2010. Therefore, if any purchase price payments were funneled through Bank Kypra, bank statements and payment instructions to support these would not be held by BOC or Uniastrum. Only some legal documentation from Bank Kypra was transferred over to Uniastrum (as confirmed by the Legal Officer).

11. Recommendations for Further Work

11.1.1 Given the absence of subpoena power attendant to the Investigation, there are certain matters that could not be pursued. It is recommended that more clarity would likely be available in the event that the following matters were pursued by parties with such enforcement authority:

11.1.1.1 Compel production of bank statements to ascertain the payment trail of payments associated with the acquisition;

11.1.1.2 Acquisition and review of electronic data from Russia; and

11.1.1.3 Procurement and analysis of post acquisition disbursement of funds from the Escrow account.

At

INVESTIGATION REPORT
BANK OF CYPRUS - MARFIN POPULAR BANK GROUP -
REVIEW OF CROSS-BORDER MERGER

PREPARED FOR THE CENTRAL BANK OF CYPRUS

26 MARCH 2013

ALVAREZ & MARSAL GLOBAL FORENSIC AND DISPUTE SERVICES, LLP
STRICTLY PRIVATE & CONFIDENTIAL

Table of Contents

1 INSTRUCTIONS.	1
1.1 INSTRUCTIONS ..	1
2 EXECUTIVE SUMMARY	2
3 TIMELINE OF EVENTS ..	3
3.1 BACKGROUND .	3
3.2 PRINCIPAL CONCERNS ..	3
4 THE CBC'S SUPERVISION OF MEB	4
5 RELEVANT LEGISLATION AND POWERS	5
5.1 RELEVANT LEGISLATION	5
5.2 THE BANKING LAW.	5
5.3 CBC RELEVANT POWERS....	5
6 CONSEQUENCES OF THE PROPOSED MERGER	6
6.1 CONSEQUENCES OF CHANGING MEB FROM A SUBSIDIARY TO A BRANCH	6
6.2 TRANSFER OF GREEK LIABILITIES TO CYPRUS..	6
6.3 CBC'S KNOWLEDGE OF POTENTIAL LIABILITIES	6
7. CONCLUSIONS AND RECOMMENDATIONS.....	7

1. Instructions

1.1 Instructions

1.1.1. Alvarez & Marsal ("A&M") was instructed by the Central Bank of Cyprus ("CBC") on 21 August 2012 to conduct an Investigation as independent persons, appointed in accordance with Section 24 of the Central Bank of Cyprus Laws of 2002 to 2007, to assist the CBC in accordance with the Mandate (the "Investigation").

1.1.2.

Specifically, the Investigation was tasked with assisting "the Governor to take all necessary legal and regulatory remedies, whether they concern the conduct of supervision by the Bank, the procedures followed by some systemically important local banks (hereinafter referred to as "the Cypriot banks") to acquire Greek Government Bonds and / or investing abroad in the form of a branch network and/or subsidiaries banks, having regard to the requirements specified by the provisions of the Banking Laws of 1997 to (No. 2) 2011 and the Central Bank of Cyprus Laws of 2002 to 2007 and the Regulations / Directives/ Guidelines issued under these Laws, or otherwise at the discretion of the Governor".

1.1.3. This report sets out findings, conclusions and recommendations based on our work conducted up to 26 February 2013 in relation to the cross-border merger of Marfin Popular Bank ("MPB") and Marfin Egnatia Bank S.A. ("MEB") and the CBC's regulation of this merger.

- 1.1.4. This report has been prepared for the CBC solely for use in relation to the Investigation and must be read in conjunction with our Statement of Protocol of 26 March 2013. It may not be used for any other purpose, reproduced or disclosed to any other party in whole or in part without our prior notice. In no event, regardless of whether notice has been provided, will we assume any liability or responsibility to any third party to which this report is disclosed or otherwise made available.

2. Executive Summary

- 2.1.1 On 2 July 2012, Marfin Popular Bank Group received a €1.8 billion bail out from the Cypriot Government which was needed to recapitalise the bank following losses sustained on its holdings of Greek Government Bonds and its loan portfolio. The size of the bail out has led to allegations that the funds required were exacerbated by the conversion of MPB's Greek subsidiary into a branch, thereby transferring liability from Greece to Cyprus.
- 2.1.2 The initial intention of MPB was to move the head office from Cyprus to Greece, however, following the announcement of this decision on 19 May 2009 there were concerns raised in Cyprus over the reputational damage and economic loss that would result from one of the Republic's systemic banks moving to Greece. As a result MPB decided to merge the banks such that the head office remained in Cyprus and the Greek operations became a branch of the Cypriot bank.
- 2.1.3 Prior to the conversion of the Greek subsidiary there would have been no legal requirement for MPB to recapitalise MEB following the losses sustained through PSI and its loan portfolio. As a subsidiary it would have been a separate legal entity that was under the supervision, and therefore the fiscal responsibility, of Greece. However, a number of factors suggest that the parent, although not legally responsible, would have been required to recapitalise its subsidiary.
- 2.1.4 Prior to the finalisation of the cross-border merger in March 2011, the Bank of Greece ("BOG") had conveyed in writing to the CBC its concerns about MEB's concentration and credit risk policies and the control weakness identified during its Supervisory Review and Evaluation Process ("SREP") review on the 31 December 2009 data.
- 2.1.5 The appropriateness, and financial impact, of the conversion of the subsidiary to a branch needs to be considered in the light of a number of factors:
- 2.1.6 The reorganisation of the bank was, in part, motivated by reducing the time and costs of dealing with two regulators. The initial plan was to move the headquarters of the merged bank to Greece. However, following apparent political and other pressure from Cypriot stakeholders this was reversed and the merged bank's regulatory control was to rest with Cyprus.
- 2.1.7 Prior to the conversion to a branch, the CBC regulated the Greek operations on a consolidated basis. When an attempt was made by the CBC to visit MEB in Greece, the CBC was not afforded access on the basis that the bank's regulator was the BOG. As a branch of the Cypriot bank the CBC had full supervisory control of the Greek operations.
- 2.1.8 The powers of the CBC in respect of the conversion to a branch did not enable it to force the status quo, instead the CBC faced the option of accepting the conversion or ultimately forcing MPB to terminate its operations in Greece.

3. Timeline of Events

- 3.1 Background
- 3.1.1 Cyprus Popular Bank Co (formerly known as Marfin Popular Bank) is one of the largest banking groups in Cyprus and the Hellenic region. In 2006 the mergers in Greece of Egnatia, Laiki and Marfin formed Marfin Egnatia Bank which was 95% owned by Marfin Popular Bank.
- 3.1.2 Following the merger, the structure of the Group was such that the parent company, MPB, was located in Cyprus, with its subsidiary, MEB, based in Greece.
- 3.1.3 On 15 May 2009 the Board of Directors ("BOD") of the MPB Group approved a decision to

undertake a cross-border merger of MPB and MEB, with the original intention being to move the head office of the merged bank from Cyprus to Greece.

- 3.1.4 The decision to undertake the merger was motivated by a number of factors, one of which was the desire to reduce the regulatory and financial burden on the MPB Group of dealing with two regulators. The decision to move the head office from Cyprus to Greece was also due to concerns over the regulatory environment in Cyprus and MPB's alleged unfavourable treatment by the Cypriot regulator as compared to its competitors.
- 3.1.5 Following the announcement on 19 May 2009 of the decision to move the head office, there were concerns raised in Cyprus over the reputational damage and economic loss that would result from one of the Republic's systemic banks moving to Greece.
- 3.1.6 Following these concerns, Mr Andreas Vgenopoulos ("Mr Vgenopoulos"), as Vice Chairman of MPB, attended a Cypriot Parliamentary session on 13 July 2009.
- 3.1.7 At this Parliamentary session, Mr Vgenopoulos cited his frustrations with the Cypriot banking regulatory system in general, and raised the following concerns:
 - 3.1.7.1 Alleged unfavourable discrimination of MPB compared to Cypriot competitors;
 - 3.1.7.2 Alleged governance issues within the CBC;
 - 3.1.7.3 The CBC permitting one of its former employees, who had been working on an investigation into MPB, to take up a position with a competitor with immediate effect (and the associated confidentiality issues); and
 - 3.1.7.4 That certain CBC requirements on regulatory capital were too strict compared to European counterparts' requirements.
- 3.1.8 Subsequent to this parliamentary meeting, on 15 September 2009, the BOD of MPB approved a revision to the cross-border merger under which MEB would be absorbed into MPB, with the head office of the merged entity to be in Cyprus, under the supervision of the CBC
- 3.1.9 The minutes of the BOD meeting set out that this change in the cross-border merger was due to political and other pressure from Cypriot stakeholders.
- 3.1.10 Despite the BOD approval for the merger being given on 15 September 2009, the merger did not proceed at this time on account of legislation on covered bonds not being passed by the parliament in Cyprus. This meant that €1 billion of covered bonds issued by MEB could not be transferred to MPB until this law came into effect on 23 December 2010.
- 3.1.11 On 15 December 2010, the District Court of Nicosia approved the completion of the cross-border merger of MEB and MPB, in accordance with EU Directive 2005/56, with the merger being finalised on 31 March 2011.
- 3.1.12 In accordance with the Banking Laws of Cyprus and Article 25 of the EU Directive 2006/48/EC the CBC sent a letter dated 22 March 2011 to the BOG informing them of MPB's intention to establish a branch in Greece.
- 3.1.13 On 2 July 2012, MPB Group received a €1.8 billion bail out from the Cypriot Government which was needed to recapitalise the bank following losses sustained on its holdings of Greek Government Bonds and the loan portfolio. As a result of the approved merger of MEB into MPB, the bail out required from the Cypriot Government included the liabilities of the Greek operations and prompted questions regarding the approval of the merger.

Timeline of Events

13/7/09

Mr Vgenopolous attended the

Cypriot Parliamentary Meeting to discuss, inter alia, concerns that the Cypriot banking regulatory system was too strict and liquidity requirements were too onerous

15/12/10 Following the enactment of the Cypriot Covered Bond Law, the District Court of Nicosia approved the cross-border merger of MEB into MPB

2009

2011

30/6/09 The MPB Group considered the merger to have taken place from an accounting perspective as of 30 June 2009, as evidenced in the Group's 2009

Annual Report 15/9/09 Internal decision to alter the structure of the cross-border merger via the absorption of MEB into MPB approved 22/3/11

The CBC notified the Bank of Greece of MPB's intention to establish a branch in Greece, in accordance with Article 25 of EU directive 2006/48/EC on the freedom of establishment of a branch in another member state of the EU

Page 7



3.2 Principal Concerns

- 3.2.1 The question underpinning the review of the cross-border merger is whether or not, following the losses sustained from the PSI and the deterioration of the Bank's loan portfolio, Cyprus had to provide materially more funding to bail out MPB than it would have done had the merger not taken place.
- 3.2.2 This needs to be considered in conjunction with:
- 3.2.2.1 Whether, given the contemporaneous information, the CBC maintained a desire to prevent the merger;
- 3.2.2.2 Provided that the CBC had the desire to prevent the merger, it maintained the regulatory and legal authority to do so;
- 3.2.2.3 The politically sensitive situation in respect of the merger. The initial plans for the merger were to move the banking operations, and therefore the liabilities, to Greece. It was in part due to the political pressure that the Bank decided to remain headquartered in Cyprus and therefore moved the Greek operations so as to be supervised by the same supervision authority as the headquarters; and
- 3.2.2.4 Even if the status quo had remained, whether the Cypriot parent of MEB would have been pressured to recapitalise its subsidiary even though there is no legal obligation to do so.

4. The CBC's Supervision of MEB

- 4.1.1 Prior to the conversion of MEB to a branch of MPB, the CBC was the primary regulator in respect of MPB and regulated MEB on a consolidated basis. The principal supervision in respect of MEB was conducted by BOG and the CBC was entitled to conduct supervision reviews of MEB in co-operation and conjunction with the BOG.
- 4.1.2 Whilst MEB was regulated in Greece, the CBC sometimes found it difficult to properly supervise the bank as they were not afforded access on the basis that the BOG has supervisory responsibility for the bank. As a result, one of the arguments in favour of the merger is that it provided the CBC with stronger regulatory powers in respect of the Greek operations on the basis that primary supervisory responsibility for the newly established branch rested with CBC.
- 4.13 Post finalisation of the merger, the CBC undertook a SREP review, following which it required MPB to hold €1.56 billion of additional capital against its sovereign bond portfolio and €2.1 billion against its loan portfolio (51% of which was concentrated in Greece).
- 4.1.4 The table below summarise the main interaction of the CBC with BOG and MEB between October 2008 and March 2011:

Onsite examination October 2008

Joint onsite examination visit with BOG in March 2009

The CBC was not afforded access to MEB on account of BOG being its primary regulator

- €800 million of loans granted to various entities for the purpose of investing in MIG, structured as bullet loans
- Loans granted to the MIG Group on favourable terms (e.g. low interest rates, long term repayment etc)
- Deterioration of profits by 68% due to low margin and an increase in provisions for NPLs
- Concerns over conflicts of interest on the BOD
- Overall assessment of MEB as a high risk entity

The CBC undertook a joint onsite examination with the BOG

CBC required MPB to hold additional capital to cover the risks identified in its subsidiary, and to increase provisions for NPLs

On 27 January 2011 CBC wrote to BOG asking if, in light of the cross-border merger of MPB and MEB, the BOG had any supervisory concerns over MEB

The BOG set out that, following its SREP review of MEB (based on 31.12.09 data) it had rated MEB at 3.25 under the Bank Risk Assessment System, which was lower than the average of the Greek banking system. The BOG set out that improvements were required to:

- Internal control systems (specifically relating to provisions for avoiding conflicts of interest and observance of sound risk management policies)
- Concentration risk management policies

- Sustained inability of funds
- Credit risk provisioning policy

Following CBC's own SREP review on data for the 15 months to 31 March 2011, the CBC required MPB to hold additional capital of €2.1 billion against its consolidated loan portfolio

The BOG also stated that MEB's credit risk was higher than assessed under its ICAAP, and additional capital should be held to mitigate this risk

The CBC instigated quarterly and then monthly sovereign bond reporting from June 2009	The MPB Group held c€3 billion of GGBs, with approximately €2 billion booked in CBC required additional capital of MEB and €1 billion in MPB	€1.5 billion to be held against the sovereign bond portfolio
---	--	--

5. Relevant Legislation and Powers

5.1 Relevant Legislation

5.1.1 External legal advice in respect of the conversion of MEB from a subsidiary into a branch of MPB has highlighted three key areas of legislation that are relevant in considering the requirements of the regulators and the bank wishing to convert its subsidiary into a branch.

5.1.1.1 Law 66(I)/1997 on Banking Activities (the "Banking Law");

5.1.1.2 EU Directive 2005/56/EC on cross-border mergers of limited liability companies (the "Mergers Directive"); and

5.1.1.3 EU Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions (the "Credit Institutions Directive").

5.1.2 The Mergers Directive has been integrated into Cypriot company law and sets out the requirements in respect of a cross-border merger of two or more limited liability companies within the EU. Although this is relevant to the merger of MPB in respect of the transfer of assets and liabilities and registering and consolidating the existence of the merged entity, it does not relate to the transferring of a subsidiary's banking licence into a licence for the parent company to operate a branch in another member state.

5.1.3 The Credit Institutions Directive, which has been incorporated into the Banking Law, is the relevant EU legislation in respect of the transfer of MEB into a branch of MPB.

5.2 The Banking Law

5.2.1 The outcome of the cross-border merger of MPB and MEB, was that a branch of a Cypriot registered bank was created in Greece, in place of a separate legal entity with its own Greek banking licence. The operations of that branch were therefore subsumed under the parent's banking licence, i.e. the licence granted to MPB by the CBC. Consequently the newly merged entity was governed by the Banking Law.

5.2.2 Sections 7 and 10 of the Banking Law set out the requirements in respect of a Cypriot bank that wishes to establish a branch in another EU member-state. Based on the legal advice received these procedures also apply in the case of a bank wishing to convert a subsidiary it holds in another member-state into a branch.

5.2.3 Under the legislation, in order for a bank to convert a subsidiary into a branch it must inform the CBC and provide them with all the relevant details of the branch, such as the business envisaged, structure of the branch, names of the responsible management and the capital base and capital adequacy ratios of the bank.

5.2.4 Once the CBC has received this notification it has three months to communicate the information to the supervisory authority of the host nation, which the CBC did in this instance. Alternatively, the CBC could refuse to do this, in which case it must notify the bank of the reasons for its refusal.

5.2.5 In addition to the approval process, the CBC retains the right at any time to impose new conditions in respect of any foreign branch that has been previously approved. This could include cancellation of the approval to have a foreign branch.

5.2.6 Furthermore, Section 30 of the Banking Law, provides a wide range of powers that include the ability of the CBC to restrict the scope of a bank's activities or set limits to a bank's network. These powers can be used where the CBC considers these actions necessary for the safeguarding of the interests of depositors or creditors.

5.3 CBC Relevant Powers

- 5.3.1 Other than the ability to refuse a notification/request to establish a branch in a member- state, the CBC has other discretionary powers available to it in respect of banking entities that fall under its remit.
- 5.3.2 Section 7(3) of the Banking Law provides that the CBC may, by giving notice in writing, revoke an approval granted in respect of the operation of a branch, and that the termination may be within such time limits as the CBC specifies in its notice.
- 5.3.3 Section 41(2) of the Banking Law states that in respect of the ability to revoke an approval, such a decision must, amongst other matters, take into account international best practice, the protection of deposits and the smooth running of the banking system. Furthermore, in all cases the CBC must provide reasons and directions in relation to any decision.
- 5.3.4 The revocation of the approval for MPB's branch in Greece could have had a significant impact on the Cypriot banking system as the CBC would have needed to set out the reasons for its refusal, such as the need to safeguard the interests of the depositors. Mr Costas Poullis, former head of Supervision at CBC, stated in his interview that revoking the approval for MPB to operate a branch in Greece, and therefore essentially terminating the Bank's operations in Greece, was not an option as it would have had a significant impact on the confidence of the banking sector. Mr Poullis stated that post the conversion to a branch, the CBC enforced stricter capital requirements on the bank.

6. Consequences of the Proposed Merger

6.1 Consequences of Changing MEB from a Subsidiary to a Branch

6.1.1 As a result of the conversion of the Greek subsidiary into a branch of MPB a number of advantages and disadvantages have been cited, some of these relate to the banking operations of MPB and others to the regulatory regimes, and are set out below.

- The CBC became the main regulator allowing access to **MEB's** books and records for supervision. This also allowed greater authority to be exercised over MEB when enforcing change (i.e. the CBC's regulatory control over a significant proportion of the Group's activities was enhanced).
- Post merger there was no requirement for separate capital to be held against operations at **MEB (i.e. the branch)**, where there had been as a subsidiary.
- On an individual entity basis, MPB's regulatory capital increased following the absorption of MEB which had the potential to free up more capital to employ elsewhere in the business (on the assumption that pre merger MPB held sufficient capital to cover regulatory requirements).
- Liability was transferred from the Greek deposit protection scheme to the Cypriot deposit protection scheme.
- As a subsidiary, and therefore a separate legal entity, there was no legal requirement for MPB to cover losses realised in MEB, or to recapitalise MEB should the need arise. (However, consideration should be given to the fact that there may have been political and /or other pressure on MPB to recapitalise MEB. Therefore in real terms the liability to recapitalise the bank may not have changed).
- Post the merger restructuring options available in the case of insolvency were reduced; whilst this would not necessarily be a primary consideration for a business when deciding on whether to operate a branch or subsidiary, a regulator should always consider the full implications of any actions taken by the institutions it regulates, in relation to all eventualities (including the possibility of that institution becoming insolvent).

6.2 Transfer of Greek Liabilities to Cyprus

6.2.1 One of the key concerns raised in relation to the approval of the cross-border merger was that by converting MEB from a subsidiary to a branch it was no longer a separate legal entity from MPB and therefore all assets and liabilities of the former subsidiary were subsumed into MPB.

6.2.2 Based on company law a subsidiary and parent are two separate legal entities and therefore the parent company does not, unless there are cross-guarantees in place, have the obligation to recapitalise a subsidiary based in another member state.

6.2.3 A branch, as distinct from a subsidiary, is inseparable from the parent and therefore any losses or financial commitments of the branch are the legal obligation of the parent.

6.2.4 The Vienna Initiative, launched in 2009, resulted in a number of large Western European

banks pledging to support their foreign subsidiaries in CESEE area. Whilst MPB is a bank based in the CESEE area the fact that there was consideration of parent companies supporting foreign subsidiaries in the event of a crisis demonstrates that more than the legal situation was being considered in relation to potential cross-border banking crises.

- 6.2.5 An IMF discussion note in 2011 regarding the question of branch or subsidiary states that although there is no legal obligation to support a subsidiary "*there is often an expectation that the parent will support its troubled affiliates*"

6.3 CBC's Knowledge of Potential Liabilities

6.3.1 Following the CBC's joint onsite audit with BOG in March 2009, the CBC was aware of the following issues with MEB's loan portfolio:

6.3.1.1 €1.3 billion of outstanding loans, representing 11% of the portfolio, had been granted for the purpose of investing in shares. These loans were structured such that the repayment of capital was only required at the end of the loan term via balloon payments. As such, MEB was exposed to an increased risk of non payment of capital and deteriorating profitability from the low interest rates.

6.3.1.2 Loans to MIG were granted on favourable terms, for example, at low interest rates and/or with long term repayment plans, further increasing the risks to which MEB was exposed.

6.3.1.3 Insufficient collateral held against loans, either due to incorrect procedures being followed at the time the loans were granted, or due to the deterioration of the value of the collateral without redress.

6.3.2 The above issues resulted in a significant deterioration in profitability of 68%, between 2007 and 2008 and, further, were due to weaknesses in concentration and credit control policies.

6.3.3 Prior to the finalisation of the cross-border merger in March 2011, the BOG conveyed in writing to CBC its own concerns about MEB's concentration and credit risk policies and the control weakness identified during its SREP review on the 31 December 2009 data.

6.3.4 Other than the 2009 onsite audit, CBC did not undertake any additional joint or independent reviews on MEB's data until after the merger was finalised despite the findings from the onsite review in March 2009 and the concerns raised by BOG in March 2011.

7. Conclusions and Recommendations

7.1.1 It is apparent from the Investigation that the CBC did not take any actions to stop the cross-border merger which essentially transferred the liability of the former Greek subsidiary to Cyprus. The lack of action on the part of the CBC is due to the following key factors:

7.1.1.1 The structure of the regulation and legislation is such that under the Mergers Directive the bank did not require any authorisation from the CBC, this resulted in the bank being able to transfer the assets and liabilities to Cyprus without approval from the CBC.

7.1.1.2 The subsequent notification of the conversion of the Greek subsidiary into a branch of the Cypriot bank left the CBC with the option of accepting the conversion, and therefore notifying the BOG, or forcing the bank to cease operations in Greece. Given the desire to maintain the bank's headquarters in Cyprus and the perceived regulatory benefits, the CBC notified the BOG of the creation of MPB's branch in Greece.

7.1.2 Based on the findings of the Investigation it would appear that the current regulation and legislation does not provide sufficient support to the CBC where a Cypriot bank wishes to convert an existing foreign subsidiary into a branch. We recommend the performance of a review of the

legislation and consideration of amendments that would enable and require the CBC to consider the impact of such transfers and what powers should be given to the CBC, or other relevant authorities, in respect of the approval or rejection of such transfers.

¹³ See, for example, Document ID: 0.7.12.2163636 (Exhibit 6)

¹⁴ Mr Karydas in interview (13 February 2013) [Page 15 of transcript/part 1] acknowledged the main reason for the purchase of GGBs using

⁴⁷ See the remainder of section 4 below for dates of the specific meetings in which changes to limits for investments in Greece and Cyprus were agreed

⁴⁸

Confirmed by Mr Karydas in "Memo on the restructuring and Re-examination of your decision concerning me" dated 16 August 2012 -

⁶⁴ Document provided by BOC "GROUP ALCO DECISIONS" (Exhibit 28)

⁶⁵ Mr Karydas in "Memo on the restructuring and Re-examination of your decision concerning me" dated 16 August 2012 states that "none of the General Managers attending disagreed with the increase in the limit considering the accumulation risk acceptable." (Exhibit 23)

⁷⁴ iCAAP Report dated 30 June 2010 (Exhibit 16)

⁷⁵ Interview with Mr Patsalides [Page 14,15 of transcript/part 4]

⁸⁶ Document ID: 0.7.12.1280160 Email from Mr Alepis to Dr Patsalides and other Treasury department staff (Exhibit 39)

⁸⁷ Interview with Dr Patsalides, 30 August 2012 [page 2 and 3 of transcript/part 2]

⁹⁶ Dr Patsalides in interview [page 13 and 14 of transcript/part 4] advised that instructions from Mr Eliades and Karydas were received verbally. He said GGBs were sold on the verbal instructions of Mr Eliades who would review the AFS gains and request Treasury to sell.

⁹⁷ Mr Kypri in interview [page 13 of transcript/part 1] stated that all instructions to purchase GGBs were done at the behest of Mr Karydas and Mr Eliades without informing any other BoC executives.

¹⁰³ Stockwatch news dated 10 December 2009 (in Greek) -

http://www.stockwatch.com.cy/nqcontent.cfm?name=news_view&ann_id=110243&lang=gr (Exhibit 2)

¹⁰⁴ Mr Kypri confirmed in interview [page 10 and 11 of transcript/part 1] that Stockwatch called him ask if the BoC had sold off the GGBs. Mr Kypri confirmed this to Stockwatch.

an

⁴³ Exhibit 7: 9 July 2010 Indictment. It should be noted that we have not reviewed the underlying documentation to support the assertions made in the indictment

⁴⁴ Exhibit 9: 6 August 2009 Memo

⁶⁸ It is unclear who the Relevant Investor refers to - possibly EBRD which has a 15% shareholding in BT

⁸³ Exhibit 24: Share purchase forms dated 7 December 2009

BOC's acquisition of 80% of Uniastrum fits within the parameters of multiples* of Russian M&A deals

* Based on 2& June 2008
announcem&nt