Cypriot Economic Crisis – Crime and Punishment: Great Expectations or Realistic Possibility?

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Abstract

For many an ancient Greek tragedy, a precondition for the arrival of the effect of catharsis (renewal and restoration), is the attribution of nemesis, the just punishment for wrongdoings, arrogance and hubris before the Gods. Wrongdoings, arrogance and hubris were palpably present in the Cypriot economic crisis, in the banking as well as the fiscal sectors of the economy, but catharsis has yet to arrive.

As the people and the society slowly come to grips with the effects and consequences of the catastrophe, a number of burning questions are on every sufferer's mind which this article will discuss and strive to provide meaningful answers from a legal practitioner's perspective: Why did the legal and regulatory system prove unable to prevent such a catastrophe by allowing the banks to fail in so many respects? Is the arsenal of the legal and regulatory system strong enough to enable it to rise to the challenge of doling out just punishment? Are people's expectations for the punishment of those who are to blame, fanned by politicians' rhetoric, too high? What changes and improvements to the legal and regulatory system are necessary so as to substantially reduce the likelihood that similar failings will occur in the future?

Keywords: Cyprus economic crisis, corporate governance, legal system, punishment, personal responsibility, corruption

Section I

Introduction

After having spent eight years in a *katorga* prison in Siberia[1] for political disobedience to the Tsar, finding himself unable to pay his bills or afford proper meals, and owing large sums of money to his creditors, the great Russian author Fyodor Dostoevsky found success when his novel *Crime and Punishment* was serialised by a Russian literary journal in 1866.

The story focuses on the mental anguish and dilemmas faced by Raskolnikov, an impoverished ex-student in St Petersburg who devises and carries out a plan to kill an

1 *Katorga*: A Russian word for hard labour, derived from the ancient Greek word *katergo*.

unscrupulous money lender for her cash. At the end, after having had the opportunity to get away with murder for lack of evidence, he chooses to confess for his crime and, echoing the life of the author, is consequently sentenced to eight years' of penal servitude in Siberia.

Such mental anguish and a desire to atone for one's failings appears to be lacking in our times, and following the financial catastrophe that recently befell Cyprus this seems to be especially absent from the consciences of the unscrupulous bankers, creditors and money lenders who contributed to the crisis. The possibility of sending those responsible for this crisis and the ensuing economic catastrophe to a *katorga* prison in Siberia also appears to be rather remote, although one would venture to think that this is the wish of many of the victims of this tragedy.

A central theme in the ancient Greek tragedies is that punishment serves not only as a just form of retribution for wrongs committed, but it is also a precondition to achieve *catharsis*; that is, the renewal and restoration of balance. In ancient Greece, this was known as *nemesis*, the punishment for wrongdoings, arrogance and hubris before the gods. Wrongdoings, arrogance and hubris were palpably present in the recent Cypriot economic tragedy, in the banking as well as the fiscal sectors of the economy, but catharsis has yet to arrive.

As the Cypriot people and society slowly come to grips with the effects and consequences of the recent financial catastrophe, they are faced by the following burning questions which my contribution to this Special Issue of *The Cyprus Review* will discuss and attempt to answer from a legal practitioner's perspective:

- Why did the legal and regulatory system prove unable to prevent such a catastrophe by allowing the banks to fail in so many respects?
- Is the arsenal of the legal and regulatory system strong enough to enable it to rise to the challenge of doling out just punishment?
- Are people's expectations, fanned by politicians' rhetoric, for the punishment of those who are to blame, too high?
- Is there a realistic possibility of 'justice being done'?
- What changes and improvements to the legal and regulatory system are necessary so as to substantially reduce the likelihood that similar failings will occur in the future?

SECTION II

Why Did the Legal and Regulatory System Prove Unable to Prevent Such a Catastrophe by Allowing the Banks to Fail in so Many Respects?

International experience has shown that the aversion to or limitation of financial or banking crises of this magnitude that are connected to the actions or negligence of

financial institutions, presupposes, from a legal and regulatory point of view, the existence of a number of lines of defence, that are employed at different levels or stages:

(i) At the **first level**, there must exist **effective corporate governance** of the banks.
(ii) At the **second level**, a capable and independent system of **internal audit** must be in place which should detect and bring forward to the relevant committees and to the board of directors any misgivings relating to the functioning of the financial institution and its board committees.
(iii) At the **third level**, there must exist **prudential supervision by the regulatory authorities** that is based on a sound legal system; and clear guidelines that effectively prevent or limit the abuses of regulatory rules by senior officers, board members and the financial institution in general.
(iv) The **last line of defence** must be the presence of a **deterrent framework of personal administrative and criminal responsibility** of board members and senior managers who may – through their decisions as to the way in which the business of the financial institution is carried on, or their failure to take steps that would prevent such decisions being taken – bring about, contribute to or otherwise fail to prevent the demise of the financial institution.

In the case of the Cypriot banking system, each of the above four lines of defence either failed or was palpably deficient or absent. The failure of each of the above lines of defence will be examined in turn.

It should also be borne in mind **that the crisis was not only economic-banking in nature, but deeply political as well, and was politicised both in Cyprus and overseas**. During the electoral frenzy of 2012–2013 public perceptions roared both in Cyprus and in Germany, and using the handling of the crisis to gain political capital was always high on the agendas of the main players and decision makers. Under a normal, non-polarised (due to elections and other factors), political landscape, the legal and regulatory system might have been better able to cope, and the economy could at least have avoided some of the more draconian and dramatic aspects of the crisis, mainly the haircut of deposits and the wiping out of banking bonds. The political dimension of the crisis, as presented (or fuelled) by the media, will also be considered in this part.

The Failure of Corporate Governance

Bank of Cyprus Public Company Ltd and Cyprus Popular Bank Public Co Ltd, the two major Cypriot banks which were mostly affected by the crisis, in respect of their corporate governance, had to comply with two detailed sets of rules:

(a) In respect of their status as licensed credit institutions, they had to comply with the Central Bank Directive on 'The framework of principles of operation and

criteria of assessment of banks' organisational structure, internal governance and internal control systems' of 2006–2012[2] (the 'Corporate Governance Directive').

(b) In respect of their status as companies with titles listed on the main market of the Cyprus Stock Exchange (the 'CSE'), they had to comply with its Corporate Governance Code (the 'CSE Code'),[3] and report back on their compliance with the CSE Code in their annual, audited Financial Report, in a special section of the Directors' Report.

The Corporate Governance Directive included such lofty principles as:

- The Board of Directors should establish the strategic objectives and ethical standards which will direct the ongoing activities of the bank, taking into account the interests of all stakeholders.
- The corporate values should recognise the critical importance of the timely and frank discussion of problems.
- The Board of Directors should ensure that Senior Executive Management implements strategies, policies and procedures designed to promote professional behaviour and integrity.
- The Board of Directors should have sound knowledge of each of the types of material financial activities the bank intends to pursue.
- The non-executive and independent Board members should maintain, under all circumstances, his/her independence of thought and opinion when analysing, deciding and acting for the bank; and that s/he must clearly express his/her opposition to any decisions of the Board of Directors which may harm the interests of the bank.

The CSE Code also includes the following cardinal principles:

A1: Every listed Company should be headed by an effective Board of Directors, which should lead and control the company.

A3: The Board of Directors should be supplied in a timely manner with valid, correct and complete information, enabling it to discharge its duties.

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2 Regulatory Administrative Decision 460/2006, published in the Greek language, in Part I of the Third Annex of the Official Gazette of the Republic on 8 December 2006.

3 The Cyprus Stock Exchange Corporate Governance Code, available at: [http://www.cse.com.cy/el-GR/regulated-market/listing/corporate-governance], retrieved 14 December 2014. The Code existed since 2002 and was updated a number of times. Its adoption is compulsory in respect of the issuers that have titles listed on the main market of the Stock Exchange.

C2: The Board of Directors should maintain a sound system of internal control to safeguard shareholders' investments and the Company's assets.

The rules, therefore, were present. But they were not effectively applied.[4] Year after year, the banks presented Potemkin villages in their Directors' Reports, regarding their reportedly sound corporate governance structures and compliance ethos. The Central Bank was supposed to oversee the implementation of the Corporate Governance Directive at all times, but it does appear that it failed to effectively carry out its prudential responsibilities as will be analysed in the ensuing paragraphs. The Cyprus Securities and Exchange Commission ('CySEC'), which is the Cypriot capital market's regulator, had only *ex post* authority to the extent that misleading statements for supposed compliance with the Corporate Governance Code of the CSE were included in the Annual Financial Reports[5] of the listed companies (the banks) or prospectuses for the public offer of securities.[6]

According to the Final Report of the Independent Commission on the Future of the Cyprus Banking Sector[7] (also referred to as the 'Future of Banking Commission' or the 'Future of Banking Final Report'), the failure of corporate governance was one of the most important factors in explaining how Cyprus' largest banks brought disaster upon themselves. The Future of Banking Final Report notes at par. 12.1[8] that:

'12.1 The evidence from bank documents and recent investigations supports the now widely accepted view that:

4 As the great enlightenment philosopher and jurist Montesquieu states in his monumental work 'The Spirit of Laws' [*De l'esprit des lois*], 'When I visit a country, I do not examine if it has good laws, but whether the existent laws are effectively enforced, because good laws exist everywhere' ['Quand je vais dans un pays, je n'examine pas s'il y a de bonnes lois, mais si on exécute celles qui y sont, car il y a de bonnes lois partout'].

5 Misleading statements leading to market manipulation would infringe Sections 19 and 20(1)(c) of the Insider Dealing and Market Abuse Manipulation (Market Abuse) Law of 2005, No. 116(I)/2005, as amended, Republic of Cyprus.

6 Misleading statements included in prospectuses for the public offer of securities would likely infringe Section 8(1) of the Public Offer and Prospectus Law of 2005, No. 114(I)/2005, as amended, Republic of Cyprus.

7 The Final Report of the Independent Commission on the Future of the Cyprus Banking Sector, 31 October 2013 (the 'Future of Banking Final Report'), available at: [http://www.icfcbs.org/], retrieved on 14 December 2014. The Commission was set up by the Central Bank of Cyprus to make recommendations on ways to raise the strength of the sector, to improve supervision, and to promote banking competition in Cyprus for the benefit of consumers and businesses.

8 The Future of Banking Final Report, at par. 12.1–12.1.5.

12.1.1 While banks were formally compliant with relevant EU/EBA governance requirements, their performance in practice was woefully deficient.

12.1.2. Weak boards, with inappropriately qualified members, failed to carry out their responsibility to ensure that their banks were run prudently, with strong policies and an attitude of independence and challenge.

12.1.3. This allowed powerful senior executives to pursue risky strategies that were strongly influenced by personal ambition, and to bypass internal controls and procedures.

12.1.4. Proper board procedures were flouted, reporting lines were diverted, and necessary information did not reach the directors. In some cases, nonexecutive board members were deliberately kept in the dark about controversial management decisions, and board minutes did not always accurately reflect what had actually happened at board meetings.

12.1.5. A risk management culture was missing at all management levels.'

Also, the Future of Banking Final Report links the risky and aggressive growth strategies pursued by the two major banks in the 2000s with weak bank governance. It states at par. A.9[9] that:

'A.9 These reckless ventures were made possible by the failure of the boards of the banks to put independent checks on the ambitions of strong-willed chief executives and to ensure that their banks had risk strategies and controls that were enforced. Instead, directors lived by a culture of deference which was nurtured in some cases by loans and supply contracts. There were also serious weaknesses in the governance of the co-operative banks, particularly as regards the independence of directors and the quality of credit and risk controls. It is no exaggeration to say that the effectiveness of corporate governance in Cyprus' banking sector, while possibly compliant in a formal sense, was close to non-existent in practice as the crisis evolved.'

Following the disaster in relation to the Greek Government Bonds ('GGBs') which wiped out the two major banks' own funds to amounts equivalent to about 23% of the national GDP through their imposed haircut,[10] the CySEC also conducted an

9 *Ibid*., at par. A.9.

10 In late July 2011, private creditors had agreed to a Greek Government debt cut to the tune of 21%. Early on the morning of 27 October 2011, the 17 Eurozone heads of state and government, agreed to a haircut in the magnitude of 50%. The private sector participation ('PSI') eventually reached, in March 2012, the level of 75%. The two major Cypriot banks had invested a very high portion of their own funds in Greek Government Bonds. Further, the balance sheets of Cypriot banks were about seven times as large as the islands' annual GDP in 2011, and the two major banks accounted for more than 60% of the total banking activity in Cyprus. Using data from the European Banking Authority, Professor Stavros A. Zenios of the University of Cyprus, calculated that the PSI participation of the Cypriot banks in GGB's

investigation into the matter of investments of the two banks in bonds. The CySEC had no authority to investigate the soundness of the banks' investment decisions as they occurred, or to ask them to reduce their exposures or take further provisions. Its investigation centred on alleged breaches of the obligations of the two banks to properly inform investors via their obligatory financial reporting regarding the magnitude of their investments in GGBs and their investment grade downgrading by the international credit rating agencies, and to include this information in their prospectuses for the public offer of securities issued by the two major Cypriot banks in 2010 and 2011.

Within this regulatory framework, CySEC also examined the application by the two banks of the Corporate Governance Code of the CSE, and in 2014 it found that the two banks were in breach of the cardinal corporate governance principles mentioned above in the CSE code (pp. 252–253).[11]

According to the two decisions, CySEC found each of the two companies in breach of principle A1, that: 'Every listed Company should be headed by an effective Board of Directors, which should lead and control the company', **since they did not manage the risks effectively in relation to the investments in GGBs**.

The CySEC also found the two companies in breach of principle A3, that: 'The Board of Directors should be supplied in a timely manner with valid, correct and complete information, enabling it to discharge its duties', since **a crucial letter sent in March 2010 by the Central Bank to all banks that had holdings in GGBs, asking them to report to the Central Bank their strategies to confront the risks from the high holdings in GGBs, was not communicated to the Board of Directors, but was handled only by executives**.

The CySEC further found the two companies in breach of principle C2, that: 'The Board of Directors should maintain a sound system of internal control to safeguard shareholders' investments and the Company's assets', since it found **that the two banks did not**

imposed haircut was equivalent to 23.03% of the national GDP, as compared to 11.65% for Greece, 0.25% for France and only 0.14% for Germany: See p. 35 of the Report of Stavros A. Zenios, *The Destruction of the Cypriot Economy: From Lapse of Judgment to Mismanagement*, 26 September 2013, available at: [www.zenios.wordpress.com], retrieved 2 December 2014. The combination of the above factors along with the rapidly growing public debt of Cyprus (the public debt had increased from around 47% in 2007 to over 85% of the annual GDP in 2012), meant that it was impossible for the Cypriot government to bail-out the two banks without external assistance, which led to the Troika Memorandum of Understanding (MoU).

11 CySEC decisions of 28 April 2014 regarding the imposition of administrative fines to Cyprus Popular Bank Public Co Ltd and Bank of Cyprus Public Company Ltd, to their Members of the Board and to other persons (investigation regarding Greek Government Bonds) [in Greek], Public Information, Announcements, 5 June 2014. Available at: [http://www.cysec.gov.cy/en-GB/public-info/announcements/], retrieved on 2 December 2014.

maintain sound internal auditing systems enabling their internal audit function to detect the problematic risk management of the two banks in relation to investments in GGBs.

This last finding of the CySEC brings us to the failure of the second line of defence of the two major financial institutions, that of the Internal Audit, which will next be examined.

The Failure of the Internal Audit

The system of the internal audit of large organisations consists of a number of key components: the internal audit department headed by the Internal Auditor, the audit committee of the board of directors which should be chaired by an independent director with audit experience and to which the Internal Auditor must have a clear reporting line, and the Board of Directors which should maintain a sound system of internal control to safeguard shareholders' investments and the company's assets. It appears that, in the case of the two major Cypriot banks, all the above components were problematic.

We already noted that, according to the CySEC decisions, the two banks did not maintain a sound internal audit system enabling their internal audit function to detect the problematic risk management of the two banks in relation to their investments in GGBs. The prevalent culture was also not conducive to this end. As stated in the Alvarez & Marshall report on the investigation regarding the Bank of Cyprus' holdings of Greek Government Bonds, **'there was a dominance of senior executives within the Bank ... resulting in a culture whereby senior management decisions were not challenged'**.[12]

Particularly in relation to the internal audit department of large organisations, its role is to provide independent, objective assurance and consulting activities and to assist the company to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. Key to the successful execution of its duties is having the ability to raise an independent challenge, audit the key controls and formally report on assurance. However, in the case of the two major Cypriot banks, evidence points instead to a lack of sufficient independence of the Internal Auditor from the executive arm.

As stated in the CySEC decision regarding the Bank of Cyprus' investments,[13] the then Group Internal Auditor, in its report dated 31 January 2012 regarding investments

12 Alvarez & Marshall, Global Forensic and Dispute Services, LLP, *Investigation Report Bank of Cyprus – Holdings of Greek Government Bonds*, 26 March 2013, par. 2.4.1.2; available at: [http://cdn.cyprus-property-buyers.com/wp-content/uploads/2013/04/April04_2013_AM.pdf], retrieved 5 December 2014.

13 CySEC decision of 28 April 2014 regarding the imposition of administrative fines to the Bank of Cyprus Public Company Ltd, p. 27.

in Greek Government Bonds, did not detect any problems in relation to risk management. However, in its report on the same subject in November 2012 under a different Bank CEO, the Internal Auditor changes his position and detects a multitude of problems regarding risk management. The Group Internal Auditor at that time made the following statement to the Tri-Partite Commission of Investigation on the 'State of the Cypriot Banking System and the Economy of the Republic of Cyprus':

> 'Summarizing the re-purchase of GGBs, it occurred without the prior notification and approval of the Board of Directors and with the purpose of increasing revenues from high-performance interest and financed by a large sum through low-cost finance by the European Central Bank, completely ignoring the assessment of risks as required by pillar 2 and by the guidelines of the Central Bank of Cyprus, as well as by the risk-taking policy of the Group.'[14]

Without assessing the substance of the above statement, it seems that the Internal Auditor's independence had been compromised, since his views changed fundamentally with the change of leadership at the bank, and his initial report appears to have been tailor-made to suit the requirements of powerful executives.

There are also grounds for arguing that the functioning of the audit committees of the boards of directors of the two major banks was also problematic:

(i) Doubts can be raised regarding the true independence of some of the board members that comprised the audit committees. As will be expanded upon further below (see pp. 261–262), there was laxity regarding the satisfaction of important, minimum criteria for establishing and maintaining independence.

(ii) Doubts can also be raised regarding the audit experience of the Chairs of these committees. For example, no particular audit experience is evident from the CVs of the chairmen of the Bank of Cyprus' audit committees of the board of directors for the years 2010–2011.[15]

In light of the above, it can be argued that, in the case of the banks, the operation of all the key components of their internal audit systems either did not or could not rise to

14 Tri-Partite Commission of Investigation Report on the *State of the Cypriot Banking System and the Economy of the Republic of Cyprus*; available at: [http://www.stockwatch.com.cy/media/announce_pdf/Report_Committee_Ypourgiko_3.10.2013.pdf], pp. 111–112, retrieved 5 December 2014.

15 Corporate Governance Reports of the Bank of Cyprus for the years 2010 and 2011, are available at: [http://www.bankofcyprus.com/en-GB/Start/Investor-Relations/Corporate_Governance/Board-of-Directors/], retrieved 20 December 2014.

the challenge of adequately meeting the heavy demands of the highly complex environments found in the largest Cypriot organisations.[16]

The Failure of Prudential Supervision by the Regulatory Authorities

It is clear that it is my view that the prudential supervision of the two major Cypriot banks by the Central Bank of Cyprus was seriously wanting. I cannot but agree with the Report of the Parliamentary Committee of Institutions, that found that the Central Bank of Cyprus showed a lapse of duty in relation to the exercise of the effective monitoring of the investments made by the Bank of Cyprus in GGBs, since **it took no measures when the Bank did not answer the crucial Central Bank letter of March 2010, nor did it take any measures when it became obvious that the Bank was still purchasing bonds despite the oral assurance given to the Central Bank that this practice would cease.**[17] It should be added that, according to the testimony given by a senior Central Bank official to the CySEC regarding the investments made by the Cyprus Popular Bank in GGBs, the Central Bank did not make a request in writing that it ceases to purchase GGBs, as this would have been considered 'non-filial' to a brother nation, or even 'unethical'.[18] **It appears, therefore, that not only was the government at that time acting on political motives for accepting the significant haircut on Greek Government Bonds in October 2011, but also that the Central Bank of Cyprus was affected by extra-institutional considerations in its decision making.**

Consequently, the Central Bank of Cyprus, whilst exercising its role as a **regulatory**

16 The Members of the Board of Directors of the Bank of Cyprus, maintained different views as to the quality of information they received and the execution of their functions. Some of them stated to the Alvarez & Marshall investigators that they did not have sufficient banking experience and insufficient information was given to them in relation to the actions of the executives so that they could challenge them. However, the Chairman of the Board of Directors of the Bank of Cyprus in the period May 2008–August 2012, at his testimony to the Tri-partite Commission of Investigation stated that the Bank of Cyprus 'had a good and effective system of controls': Report of the Tri-Partite Commission on the state of the Cypriot Banking system and the economy of the Republic of Cyprus, p. 86.

17 House of Representatives, Parliamentary Committee of Institutions, *Supplementary Report on* '*The Functioning of the Institutions of the Financial System*' (May 2014) [in Greek]; available at [http://www.parliament.cy/easyconsole.cfm/id/220], p. 35, retrieved 1 December 2014.

18 Testimony to the CySEC of Costas Poullis, senior manager of the Central Bank of Cyprus, and author of the Central Bank Letter of March 2010: «*[Ο]ύτε νομική εξουσία είχαμε, ούτε ηθική, να πούμε για ένα αδελφό κράτος να μην αγοράζεις τα ομόλογά του ....*»: ['We had neither legal nor moral authority, to say for a brother nation, do not buy its bonds ...'] (included in the CySEC decision of 28 April 2014 regarding the imposition of administrative fines to the Bank of Cyprus Public Company Ltd, p. 24). It should be remembered that the political decisions regarding the 50% haircut on GGBs were taken 18 months later, in October 2011.

authority (by promulgating directives and rules), failed to effectively exercise its role as a **supervisory authority** and did not utilise the powers provided by the legislation to lead, or enforce, compliance.[19] Two other examples lend further credence to support this conclusion:

(i) In relation to the evident non-compliance of the two major banks and their Boards with the Central Bank Corporate Governance Directive, the Central Bank had the power to investigate and impose sanctions on the financial institutions and penalise the board members or executives involved. However, the Central Bank has never taken any measures against either of the two banks or any of the board members or executives involved.[20]

(ii) The Central Bank conducted special investigations into the practices employed by the two major banks for the sale and promotion of the bonds they issued in the period 2007–2011. Having found both banks to have committed a multitude of violations contravening the relevant legislation[21] in its decision of

19 The distinction between banking *regulation* and *supervision* should be borne in mind. According to the glossary used in the Special Report of the Court of Auditors of the European Union on the European Banking Supervision:

> **Banking regulation** is a form of government regulation which imposes on banks certain requirements, restrictions and guidelines. The regulatory structure creates transparency between banking institutions and their clients. The objectives of banking regulation inter alia are prudential (to reduce the level of risk to which bank creditors are exposed), systemic risk reduction (to reduce the risk of disruption resulting from adverse trading conditions for banks causing multiple or major bank failures), and rules about the fair treatment of customers.
>
> **Banking supervision** is the act of monitoring the financial performance and operations of banks in order to ensure that they are operating safely and soundly and following rules and regulations. Bank supervision is conducted by governmental regulators and occurs in order to prevent bank failures.
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> Reference: European Court of Auditors Special Report 2014 No. 5: European banking supervision taking shape – EBA and its changing context, available at: [http://www.eca.europa.eu/Lists/ECADocuments/SR14_05/SR14_05_EN.pdf], p. 5, retrieved 15 December 2014.

20 Section 42 of the Business of Credit Institutions Law of 1997, as amended, Cyprus, empowers the Governor of the Central Bank to impose administrative fines ranging from €1,000–€5,000 and in case of a continuing violation the Governor is additionally empowered to impose a further administrative fine, ranging from €100,000–€500,000 for each day during which the violation continues. Further, if proven that the violation was due to fault or negligence or omission or in the knowledge of the member of the management body and/or of its chief executive officer and/or of a manager, the Governor has the power to impose personal fines, ranging from €1,000–€5,000 and in case of a continuing violation the Governor is additionally empowered to impose a further personal administrative fine, ranging from €100–€5,000 for each day during which the violation continues.

21 The relevant legislation is the Investment Services and Activities and Regulated Markets Law of 2007 as

> September 2013, the Central Bank's Governor imposed only insignificant fines to the Bank of Cyprus and no fines at all to the Cyprus Popular Bank.

It should not be forgotten that the two abovementioned banks constituted the only systemically important banks of Cyprus. In light of the fact that they made very significant investments of their own funds into Greek Government Bonds – of which the Central Bank was well aware – the failure to take sufficient supervisory measures to guard against the risks that these investments entailed for the entire banking system of Cyprus, points to a larger failure to adequately manage the banks' systemic risks by the Central Bank of Cyprus. Systemic risk is not managed with the benefit of hindsight but with the prudence of prevention. Who guarded the guardians (in this case the banking supervision department of the Central Bank of Cyprus)? No-one, really. As noted in the Future of Banking Final Report:

> 'Poor governance arrangements of the Central Bank of Cyprus contributed – over a number of years – to the 2012 crisis by concentrating too much power in the hands of the Governor, and by exempting the supervision department from the internal audit process which meant it did not receive board level scrutiny.'[22]

The Failure of Attribution of Personal Responsibility of Board Members and Senior Managers Regarding Banking Business

During his presidency, US President Harry Truman kept a sign on his desk at the Oval Office with the simple phrase: 'The Buck Stops Here'. The phrase refers to the fact that the people at the top of the chain of command have to make the decisions and accept ultimate responsibility for those decisions.

Let us juxtapose this mentality with the situation existing in the board of the Bank of Cyprus. When requested by the Parliamentary Committee of Institutions to provide information regarding the purchase of GGBs, the board responded that it did not approve the purchase of bonds, since it had no such authority. According to the Alvarez & Marshall Report, the board had responsibility for the risk management of the bank's investments, which had been delegated to the Board Risk Committee. This committee in turn entrusted the risk management to the Executive Risk Committee and the Assets and

amended, Law No. 144(I)/2007, and the Central Bank Directive for the Directive for the Professional Conduct of Banks when Offering Investment or Ancillary Services and when Performing Investment Activities, R.A.D. 558/2007.

22 Future of Banking Final Report, par. 17.10.

Liability Committee, which reported to the Board Risk Committee, which in turn reported to the full board.[23]

In other words, **an almost impenetrable accountability firewall of committee and collective responsibility was created in the Cypriot banks and regulatory system that prevented corrective action being taken against individuals**. One of the main conclusions of the UK Parliamentary Commission on Banking Standards which examined the recent failings of the UK banks could well have been written for Cyprus' banks and their supervisors:

> 'One of the most dismal features of the banking industry to emerge from our evidence was the striking limitation on the sense of personal responsibility and accountability of the leaders within the industry for the widespread failings and abuses over which they presided. Ignorance was offered as the main excuse. It was not always accidental. Those who should have been exercising supervisory or leadership roles benefited from an accountability firewall between themselves and individual misconduct, and demonstrated poor, perhaps deliberately poor, understanding of the front line. Senior executives were aware that they would not be punished for what they could not see and promptly donned the blindfolds. Where they could not claim ignorance, they fell back on the claim that everyone was party to a decision, so that no individual could be held squarely to blame – the Murder on the Orient Express defence.'[24]

To be fair, although some members of the boards of the two major banks did voice, at certain stages, their criticism of the actions of certain executives, none of them refused to sign accounts or prospectuses for the public offer of securities, or alert the authorities in advance about any perceived riskiness of the investments or growth strategies pursued by the banks. The main reason that this occurred, is that it appears that the boards were lacking sound foundations in their structures and did not have a culture which fostered independent challenges and critiques of executive decisions. It has been stated above (p. 254) that one of the findings of the Future of Banking Commission was that 'directors lived by a culture of deference which was nurtured in some cases by loans and supply contracts'. Mr Pikis, the former Chief Justice of the Supreme Court of Cyprus, when heading the Tri-Partite Investigatory Commission on the 'State of the Cypriot Banking System and the Economy of the Republic of Cyprus', enquired into the former bank directors regarding the significant credit facilities that their companies were receiving

23 Parliamentary Committee of Institutions, *Supplementary Report* '*The Functioning of the Institutions of the Financial System*', pp. 21–22.

24 House of Lords, House of Commons, Report of the Parliamentary Commission on Banking Standards, *Changing Banking for Good*, Volume I: Summary and Conclusions and Recommendations, 12 June 2013, available at: [http://www.parliament.uk/bankingstandards], at para. 14, retrieved 25 November 2014.

from the banks, during the same period of time they served as independent, non-executives on the boards.[25] The former directors pointed out that the credit facilities were covered by floating charges and personal guaranties. The tolerance for deviations from central principles of the directors' independence was, unfortunately, also supported by laxity in the regulatory standards. By way of example, in the third revised edition of the Corporate Governance Code of the CSE of March 2011, a provision was added that allowed listed companies to consider directors as independent although they would not satisfy the minimum criteria of independence stated in the CSE Code, by providing an explanation in their annual corporate governance report.[26] In the Annual Corporate Governance Report of the Bank of Cyprus for 2011, the bank made use of the above provision to state that although five out of nine of its stated independent directors did not satisfy the minimum criteria for independence (two of them did not satisfy the criterion of not taking out loans for more than €500,000 and three of them did not satisfy the criterion of holding a maximum tenure of nine years), the bank still considered them to be independent directors.[27]

The Political Landscape in the Unfolding of the Crisis and the Positioning and Stance of the Media

The Cypriot economic crisis coincided with three major political events and one major economic event. The political and economic events are interlinked, and created a snowball effect which had a very significant bearing on the Cypriot crisis. The political events were the two elections that took place in Cyprus and in Germany and the change of leadership of the Eurogroup. The Cypriot presidential elections took place on 17 February 2013, with a runoff on 24 February. The German federal elections were held on 22 September 2013. The change at the helm of the Eurogroup took place on 21 January 2013. The economic event was the most serious crisis in the euro currency union that had ever been experienced, the effects of which forever changed the European project between late 2011–late 2012. As noted by Peter Spiegel in an in-depth article in *The Financial Times*, 'strict budget rules were made inviolable; banking oversight was stripped from national authorities; and the printing presses of the European Central Bank would become the lender of last resort'.[28]

25 Report of the Tri-Partite Commission of Investigation, pp. 67, 71.

26 The Cyprus Stock Exchange Corporate Governance Code, 3rd revised edition March 2011, available at: [http://www.cse.com.cy/el-GR/regulated-market/listing/corporate-governance/], par. A.2.3; retrieved 20 October 2014.

27 Corporate Governance Report of the Bank of Cyprus for the years 2011, par. 1.2.

28 Peter Spiegel, 'How the Euro was Saved, Part One', *The Financial Times*, 11 May 2014, In-Depth, retrieved 25 February 2015.

Therefore, by focusing on the developments leading up to the crisis and the events of March 2013, the media coverage of the Cypriot economic crisis will be examined in the following paragraphs, from three different angles:

(i) The stance and positioning of German newspapers;
(ii) The view of the international financial newspapers; and
(iii) The Cypriot daily newspapers at the opposite ends of the ideological spectrum.

German Politics and Media

In the light of the upcoming German federal elections and the country's position as the Eurozone's paymaster, the debate over how to deal with the Cypriot crisis provided all the main parties in Germany with a way to gain political capital and differentiate themselves in order to attract the popular vote. The German public was never enthusiastic about bailouts and matters were further complicated by the internal divisions in the ruling Christian Democratic Union party ('CDU'). This meant that the Chancellor could no longer rely on her government's ability to secure a majority vote at the German Federal Parliament from its own benches alone regarding an aid package for Cyprus, and would therefore need support from the main opposition party, the Social Democratic Party ('SPD'). The German media took a stance that ranged from the sensationalist – with inflammatory headlines and content coming from the tabloid *Bild* – to the much more measured and analytical approach of the journal *Der Spiegel*.

At one end, *Bild* (the best-selling non-Asian newspaper in the world) bore article headlines in March 2013 such as **'Attention, CyprIDIOTS!'**[29] (a conjunction of the words 'Cypriots' and 'idiots') in relation to the Cypriot Parliament's decision to reject the original haircut on deposits, and **'Alles Zypr-IDIOTEN? Machen sie den Euro Kaput?'**[30] ['Are they all CyprIDIOTS? Will they Destroy the Euro?'], scorning the German government's handling of the crisis and for putting the euro in danger. The playing on the German fears of the Russian element also appeared in a sensational way in *Bild,* with headlines in relation to the Cypriot crisis such as **'Blitz Law to Stop Russians'**[31] and **'Rich**

29 Nikolaus Blome, 'Attention, CyprIDIOTS!', *Bild* Internet edition, 20 March 2013, available at: [www.bild.de], retrieved 10 December 2014.

30 'Are they all CyprIDIOTS? Will they Destroy the Euro?' [in German: 'Alles Zypr-IDIOTEN? Machen sie den Euro Kaput?'], *Bild* Internet edition, 24 March 2013, political discussion between two commentators, Augstein and Blome; available at: [www.bild.de], retrieved 10 December 2014.

31 'Blitz Law to Stop Russians' [in German: 'Blitzgesetz Soll Russen Stoppen'], *Bild* internet edition, 16 March 2013; available at: [www.bild.de], retrieved 10 December 2014.

Russians are Packing Suitcases'.[32] It should be mentioned that the above articles of the tabloid were written in the German language and the target audience was the average reader. *Bild* is considered as a high-risk factor for every public figure as its wide circulation and its constant readiness to judge and to condemn give it the capacity to cause a great deal of political damage.[33]

At the other end, *Der Spiegel*, in its online English edition, featured two well-structured and thought-provoking commentaries on the crisis. Its commentary of 26 March 2013, entitled '*Bailout Insights: What Cyprus tells us about Germany's Character*', began with the following statement:

> 'The Cypriot government was willing to do anything to save its banking industry. Yet Berlin, driven by a deep-seated fear of tax havens, sought the opposite. The resulting deal may have driven a stake through the heart of the euro-zone's much ballyhooed banking union.'[34]

In its 3 April 2013 edition, *Der Spiegel* hosted a commentary with the title '*Abject Error: How the Cyprus Deal Hurts EU Strategic Interests*.'[35] The commentator, an EU and NATO specialist, argued that it was a myth that the Cypriot president alone was responsible for at first wanting to impose a levy on savings accounts below €100,000 and that the Germans were in fact both complicit and actively in support of this action. The author also argued that, despite the Cypriots' responsibilities in allowing their banks to grow too large (to be all saved), their actions did not justify the harshness of the final deal and the risks that lay ahead for the EU because of it.

In between the above commentaries and articles of *Bild* and *Der Spiegel*, other German newspapers aired politicians' views with an eye to the upcoming elections. *Süddeutsche Zeitung* (the German daily newspaper with the largest number of subscribers) led with a

32 'Rich Russians are Packing Suitcases' [in German: 'Reiche Russen Packen Koffer'], Bild internet edition, 25 March 2013; available at: [www.bild.de], retrieved 10 December 2014.

33 Michael Steiniger, 'German Tabloid Bild Takes Down Politicians With Its Unmatched Megaphone', *The Christian Science Monitor* 18 January 2012, citing Hans-Jürgen Arlt, a professor of political communication at Berlin's Free University; available at: [http://www.csmonitor.com/World/Europe/2012/0118/German-tabloid-Bild-takes-down-politicians-with-its-unmatched-megaphone], retrieved 10 December 2014.

34 Tyson Barker, 'Bailout Insights: What Cyprus tells us about Germany's Character', *SpiegelOnline*, 26 March 2013; available at: [http://www.spiegel.de/international/europe/the-cyprus-bailout-reveals-german-fears-of-tax-havens-a-891063.html], retrieved 10 December 2014.

35 Jeffrey Stacey, 'Abject Error: How the Cyprus Deal Hurts EU Strategic Interests', *SpiegelOnline International*, 3 April 2013; available at: [http://www.spiegel.de/international/europe/cyprus-bailout-woes-harmful-to-eu-strategic-interests-a-892331.html], retrieved 10 December 2014.

front page article in January 2013, entitled: '2013 Will be the Year of the Financial Transactions' Tax', in reference to the demand of the German opposition parties for Cyprus to adopt the financial transactions' tax. The article highlighted the views of the Social Democratic Party (SPD) and the German Greens Party which was that Cyprus must be willing to reform its taxation system in order to ask for the EU's solidarity. The German financial daily *Handelsblatt* had an article in its print edition on 31 January 2013 entitled 'Merkel Falls into the Trap of Cyprus',[36] which referred to the SPD's refusal to support the economic aid package to Cyprus. The article referred to the main factors upon which the SPD ostensibly based its negative stance in relation to the Cypriot economic aid package, as being the allegations for systematic money laundering and taxation dumping. However, the article's authors postulated that the real reason for the stance of the SPD was the political calculation that if it rejected the package, due to the Christian Democratic Union's (CDU) internal divisions (p. 263 above), the aid package would not be approved by the Bundestag and Chancellor Merkel's approval ratings would suffer.

The International Financial Media

With only six days remaining before the Cypriot Presidential elections in 2013, *The Financial Times* sent shockwaves through the political spectrum in Cyprus with the publication of its article entitled 'Overblown Cyprus Discovers Painful Truths'.[37] That was the first time that a major international financial newspaper, also considered to be one of the worlds' most credible, reported that according to a confidential paper drafted by the European Commission, the Cyprus rescue plan would not be sustainable (hence impossible), without bailing-in of the bank depositors. This caused a new wave of statements by all presidential hopefuls to assure the public that bailing-in of bank depositors would not be accepted under any circumstances, and resulted in the well-known pledge of the current President Anastasiades (then a candidate) against accepting any bailing-in; a promise that was to be broken only two weeks after the elections' runoff. The article was authored by *The Financial Times'* correspondent in Berlin, who correctly observed that in Germany, the bailout had become a matter of acute political controversy for a number of reasons.

The Economist financial newspaper, published in the UK, never hid its scepticism of the euro-currency union and its future prospects. Its article of 16 March 2013, entitled

36 'Merkel Falls into the Trap of Cyprus', *Handelsblatt*, 31 January 2013.

37 Quentin Peel, 'Overblown Cyprus Discovers Painful Truths', *The Financial Times*, 11 February 2013; available at: [www.ft.com], retrieved 10 December 2014.

'The Cyprus Bail-out: Unfair, Short-sighted and Self-defeating',[38] considered the initial haircut plan for Cyprus[39] and argued that the euro-zone bailout in Cyprus appeared to move Europe further away from the institutional reforms that are needed to resolve the crisis; and that the Cypriot deal has no coherence in the larger context. The deal, *The Economist* argued, reawakened contagion risk and increased the chances of big, destabilising movements of money.

The Cypriot Newspapers at the Two Ends of the Ideological Spectrum

The two Cypriot daily newspapers at the opposite ends of the ideological spectrum generally followed pre-determined ideological affiliation paths in their treatment of the Cypriot crisis. The right-wing *Alithia*, with a headline article 'Heavy Pressures' (7 March 2013) stated that Eurozone member states attempted to put heavy pressure on Cyprus regarding the aid package but that the Cypriot government had ruled out a depositors' bail-in and any increase of the company profits taxation rate.[40] On the same day, the left-wing *Haravghi* featured the headline: 'Exiting the Euro' which argued that in case the Troika insisted on the haircut, it could not be ruled out that Cyprus would leave the monetary union.[41]

The contrast between the two newspapers became even more acute the day before the first Eurogroup council which commenced on 15 March 2013. On 14 March *Alithia* had a front page main theme with the title 'Final Touches,' reporting that the remaining chapters for the Cypriot aid package were being finalised rapidly, and highlighting President Anastasiades' statement that 'hard work brings good results', and that the government was assuring the people that there would be no haircut on deposits.[42] On the same day, *Haravghi* had a headline article on the 'Negative Climate at Eurogroup', stating that in EU circles, with Germany taking centre stage, a plan was being promoted whereby the aid-package would be limited to €10 billion and the remaining €7.5 billion would have to be found by utilising 'other measures'.[43]

38 *The Economist*, 'The Cyprus Bail-out: Unfair, Short-sighted and Self-defeating', 16 March 2013; available at: [http://www.economist.com/blogs/schumpeter/2013/03/cyprus-bail-out], retrieved 10 December 2014.

39 The original plan provided for an across the board haircut for all deposits kept in all Cypriot banks, with no insurance ceiling of €100,000 and was eventually rejected by Cypriot idiots – according to the *Bild* newspaper (page 263 of this paper).

40 *Alithia*, 'Strong Pressures', 7 March 2013, front-page.

41 *Haravghi*, 'Exiting the Euro', 7 March 2013, front-page.

42 *Alithia*, 'Final Touches', 14 March 2013, front-page.

43 *Haravghi*, 'Negative Climate at Eurogroup', 14 March 2013, front-page.

The day after the second Eurogroup ended (26 March 2013), *Haravghi*'s main theme was entitled 'The Beginning of New Evils', and it argued that the achievement of the Eurogroup agreement would bring new evils rather than solve the existing problems.[44] *Alithia* had as its headline article the President's statement that 'Criminal Investigators will be Appointed Regarding the Bankruptcy'.[45] This political promise will be considered in the context of the next part of this paper.

Section III

Is the Arsenal of the Legal and Regulatory System strong enough to enable it to Rise to the Challenge of Doling Out Just Punishment?

Are People's Expectations, Fanned by Politicians' Rhetoric, for the Punishment of those who are to Blame, too High?

Is there a Realistic Possibility of 'Justice being Done'?

According to the Future of Banking Report of the Independent Commission on the Future of the Cyprus Banking Sector,

> '[D]uring the 2000s, the two major Cypriot banks used the excess liquidity available in the Cyprus banking system to embark on aggressive growth strategies which included lending far beyond prudent levels, and making overseas acquisitions which they had difficulty controlling.'[46]

The Report also notes that

> 'although domestic sources of funding began to run low, the [banks] engaged in further expansion, including the fatal step of acquiring €5,7bn of Greek Government Bonds (GGBs), which was to cost them €4,5bn in losses'.[47]

This Independent Commission was not, of course, a court of law, and its fact finding mechanisms were different from those of criminal investigations. However, for the sake of argument, let us take its word for granted and accept all of the above as facts.

Therefore, based on the above, is there a case to be made for imprudent behaviour by the banks and/or their supervisors? **Certainly**. Risky ventures? **Absolutely**. Negligent conduct? **It follows from the rest**. Unethical? **It could also be supported**. However, the crucial question

44 *Haravghi*, 'The Beginning of New Evils', 26 March 2013, front-page.
45 *Alithia*, 'Criminal Investigators will be Appointed Regarding the Bankruptcy', 26 March 2013, front-page.
46 The Future of Banking Final Report, par. A.8.
47 *Ibid*.

that remains to be answered is whether this behaviour was also criminal in nature. And if it was criminal in nature, is there personal criminal responsibility for the wrongdoers?

The general principle, enshrined in Article 7(1) of the European Convention of Human Rights and Article 12(1) of the Cypriot Constitution, is the Latin maxim, '*Nullum delictum sine lege*' (there is no crime without a pre-existing law).[48] To use a metaphor, it is known that when World War II began, Prime Minister Winston Churchill told President Roosevelt: 'Give us the tools, and we will finish the job', meaning that Britain was requesting ammunition and materials from the United States. **The tool, in this case, is the criminal legislation that existed at the time of the commission of the relevant acts. Is it sufficient?**

The Anglo-Saxon legal system on which the Cypriot legal system is based, has traditionally not placed criminal responsibility on the boards of directors of limited liability companies, or even banking corporations, which may take excessive risk with the assets of their clients, make toxic loans or carry out reckless ventures which may even lead to the failure of – or need of – the bailing out of their banks. It may also well be argued that the business of banking, even in its traditional sense of deposit taking and providing loans, inherently involves the assumption of risks.

With regard to the above, if criminal charges are brought, there are three main areas around which the accusations will centre. The first relates to charges based on general economic offences, such as embezzlement of funds, fraud, obtaining benefit by deception and so forth. The second area is in relation to potential violation of the Business of Credit Institutions Laws. The third area relates to the role and responsibilities of the two major banks as listed companies on the Cyprus Stock Exchange, and the actions of their executives, board members and chief financial officers. In terms of the probability of indictments being brought against any of these companies or individuals, I would characterise the first area as questionable and the second as possible. The third area has already, to a certain extent, begun to materialise, and it shall be analysed further below. It should be noted that none of the three areas is free of problems or entirely straightforward.

The Great Expectations for Criminal Prosecutions – Prosecutions Based on General Economic Offences and Business of Credit Institutions Laws

The first area is in relation to charges based on general economic offences, such as fraud, embezzlement of funds, obtaining benefit by deception and so on. Here, it all depends on the evidence that can be found. Criminal intent would have to be proven, which is no

48 Article 12(1) of the Constitution of the Republic of Cyprus reads: 'No person shall be held guilty of any offence on account of any act or omission which did not constitute an offence under the law at the time when it was committed; and no person shall have a heavier punishment imposed on him for an offence other than that expressly provided for it by law at the time when it was committed.'

small feat. It is also often the case that the ranks of top management are several levels removed from those who are taking the actions; therefore evidence of their intentions is hard to find. It is noteworthy that in relation to the subprime mortgage crisis which led to the recent Great Recession in the United States, justice officials and even President Obama defended the lack of prosecutions, saying that even though greed and other moral lapses were evident in the run-up to the crisis, the conduct was not necessarily illegal.[49] The case of the former Central Bank of Cyprus Governor Mr Christodoulos Christodoulou is illustrative: although he pleaded guilty for failure to report to the tax authorities the receipt of a significant sum linked to the banker one year after the expiry of his term as Governor, no satisfactory evidence has been found up to now to link this money with the criminal offence of receiving a bribe during the exercise of his responsibilities.[50] This does not mean that regulators and supervisors cannot be subjected to criminal prosecution for their failings if the evidence is present (especially in cases of corruption in the exercise of their functions) and suggestions for the overhaul of the legislative and enforcement anti-corruption framework in Cyprus are made in pages 283–286 of this article.

The second area is in relation to the potential violations of the Cypriot Business of Credit Institutions Law.[51] Reliance, in this case, would probably have to be placed on Section 43, which stipulates that the infringement of any provisions of this law or any regulations or directives issued by the Central Bank under this law is – apart from its administrative consequences – a criminal offence punishable by imprisonment of up to five years. Liability, here, would have to be proven in an indirect way. Specifically, that due to a breach of a directive issued by the Central Bank under this law, for example the Corporate Governance Directive, there is also potential liability for breach of the criminal provision. Doubts can be maintained as to whether this course can withstand the scrutiny

49 'No Crime, No Punishment', *The New York Times* editorial, 25 August 2012; available at: [http://www.nytimes.com/2012/08/26/opinion/sunday/no-crime-no-punishment.html?_r=0], retrieved 2 December 2014. The Justice Department in the United States closed its criminal investigation of Goldman Sachs, and its greatest achievement in relation to the subprime mortgage mis-selling has been seen as the settlements/fines it reached with a number of large banks over shoddy mortgage securities transactions in the years immediately before the recent financial crisis in the United States. Citigroup reached a settlement of $7 billion, JPMorgan Chase & Co settled in 2013 for $13 billion, and Bank of America settled in August 2014 for a record of $17 billion. A significant portion of the fines was used to provide relief to the victims. In its settlement announcements, the US Government stated that the banks had committed 'egregious misconduct in the lead up to the financial crisis'.

50 Section 100 of the Criminal Code of the Republic of Cyprus, Cap. 154. An offence under Section 100 is punishable with up to 7 years imprisonment.

51 Business of Credit Institutions Law of 1997, Law No. 66(I)/1997, as amended, Republic of Cyprus.

of a criminal trial: Firstly, because no investigation has been made by the Central Bank in relation to the potential breach of its Corporate Governance Directive or any other regulation or directive issued by the Central Bank. Secondly, as noted by the Commission on the Future of Banking, there appears to have been, at least with respect to corporate governance, *formal compliance* with governance requirements. That is to say, the relevant committees existed, meetings were convened and minutes were taken. In the absence, therefore, of a clear position and decision by the regulatory authority entrusted with the responsibility to supervise compliance with its issued directives, that in practice there was no true compliance with governance requirements, criminal liability is very difficult to prove.

The third area relates to the actions of the banks in their role as listed companies on the Cyprus Stock Exchange. Due to the likelihood, the publicity and complexity of this area, it will be examined in the following separate section.

SECTION IV

The Realistic Expectations for Criminal Prosecutions: Prosecutions Based on Breaches of Listed Companies' Obligations

In the past two years, CySEC found the two major banks, their board members and their chief financial officers to be implicated in a number of administrative violations of the Cypriot Market Abuse Law,[52] of the Public Offer and Prospectus Law[53] and of the Transparency Law[54] and imposed upon them significant administrative fines. All three pieces of legislation regulate the information that must be provided to any potential and existing investors of listed companies in relation to offers made to the public to acquire new securities, as well as the information that needs to be provided to investors and the general public following the listing of securities. Therefore, this legislation **does not relate to the core business of banking**, but to the peripheral activities of certain banks as listed companies that raise capital from the public that is used for further expansion and/or the improvement of their bank capital.[55]

52 Insider Dealing and Market Manipulation (Market Abuse) Law of 2005, No. 116(I)/2005, as amended, Republic of Cyprus.

53 Public Offer and Prospectus Law of 2005, Law No. 114(I)/2005, as amended, Republic of Cyprus.

54 Transparency Requirements (Securities Admitted to Trading on a Regulated Market) Law of 2007, Law No. 190(I)/2007, as amended.

55 According to the Financial Times Lexicon [www.ft.com/lexicon], 'bank capital is the funds – traditionally a mix of equity and debt – that banks have to hold in reserve to support their business. Bank

The administrative decisions made by CySEC led to the imposition of significant administrative fines on the two major banks, on a number of their directors and on the chief financial officers of the two groups. However, according to statements made in the autumn of 2014 by the Chairperson of the CySEC, Ms Demetra Kalogerou, the majority of the people fined did not pay their fines, and the CySEC will proceed with legal measures for enforcing their payment. The fact that the fines were administrative in nature and imposed by the said regulatory authority and not by a court of law – as would have been the case if the fines were imposed by criminal courts – means that their payment cannot be directly enforced by the regulator, but only through civil law suits, which might take a long time to adjudicate.

It could, therefore, be argued that the administrative sanctions alone are not considered as a 'just punishment' for the catastrophe that was brought upon or allowed to occur by the two banks and caused the suffering of thousands of people. The question now becomes whether these administrative decisions either lead or pave the way for criminal prosecutions to follow.

The first point to note is that there is a high likelihood that the laws upon which the CySEC based its administrative decisions will be used as the legal tool for the filing of criminal indictments against the individuals involved. This prospect is based on the following factors:

A. Legal Factors

(i) Same provisions constituting administrative and criminal offences: The same provisions of the Transparency Law and the Market Abuse Law that sanction the provision of misleading information to the public or the failure to publicise price-sensitive (insider) information following a listing of securities, constitute, at the same time, both administrative and criminal offences, with no need to prove the element of intent.[56]

capital has been in the spotlight since the financial crisis began. The two capital ratios that banks routinely cite are the tier one capital ratio and a subset of that – the core tier one capital ratio, also called the equity tier one ratio. Tier one is essentially top-notch capital, with core tier one a subset comprising the best of the best. The Basel Committee on Banking Supervision, whose Basel III rules form the basis for global bank regulation, is focused on the core tier one ratio, which, like the Americans, it refers to as the equity tier one ratio. It essentially will consist of only equity and retained profits.'

56 For instance, pursuant to the Transparency Law, Law Nu. 190(I)/2007 Section 40, the provision of false or misleading data or information is, at the same time, an administrative offence (punishable by a fine of up to €341,000) and a criminal offence, punishable by up to 5 years of imprisonment. Also, pursuant to the Market Abuse Law Section 19 as detailed in Section 20(1)(c), the dissemination of information through the media which gives, or is intended to give, false or misleading signals as to financial instruments, including the dissemination of rumours and false or misleading news, where the person

(ii) Assignment by law of personal responsibility: The laws regulating the admission of securities to the Stock Exchange and the information that must be publicised by the listed companies following listing, assign direct, personal legal responsibility on the directors signing the prospectuses and the financial reports.

B. Practical Factors

The CySEC has already found a number of bank board members and executives of the two major banks in administrative violations, and there is a significant body of data and material collected for the CySEC investigations which will be utilised for the speedy progress of criminal investigations and indictments. The prosecutorial effort would focus on building up strong enough criminal cases premised on the CySEC findings which could lead to criminal convictions, where the criminal standard of proof of guilt is higher than in administrative cases (i.e. beyond reasonable doubt as compared to the balance of probabilities).

The second point to note is that, as stated in the publicised CySEC decisions, the CySEC found the two banks and a number of their directors and responsible persons in a number of violations in relation to certain provisions of the capital markets laws. It is expected that, in taking decisions on whether or not to criminally prosecute any of the individuals that have been found administratively liable, factors such as their position and involvement in the running of the banks will be taken into consideration. The stronger cases from a prosecutorial point of view, and thus more likely to be prosecuted, will be in respect of those individuals who held executive positions and were involved in the everyday running of the affairs of the two banks. The abovementioned CySEC decisions will be analysed in the following paragraphs.

Cyprus Popular Bank Ltd

CySEC decision of 28 April 2014, announced on 5 June 2014:[57]

Violations of Section 40(1) of the Transparency Law and ensuing fines and reprimands of 15 Directors and the Chief Financial Officer of the Group in respect of signing the Half-

who made the dissemination knew, or ought to have known, that the information was false or misleading, is both an administrative offence punishable with an administrative fine up to €855,000 and a criminal offence punishable by imprisonment of up to ten years and/or by a fine up to €171,000.

57 CySEC decision of 28 April 2014 regarding the imposition of administrative fines to Cyprus Popular Bank Public Co Ltd, to its Members of the Board and to other persons (investigation regarding Greek Government Bonds) announced on 5 June 2014. Notably, this was the first time ever that CySEC made available its full decision regarding administrative violations against any person on its website and not just a summary announcement.

According to the Announcement, the CySEC's investigation focused, among others, on the following:

1. The information that Cyprus Popular Bank Public Co Ltd and Bank of Cyprus Public Company Ltd

Yearly Financial Reports and the Annual Financial Report for 2010. Fines imposed in relation to the signing of the Half-Yearly Financial Report totalled €595,000 and ranged from €15,000 to €130,000. Fines imposed in relation to the signing of the Annual Financial Report totalled €680,000 and ranged from €20,000 to €140,000 per person.

CySEC decision of 28 April 2014, announced on 5 June 2014:[58]

Violations of Section 20(4) of the Public Offer of Securities Law, Law No. 114(I)/2005 and ensuing fines of five Directors in respect of signing four prospectuses for the public offer of securities: Prospectuses dated 28 May 2010 (total fine €320,000), 1 September 2010 (total fine €270,000), 21 December 2010 (total fine €410,000) and 19 May 2011 (total fine €500,000). Fines imposed ranged from €20,000 to €140,000 per person.

CySEC decision of 28 April 2014, announced on 5 June 2014:[59]

Pursuant to the same decision of 28 April 2014, the CySEC also found the body corporate (the Cyprus Popular Bank Ltd) in a number of violations, including six counts of violations of Section 19 of Market Abuse Law as detailed in Section 20(1)(c) for spreading misleading indications in six financial reports in the period 2010–2011 regarding the banks' investments in Greek Government bonds, and three counts of violations of the same provision resulting from provision of information from prospectuses. The total administrative fine to the Bank as a consequence of the CySEC decision of 28 April 2014 amounted to €1,050,000.

CySEC decision of 30 September 2013, announced on 10 October 2013:[60]

Violation of Section 11(2)(b) of the Market Abuse Law by a former Chief Executive Officer of Marfin Popular Bank, for making a misleading statement regarding the financial soundness and capital reserves of the Bank. The imposed fine amounted to €100,000.

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provided to investors and the public at large, through the publication of their Financial Reports and the publication of Prospectuses for the year 2010 and the year 2011 until the first Private Sector Involvement (PSI), in relation to the amount of their investment in GGB and the risks of this investment at a time when the GGB were undergoing continuous downgrades;

2. Whether Cyprus Popular Bank Public Co Ltd and Bank of Cyprus Public Company Ltd applied the Principles of Corporate Governance of the CSE (CGC), which, as stated in the Financial Reports and Prospectuses, both Companies had adopted in 2010 and 2011.

58 CySEC decision of 28 April 2014 regarding Cyprus Popular Bank Public Co Ltd.

59 *Ibid*.

60 CySEC decision of 30 September 2013 regarding administrative sanctions imposed on Mr Efthimios Bouloutas [in Greek]. Public Information, Announcements, announcement date 10 October 2013; available at: [http://www.cysec.gov.cy/en-GB/public-info/announcements/], retrieved 5 December 2014.

Bank of Cyprus Ltd

CySEC decision of 28 April 2014, announced on 5 June 2014:[61]

Violations of Section 40(1) of the Transparency Law and ensuing fines and reprimands of 18 Directors and the Chief Financial Officer of the Group in respect of signing of the Half-Yearly Financial Report for 2010 and the Annual Financial Report for 2010. Fines imposed in relation to the signing of the Half-Yearly Financial Report totalled €620,000 and ranged from €30,000 to €120,000 per person. Fines imposed in relation to the signing of the Annual Financial Report totalled €860,000 and ranged from €50,000 to €140,000 per person.

CySEC decision of 28 April 2014, announced on 5 June 2014:[62]

Violations of Section 20(4) of the Public Offer of Securities Law and ensuing fines and reprimands of 16 Directors in respect of signing of two prospectuses for the public offer of securities: Prospectuses dated 20 August 2010 (total fine €440,000) and 5 April 2011 (total fine €560,000). Fines ranged from €30,000–150,000 per person.

CySEC decision of 28 April 2014, announced on 5 June 2014:[63]

Pursuant to the same decision of 28 April 2014, the CySEC also found the body corporate (the Bank of Cyprus Ltd) in a number of violations, including six counts of violations of Section 19 of the Market Abuse Law as detailed in Section 20(1)(c) for spreading misleading indications in six financial reports in the period 2010–2011 regarding the Banks' investments in Greek Government bonds and two counts of violations of the same provision resulting from provision of information from prospectuses. The total administrative fine to the Bank as a consequence of the CySEC decision of 28 April 2014 amounted to €950,000.

CySEC decision of 11 November 2013, announced on 27 November 2013:[64]

On 29 July 2013, CySEC found the Bank of Cyprus Ltd in violation of Section 11(1)(a) of the Market Abuse Law, on the grounds that it failed to publicise, as soon as possible, namely on 15 June 2012, insider information, to the effect that its capital needs for

61 CySEC decision of 28 April 2014 regarding the imposition of administrative fines to the Bank of Cyprus Public Company Ltd, to Members of its Board of Directors as well as to other persons (Greek Government Bonds).

62 CySEC decision of 28 April 2014 regarding Bank of Cyprus Public Company Ltd.

63 *Ibid*.

64 CySEC decision of 11 November 2013 regarding Bank of Cyprus Plc [in Greek]. Public Information, Announcements, announcement date 27 November 2013; available at: [http://www.cysec.gov.cy/en-GB/public-info/announcements/], retrieved 5 December 2014.

covering the requirements of the European Banking Authority had increased from €200 million to €400 million with the likelihood of further increases. Further to this decision, the CySEC decided, on 11 November 2013, to impose an administrative fine on the body corporate of €70,000, and personal fines to four Directors (the three Executive Directors and the Chairman in June 2012), since it found that the violation of the corporation was due to their fault and negligence. Fines to the four directors totalled €220,000 and ranged from €50,000 to €60,000 per person.

It should be highlighted that the power of CySEC to impose administrative fines on directors of corporations for their corporations' breaches of provisions of the Market Abuse Law is founded on Section 48(4)(a) of the Market Abuse Law. Importantly, Section 48(4)(a), stipulates that in cases where a breach by the corporation is found, the burden of proof is shifted onto the shoulders of directors, managers and officials of the corporation who must prove that the violation was not due to their own fault, wilful omission or negligence.

The Attorney General proceeded in December 2014, to file criminal charges against the body corporate and the same four directors plus the Vice-Chairman in June 2012, based on the same facts, that is, for failure to publicise, as soon as possible, that the bank's capital needs for covering the requirements of the European Banking Authority had increased significantly from the initially publicised figure of €200 million. Also, two of the Directors were charged with spreading misleading indications at the annual general meeting of the shareholders of the bank that took place on 19 June 2012 regarding the true capital needs of the bank, and at the same AGM, they concealed information available regarding the true capital needs of the bank. The above charges are based on provisions in the Market Abuse Law,[65] the violation of which constitutes both administrative *and* criminal offences. The criminal offences related to the failure to publicise material information and the spreading of misleading indications at the AGM, fall under Part IV of the Market Abuse Law (Market Manipulation), and are punishable by imprisonment of up to ten years and/or a fine of up to €170,000. The criminal offences related to the concealment of material information fall under Part III of the Market Abuse Law (Obligations of Issuers), and are punishable by imprisonment of up to five years and/or a fine of up to €85,000.

CySEC decision of 30 September 2013, announced on 4 October 2013:[66]

On 2 July 2013, CySEC found the Bank of Cyprus Ltd to be twice in violation of Section 11(1)(a) of the Market Abuse Law, on the grounds that it failed to publicise, as soon as

65 Sections 20(1)(c) and 23(3) in relation to the spreading of misleading indications and Sections 11(2)(b) and 15(3) in relation to the concealment of material information.

66 CySEC decision of 30 September 2013 regarding administrative sanctions imposed on Bank of Cyprus

possible (on 13 January 2010 and on 28 April 2010) insider information; that is, in relation to the magnitude of the investments of the Bank in Greek Government Bonds.

Further to this decision, the CySEC decided on 4 October 2013 to impose an administrative fine to the body corporate of €70,000 on the first count and €90,000 on the second count, and issue personal fines and reprimands to six directors, since it found that the violation of the corporation was due to their fault and negligence. Fines to the directors totalled €110,000 regarding the first count and €190,000 regarding the second count and ranged from €10,000 to €80,000 per person.

In respect of the above imposed administrative fines, the analysis above (p. 275) regarding the shifting of the burden of proof to directors of corporations found in breach of the Market Abuse Law, also applies here.

To Boldly Go, Where No (Cypriot) Prosecutor Has Gone Before

The prosecution of banks, and bankers, for peripheral, non-banking activities in relation to the banking crisis in Cyprus, is certainly not an ideal state of affairs. However, for the reasons that have been analysed above, it appears to present, at this stage, the most realistic possibility for criminal indictments to be filed. As we have seen already, the Attorney General filed one criminal indictment in relation to the potential criminal violations of the Market Abuse Law regarding a certain set of facts that were originally administratively examined and pursued by the CySEC. The charges are based on provisions of the Market Abuse Law, the violation of which constitutes both administrative *and* criminal offences. The people who were charged are former executive directors of a bank, the Chairman and Vice-Chairman. As analysed in pages 272–276 above, the CySEC found a significant number of former directors and high-ranking officers to be in administrative violation of the Market Abuse Law, the Transparency Law and the Public Offer of Securities Law. The filed indictment points to the conclusion that, especially in relation to the violations of the Market Abuse Law and the Transparency Law which contain sections providing for both administrative and criminal offences with no need to prove the element of intent, criminal indictments will follow the administrative decisions where evidence to the criminal standard can be found. In such a case, consistent with the policy applied in respect of the current prosecution, the executive directors and senior board members and/or officers of the banks will likely be indicted. Although not an ideal state of affairs, such prosecutions, if effectively pursued, will not be devoid of utility; they will send a

Plc and Board Members [in Greek]. Public Information, Announcements, announcement date 4 October 2013; available at: [http://www.cysec.gov.cy/en-GB/public-info/announcements/], retrieved 5 December 2014.

strong signal of discouragement to potential future offenders. They will also meet, to a certain extent, people's expectations for the punishment of wrongdoers and can help to rebuild the eroded public confidence to the administration of justice.

It should, however, be borne in mind, that the Market Abuse Law, Transparency Law and Public Offer and Prospectus Law have never before been used for criminal prosecutions in Cyprus. This is not a Cypriot-specific phenomenon. In most of the European jurisdictions, there has traditionally been a preference for employing administrative measures in respect to punishing capital market violations (by contrast with the US, where market abuse has, since the early 1930s, always constituted a criminal offence). This policy has been gradually changing.[67] In Cyprus, since the enactment of the above legislation (e.g. since 2005 for the Market Abuse Law) the CySEC has been forwarding the briefs of cases where it had found administrative violations of various persons to the Attorney General's department and the same violations could give rise to criminal prosecutions. The Attorney General has never, up to now, acted to file criminal indictments in these matters, perhaps casting doubt on whether the guilt of the persons involved could be proven beyond reasonable doubt which is the standard for criminal proof of guilt, and/or whether the seriousness of these violations justified criminal prosecutions. There is, therefore, no precedent in the Cypriot legal system in relation to the interpretation of the criminal provisions of the above legislation and as a result, their effectiveness and application remains to be seen.

67 The case of *R.* v. *Christopher McQuoid* [2009] EWCA Crim 1301 (10 June 2009), is the first criminally prosecuted case in the UK for insider dealing, and is illustrative of the policy shift in the area of capital markets crime. The offender, a UK solicitor, was sentenced to 8 months imprisonment (and confiscation of £35,000), for a single count of insider dealing. McQuoid appealed against the severity of his sentence and submitted that this should be reduced, because this happened to be a case under consideration by the regulator when it decided to change policy in relation to whether to proceed by way of criminal prosecution rather than, as before, administrative measures. The appellant, he contended, was the first; and others, no less culpable, were not prosecuted but were dealt with through the regulatory system. The UK Court of Appeal (Criminal Division) noted in its decision: 'We .... emphasise that this kind of conduct does not merely contravene regulatory mechanisms. If there ever was a feeling that insider dealing was a matter to be covered by regulation, that impression should be rapidly dissipated. The message must be clear: when it is done deliberately, insider dealing is a species of fraud; it is cheating. Prosecution in open and public court will often, and perhaps much more so now than in the past, be appropriate. Those involved in the earlier investigations when a different policy was apparently adopted (and assuming that a different policy was adopted) may have been very fortunate. But their good fortune cannot endure to the benefit of anyone else.'

SECTION V

Recent Developments and Recommended Changes and Improvements to the Legal and Regulatory System Considered Necessary so as to Effectively Guard against any Similar Future Failings

No system or set of measures can provide an absolute guarantee against future failings in the financial system. Furthermore, it is generally accepted that any measures to be adopted must not be unduly draconian, in order to avoid stifling the functioning of the banking and capital markets and stunting economic growth. Having said that, a number of changes and improvements can be considered that would substantially reduce the likelihood of any similar failings reoccurring. The changes and improvements should also take into account recent developments in the regulatory and supervisory framework[68] for the operation of the Cypriot credit institutions. Therefore, in this part, the recent developments will first be briefly considered and then, taking those into account, a number of recommendations will be put forward.

Recent Developments in the Regulatory and Supervisory Framework

The Regulatory Framework

The regulatory framework for the governance of the Cypriot credit institutions has been recently (2014) strengthened by the Central Bank of Cyprus' issuance of two directives:

(i) The Central Bank Directive to authorise Credit Institutions on the Assessment of the Fitness and Probity of the Members of the Management Body and Managers of Authorised Credit Institutions of 2014 (the 'Fitness and Probity Directive'), and

(ii) The Central Bank Directive on Governance and Management Arrangements in Credit Institutions, which came into force on 8 August 2014 (the 'New Corporate Governance Directive').

The Fitness and Probity Directive outlines the procedure (in Parts IV and V) and the criteria (in Part VI) for the assessment of the fitness and probity of candidate members and managers for the boards and senior positions of the Cypriot Authorised Credit Institutions ('ACIs') by the Credit Institutions themselves at the first stage, and by the Central Bank at the final stage. The procedure utilises a detailed questionnaire. Importantly, at paragraph 9 of the Fitness and Probity Directive, it is stated that the fitness and probity of a member or manager of a Credit Institution 'shall be continuous and,

68 See Note 20 for the distinction between banking regulation and supervision.

therefore, it shall not be assessed by the ACI only during the time of appointing the person to the position of a member or of a manager but also throughout the whole term of his/her appointment'. The criteria for the assessment on fitness and probity include general assessment criteria, reputation criteria, experience criteria and governance criteria.

The New Corporate Governance Directive states, among others, the duties of individual members of the management body and stresses that:

> '26 Each member of the management body must engage actively in the business of the institution and must be able to make their own sound, informed, objective and independent decisions and judgements to fulfil their individual and collective responsibilities; in this respect, each member of the management body must –
>
> (a) ensure they have a clear understanding of the institution's governance arrangements and their role in them;
>
> (b) ensure they have an up-to-date understanding of the business of the institution including areas for which they are not directly responsible but are collectively accountable;
>
> ...
>
> (d) act with honesty, integrity and independence of mind to effectively assess and challenge the decisions of the senior management where necessary and to effectively oversee and monitor management decision-making.'

The Supervisory Framework

Following the positive results of the stress tests that were performed in 2014 on the four significant Cypriot banks, these banks have come under the Single Supervisory Mechanism (SSM) since 4 November 2014, and are therefore directly supervised by the European Central Bank ('ECB'). Each of the four entities has total assets over 20% of the national GDP. Their day-to-day supervision will be conducted by Joint Supervisory Teams, which will comprise of staff from both the Central Bank of Cyprus and the ECB.[69] In carrying out its prudential tasks, the ECB applies relevant EU laws, and, where applicable, the national legislation transposing them into Member State law.

Changes and Improvements Considered Necessary so as to Substantially Reduce the Likelihood that Similar Failings will Occur in the Future

The passing of the baton to the European Central Bank and the enhancement of the regulatory rules, should not, however, be seen as a panacea for the regulation and

69 European Central Bank, *Guide to Banking Supervision*, November 2014, at p. 16.

supervision of the banking sector in Cyprus. Firstly, because, as argued above (end of p. 251 to p. 256) there was in place certain compliance with the fundamental corporate governance rules, but of a formalistic, rather than substantial nature; and the need to supervise compliance in *substance* would still present a challenge. Secondly, because one of the root causes of the crisis was, as analysed in pages 260–262, the failure of attribution of personal responsibility and this is an area which is not addressed in the current legal framework (see p. 268 above). Thirdly, because, as will be expanded upon in pages 283–286, there is a strong correlation between economic crimes and the corruption of public officials found on the international stage, and the current legal and enforcement system in Cyprus does not constitute an effective deterrent against the dishonest or partial exercise of public officials in their duties. Therefore, changes and improvements in the regulatory and supervisory framework are still necessary, and will be considered below.

Corporate Governance, Senior Officers and Personal Responsibility

We have seen above an enhancement of the regulatory rules regarding governance for all Cypriot credit institutions and a shifting of the responsibility for supervising the four largest Cypriot banks to the European Central Bank. Nevertheless, as argued earlier in pages 251–256, corporate governance in Cypriot banks failed so dismally in practice, not as a result of an absence of rules, but rather due to the non-application of the existing rules by the banks and their formal, rather than substantial, compliance. Simply making the rule-book more voluminous and detailed will not, in and of itself, improve the sense of personal responsibility and accountability of the board members and senior officers of the banks.

It can, however, provide the necessary foundation upon which to base a framework which would create a *presumption* of personal responsibility for any administrative breaches of the rules and place the responsibility for the failures of the banks on the shoulders of their directors and other high-ranking officers; and by creating a clear framework for establishing personal criminal responsibility for the failure of banks.

If, according to the new Central Bank directives, the individual board members and senior officers must continuously adhere to high standards of fitness and probity and they must be able to make their own sound, informed, objective and independent decisions and judgements in order to fulfil their individual responsibilities, then it is fair, reasonable and justified, for them to be presumed to be responsible for the breaches of the rules and failures of the banks that they lead, direct and rule; unless they can prove otherwise. It is a fact that large and complex corporations often make strategic and far-reaching decisions through committees or boards and these decisions may sometimes lead to the failure of the banking institutions. This should not, however, operate, as a firewall, or shield that can be used to deflect from the personal responsibility of the board members and senior managers in making important decisions.

More specifically, in respect of the breaches of the Central Bank directives (e.g. of the

New Corporate Governance Directive and the Fitness and Probity Directive) which could give rise to the imposition of **administrative sanctions** by the regulator, **the burden of proof can be shifted** to the senior managers and board members in charge. Consequently, if an administrative breach of the rules or directives by the financial institution is initially proven, the senior managers or officers in charge would not be guilty of misconduct if **they can prove**, on the balance of probabilities, that they took all reasonable steps and measures to avoid the commission of the breach. The existing reversal of the burden of proof in Section 48(4)(a) of the Market Abuse Law (discussed on p. 275), in relation to capital markets' breaches, is also a good model to follow in respect of the breaches of banking laws and directives by the banks.

It is also necessary **to put in place a clear and sufficiently deterrent legislative framework of personal criminal responsibility for directors and senior officers of banks, starting from the most serious cases which are those of bank failures**. By 'failure', it is meant that the bank has had to enter insolvency, administration or resolution. The UK Financial Services (Banking Reform) Act ('FSBRA') created such a deterrent framework with its 2013 amendment.[70] According to the amendment, personal criminal responsibility is held by the board members and senior managers who may, through their decisions regarding the way in which the business of the financial institution is carried out, or through their failure to take steps that would have prevented such a decision being taken, have brought about, contributed to or otherwise contributed to the financial institution's collapse. The presumption of innocence would not be negated, but criminal responsibility would not be based on criminal intent – which is very difficult to substantiate in cases of collective decision making – but on negligence instead. Section 36 of the FSBRA 2013 creates personal criminal responsibility for senior managers for the taking of a decision on behalf of the financial institution which eventually leads to its failure, whilst being *aware*, at the time of the taking of the decision, of the risk that the implementation of the decision may cause the failure of the institution.[71]

70 Financial Services (Banking Reform) Act 2013 (chapter 33), UK. Available at: [http://www.legislation.gov.uk/ukpga/2013/33/contents/enacted], last accessed on 14 May 2015.

71 Section 36(1) of the FSBRA 2013 states:
'**36 Offence relating to a decision causing a financial institution to fail**:
(1) A person ('S') commits an offence if—
(a) at a time when S is a senior manager in relation to a financial institution ('F'), S—
(i) takes, or agrees to the taking of, a decision by or on behalf of F as to the way in which the business of a group institution is to be carried on, or
(ii) fails to take steps that S could take to prevent such a decision being taken,
(b) at the time of the decision, S is aware of a risk that the implementation of the decision may cause the failure of the group institution,

The combined operation of having, on the one hand, more strict and detailed rules on governance, and, on the other, an enhancement of personal responsibility for the board members and senior managers in respect of the breaches of these rules and bank failures, would lead to a number of positive results, including:

(i) The Filtering Effect: An effective personal responsibility system would discourage the candidacy to board membership and senior management of persons who are not able to successfully carry out the respective duties associated with such responsible positions. To paraphrase a famous quote attributed to President Harry S. Truman, if the heat is turned up, those who cannot take it, will not enter (or leave) the kitchen.

(ii) The Deterrence Effect: With respect to board members and senior managers who maintain their posts, individual responsibility would act as a significant deterrent against rule breaking and negligence in the execution of their duties. Sanctions that may only be imposed on the corporation tend to be considered by the boards as running business costs, and the shareholders absorb their effect.

(iii) The Sanitisation Effect: As noted in the Report of the UK Parliamentary Commission on Banking Standards (2013):

> 'It is imperative that in future senior executives in banks have an incentive to know what is happening on their watch – not an incentive to remain ignorant in case the regulator comes calling'.[72]

If the board member or senior manager knows that s/he will have to take personal responsibility for any breaches of the rules unless s/he can prove that s/he took all reasonable steps and measures to avoid the commission of the breach, then it is likely that s/he will wish to be kept abreast of important issues, risks and developments, and protect him or herself from liability by taking such steps and measures, and/or directing and monitoring the departments or units required (e.g. risk management, internal audit, or compliance department) in order to take the necessary measures that would absolve the senior manager from assuming personal responsibility. This would contribute to the better and more compliant functioning of the whole organisation – or in other words, its sanitisation.

(c) in all the circumstances, S's conduct in relation to the taking of the decision falls far below what could reasonably be expected of a person in S's position, and

(d) the implementation of the decision causes the failure of the group institution.'

72 Report of the Parliamentary Commission on Banking Standards, *Changing Banking for Good*, par. 14.

Corruption and Economic Crime

International and local experience shows a strong correlation between economic crimes and the corruption of public officials, who either turn a blind eye to the obvious, or are tolerant of, or even complicit in, the violations of rules.

From a legislative point of view, we can observe that the current legislative framework in Cyprus in relation to corruption and/or the abuse of power by public officials consists of an outdated 1960 law for the prevention of corruption[73] and a scattered number of provisions in the Cypriot Criminal Code, most of which are misdemeanours or punishable, at a maximum, with relatively short sentences which do not constitute an effective deterrence. For example, the abuse of power by a civil servant is punishable, pursuant to Section 105 of the Criminal Code, by a maximum of three years' imprisonment. Receiving a bribe by a civil servant under the expressed or silent understanding that s/he will exercise its authority to favour the briber or any other person, is only a misdemeanour that is punishable by a maximum of two years' imprisonment under Section 102 of the Criminal Code. Influencing a public authority, commission or officer, in the exercise of his or her disciplinary functions, is punishable by a maximum of 12 months' imprisonment under Section 105A of the Criminal Code. It is noteworthy that the above provisions have not been updated for years or decades. An exception to this is Section 100 of the Cypriot Criminal Code which was updated in 1999 and again in 2012 and criminalises the receipt of a bribe by a public official for the taking of an action or inaction in the exercise of his or her duties. An offence under Section 100 is punishable by a maximum of seven years' imprisonment and/or a fine of €100,000 while the offender's assets resulting from the bribe are subject to confiscation.

From an enforcement point of view, we can observe that, for most, if not all of the above offences, there has not been a single instance where someone has been charged and convicted for their violation in the past 15 years. A good example illustrating this is the case of the former Bank Governor Mr Christodoulos Christodoulou. Although he pleaded guilty for the submission of false tax returns in respect of the non-declaration of an amount of one million Euros deposited to connected accounts one year after he left office, no corruption charges have been brought against him up to now. If both sides of the corruption equation, (the corrupted and the corruptor), stand to benefit, then no-one talks. The victim here is usually too distant from the place of the crime and the offenders to file a complaint; it is the tax-payer, the bank depositor, the ordinary citizen.

Therefore, not only is the legislative framework for anti-corruption in need of a radical overhaul, but so is the enforcement framework.

73 The Prevention of Corruption Law, Cap. 161, as amended, Republic of Cyprus. It consists of seven sections.

The legislative framework overhaul could come in the form of a special act of parliament, such as a Bribery or Corruption Act that would broadly define bribery and corruption. Corruption and bribery can take myriad forms, and having provisions for specific acts of corruption would unduly narrow the scope of the legislative framework and potential for enforcement. New South Wales, Australia, is a very good example of a common law jurisdiction (like Cyprus), which, in response to growing community concerns surrounding the integrity of public administrators in the 1980s, created an independent commission against corruption and endowed it with very significant powers and a wide scope of operation. Therefore, Section 8 of the Independent Commission Against Corruption Act 1988 of New South Wales (NSW), Australia defines corrupt conduct very widely as:

> '(1) (a) any conduct of any person (whether or not a public official) that adversely affects, or that could adversely affect, either directly or indirectly, the honest or impartial exercise of official functions by any public official, any group or body of public officials or any public authority, or
>
> (b) any conduct of a public official that constitutes or involves the dishonest or partial exercise of any of his or her official functions, or
>
> (c) any conduct of a public official or former public official that constitutes or involves a breach of public trust, or
>
> (d) any conduct of a public official or former public official that involves the misuse of information or material that he or she has acquired in the course of his or her official functions, whether or not for his or her benefit or for the benefit of any other person.
>
> (2) Corrupt conduct is also any conduct of any person (whether or not a public official) that adversely affects, or that could adversely affect, either directly or indirectly, the exercise of official functions by any public official, any group or body of public officials or any public authority and which could involve any of the following matters:
>
> (a) official misconduct (including breach of trust, fraud in office, nonfeasance, misfeasance, malfeasance, oppression, extortion or imposition),
> (b) bribery,
> (c) blackmail,
> (d) obtaining or offering secret commissions,
> (e) fraud,
> (f) theft,
> (g) perverting the course of justice,
> (h) embezzlement, [...]'[74]

74 Independent Commission against Corruption Act 1988, New South Wales (NSW), Australia. Available at: [http://www.austlii.edu.au/au/legis/nsw/consol_act/], accessed on 7 April 2015.

The broadening of the definition of corruption, from an investigatory point of view, would also provide new, direly needed tools to Cypriot investigators, extending their capabilities. This is because, according to the Sixth Amendment of the Constitution of the Republic of Cyprus (2010), the privilege of the privacy of communications, including telephone communications, can now be lifted pursuant to strict procedures including a court order, but only with respect to five types of offences. One of these is the serious corruption of public officials, which is punishable by a minimum sentence of five years imprisonment.[75]

The enforcement of such special legislation needs to be placed in the hands of a different state apparatus than the one currently used, which is the police. Firstly, because one needs a specialised unit in order to investigate these types of offences. Secondly, because, generally speaking, law enforcement is often a breeding ground for corruption. An independent commission should be hierarchically, functionally and fiscally independent from the police system. The models used in a number of other common law jurisdictions, place previous judicial office holders at the helm of such commissions. According to the Independent Broad-based Anti-Corruption Commission ('IBAC') Act 2011 of the State of Victoria, Australia, the Commissioner's status is that of an independent officer of the Parliament.[76] Crucially, according to Section 12 of the Act:

> 'The IBAC is not subject to the direction or control of the Minister in respect of the performance of its duties and functions and the exercise of its powers.'

The Commission's powers must also be broadly defined. Section 10 of the IBAC Act states that:

> 'The IBAC has power to do all things that are necessary or convenient to be done for or in connection with, or as incidental to, the achievement of the objects of this Act and the performance of its duties and functions.'

The jurisdiction of the NSW Independent Commission against Corruption also extends to all NSW public sector agencies (except the NSW Police Force[77]) and employees, including government departments, local councils, members of Parliament, ministers, the judiciary and the Head of State. Parliament may refer any matter to the Commission for investigation.[78]

75 Article 17 of the Constitution of the Republic of Cyprus, as amended by Law No. 51(I)/2010.
76 Section 13 of the IBAC Act 2011 of Victoria, Australia.
77 There is a special Policy Integrity Commission for this purpose.
78 Section 13, Independent Commission against Corruption Act 1988, New South Wales.

Section VI

Concluding Words

The public perception of the big banks and financial institutions, not only in Cyprus, but in other countries that recently suffered from banking and financial crises as well, is that neither they, nor their leaders ever have to fully answer for the consequences of their actions.

This perception appears to be, to a certain extent, justified in Cyprus. There can be no doubt that the Cypriot legal and regulatory system was unprepared to prevent the recent catastrophe, and its lines of defence failed dismally. The crucial question now is whether this very same legal and regulatory system can bring catharsis and just punishment, where punishment is due.

Doubts can be raised regarding whether the system will be able to adequately respond to the challenge, or whether it will be found wanting. As argued in this article, the tools for placing personal responsibility on the shoulders of senior managers to answer for the wrongdoings and even failures of the banking institutions have traditionally not been sharp enough; and therefore both changes and improvements are long overdue. The more realistic expectations regarding criminal prosecutions cannot be found in relation to the core-banking business but in the peripheral activities of certain banks in their roles as listed companies. To date, the only indictment that has been filed signifies the direction that criminal indictments will follow the administrative decisions where evidence to the criminal standard can be found. This is especially true in relation to violations of the Market Abuse Law and the Transparency Law which contain sections providing for both administrative and criminal offences with no need to prove the element of intent. In such a case, and consistent with the policy applied in respect of the current prosecutions, it is probable that the executive directors and senior board members and/or officers of other banks will also be indicted.

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