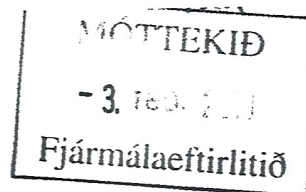


WEIL, GOTSHAL & MANGES



# MEMORANDUM

23 December 2008

**To:** The Resolution Committee of  
Kaupthing Bnk hf

**From:** Weil, Gotshal & Manges  
Grant Thornton UK LLP

**Re:** Investigations into the lending to Oscatello Investments Ltd

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- 1 In Mid November Resolution Committee (the "RC") instructed Weil Gotshal to consider a specific package of lending made by Kaupthing to vehicles associated with Mr Robert Tchenguiz.
- 2 This lending included a secured overdraft facility dated 19 December 2007 (the "Overdraft") which, as a result of various extensions and amendments, resulted in a total sum of approximately £640 million being advanced to a BVI registered entity named Oscatello Investments Limited ("Oscatello"). Oscatello is owned by the trustees of the Tchenguiz Discretionary Trust ("TDT") and is the top company in a largely offshore structure which encompassed a series of trading companies (the "Trading Companies"). The Trading Companies operated share and derivative trading accounts with Kaupthing Singer & Friedlander ("KSF") and Kaupthing Luxembourg amongst other institutions.
- 3 In order to secure the Overdraft, Oscatello granted or procured the grant of, a series of mortgages over shares in companies within the TDT/Oscatello structure (the "Mortgages"). The Overdraft contains a series of requirements and tests as to the value of the security to be posted in relation to the amount of funds advanced.
- 4 On 13 November 2008, Kaupthing was informed by the lawyers acting for TDT/Oscatello that a series of transactions had taken place which, it was our advice to you, breached the terms of the Overdraft and the Mortgages (the "TDT Transactions"). In particular, those transactions were in our opinion (and as effectively admitted by TDT/Oscatello) designed to ensure that the valuable assets to which the Mortgages could have attached were put beyond the reach of Kaupthing. It is our assessment (and that of Queen's Counsel in England instructed by us on behalf of Kaupthing) these were fraudulent transactions.

- 5 As a consequence, on 5 December 2008 we obtained an order from the High Court of the British Virgin Islands to preserve the assets in question. We also instructed the forensic and investigation services department of Grant Thornton UK LLP in London to value the assets mortgaged as security for the lending to Oscatello and, as part of that exercise, to investigate the circumstances surrounding the lending to TDT/Oscatello and, in particular, the sufficiency of the security supporting it.
- 6 We have ascertained that the total of all sums advanced to TDT/Oscatello related entities is just over **£1.6 billion as at 3 October 2008** of which £1.275 billion was expressly secured. Of this secured sum, the lending under the Overdraft (approximately £640 million) was secured by the mortgages and the balance was secured via repo transactions that have now matured. We set out below a table of the loans in question.

		As at 3 October 2008 £'000
<b>Kaupthing Iceland</b>		
<b>Lending to Oscatello Group</b>		
<b>Borrower:</b>		
Oscatello	Overdraft (no. 358-36-509)	637,059
Razino	Repo on Sainsbury shares*	461,949
Violet Capital	Repo on Mitchells & Butlers shares*	176,305
Total secured*		1,275,314
Oscatello	Profit Participation loan	222,201
Oscatello	Money Market loan	155,161
<b>Total Kaupthing Iceland</b>		<b>1,652,676</b>

\* Repo transactions matured in October/November

- 7 Grant Thornton have confirmed that based on the requirement of the Overdraft agreement that the loan should be equal to 87% of the assets, the total value of the security which (under the relevant contract) *should* have been posted to secure that lending was £1.466 million (£732 million in respect of the Overdraft of £637 million, £431 million in respect of Razino and £203 million in respect of Violet Capital). In fact at its highest, the value of the security actually posted was £1.147 million. Immediately prior to the TDT Transactions, based on the limited information available to them, Grant Thornton, have estimated the value of the security to have been a maximum of £456 million. They have also estimated the total value of the securities after the TDT Transactions – under which certain PIK notes were issued (valued at £11.5 million) on 13 November 2008 - to be a maximum of £281 million.

8 The table below summarises the position:

		As at 3 October 2008		as at 24 November 2008	
Borrower		Liabilities	Allocated Assets	Assets Shares	Assets PIK basis
		£'000	£'000	£'000	£'000
Oscatello	Overdraft (no. 358-36-509)	637,059	216,964	152,852	8,726
Razino		461,949	344,111		
Violet		176,305	154,604	-	-
Oscatello	PPL loan	222,201	-	-	-
Oscatello	MM loan	155,161	-	-	-
<b>Total allocated</b>		<b>1,652,676</b>	<b>715,679</b>	<b>152,852</b>	<b>8,726</b>
<b>Unallocated assets</b>					
Welcome Break*			57,957	49,743	41,858
Ground rent Portfolio*			193,478	193,478	193,478
<b>Total</b>		<b>1,652,676</b>	<b>967,114</b>	<b>396,073</b>	<b>244,063</b>
<b>At 100%</b>		<b>1,652,676</b>	<b>1,112,181</b>	<b>455,484</b>	<b>280,672</b>

- 9 It is understood that the funds supplied under the loans were intended to be used to fund the activities of the Trading Companies. Weil Gotshal and Grant Thornton have so far been unable to identify any sums paid by way of returns to Kaupthing as a result of those activities or as repayments of the loans. In addition we have identified that large volumes of publicly quoted shares and securities loaned by Kaupthing to TDT/Oscatello under a series of forward purchase arrangements, including repos and CFDs, are unaccounted for.
- 10 It is apparent to us that the lending to TDT/Oscatello was highly irregular. In particular we are unable to detect any or any appropriate due diligence being carried out by the previous management of the bank on the value of the security in issue. The loan to asset value is manifestly excessive and this would have been obvious to any banking official acting reasonably.
- 11 There is evidence (in particular in the form of a spreadsheet provided to Grant Thornton to assist in their valuation exercise, entitled "MEMO-RE AssetsDebt") that individuals at the most senior levels of the former management were involved in the active manipulation of the financial data in order to allow excessive lending to take place. It is also apparent that the bank's internal compliance procedures were ignored or deliberately not complied with in particular:
- (a) In respect of the Money Market Loan, which (based on the limited information available) appears to have been advanced without security to cover losses incurred on CFD transactions with KSF, Kaupthing, Luxembourg and other institutions.



- (b) The final advances under the Overdraft were effected when the security for the overdraft was far less than the value of securities in place and in clear breach of the requirement for loans to be covered by security worth 115% of the value of the loans.
  - (c) The Mitchells and Butlers shares held as security were valued in the Bank's internal records at £4.98 per share. Those internal records carry an instruction not to change this valuation when the actual market price of these shares was actually around £1.90 per share. This resulted in massive overvaluation of the security.
  - (d) The repo transaction securing Razino and Violet Capital has matured without the loan being repaid or the proceeds of sale of shares (which were grossly inadequate) reaching the bank.
- 12 In the assessment of Weil Gotshal and Grant Thornton there is strong prima facie evidence that potentially fraudulent activities took place within Kaupthing with regard to the TDT/Oscatello lending. It is vital that data relating to these activities is preserved in order that the bank can (1) recover the sums in issue and (2) ensure that proper information is provided to the FME.
- 13 In particular the documentation and information relating the lending activity and the security including the electronic data of the bank must be preserved. This includes the back up tapes for the back office and email systems for the relevant period from the inception of the loan to date and the hard drives of the following individuals:
- Sigurður Einarsson, ex-Executive Chairman of the Kaupthing Group.
  - Hreiðar Már Sigurðsson, ex-CEO of the Kaupthing Group.
  - Ingólfur Helgason, ex-CEO of Kaupthing Iceland.
  - Steingrímur Kárasón, ex-Chief Risk Officer of the Kaupthing Group.
  - Bjarki Diego, ex-Director of Group Corporate Banking and current Director of Corporate Banking at New Kaupthing Bank.
  - Guðný Arna Sveinsdóttir, ex-CFO of the Kaupthing Group and current CFO and Head of IT department of New Kaupthing Bank.
  - Guðmundur Þór Gunnarsson, ex-Account Manager at Kaupthing Bank.
  - Ingvar Vilhjálmsson, ex-Director of Capital Markets at Kaupthing Bank.
  - Helgi Sigurðsson, ex-Director of Legal Services at the Kaupthing Group and current Director of Legal Services at New Kaupthing Bank.
- 14 Given the general circumstances of this matter, the very large sums involved, the known continuing close relationship of Hreiðar Már Sigurðsson and Guðmundur Þór Gunnarsson (who reported to Bjarki Diego) with TDT/Oscatello and R20 and our collective experience in other matters of this nature we believe that there is a very real risk that relevant material will be destroyed or tampered with. We also

understand that Guðný Arna Sveinsdóttir is currently in charge of the finance and IT departments and therefore able to access email and other correspondence relating to the investigation and advice provided to RC. We are therefore of the view that, pending further investigation of this matter it is wholly inappropriate for the individuals referred to above to continue to take an active role in the affairs of New Kaupthing bank as this gives them access to the relevant data and personnel required to assist us with the recovery effort.

- 15 It is our recommendation that the RC invite the FME to use its statutory powers to seize the information and items described above and to suspend the relevant individuals from further banking activities so that the Kaupthing bank employees independent of the past transactions are able to assist us without potential interference and until such time as this matter has been determined.