Exposing BCCI's Faults

Audit, Testimony Show Disregard for Rules

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Investigators accuse it of bribery, fraud, money laundering and influence peddling. But apart from any crimes the Bank of Credit and Commerce International may have committed, it wasn't a very good bank.

BCCI defied the most commonsense rules of finance, according to congressional testimony by a former top BCCI executive and a thick stack of internal BCCI audit reports that became available last week in Washington and London.

Contrary to industry convention, BCCI lent more than $700 million to a single customer—a shipping group run by three brothers close to BCCI's Pakistani founder—and the group's failure to repay nearly wrecked the bank. It speculated on world financial markets at a dizzying pace, rolling up $849 million in losses and nearly erasing the bank's capital base. At one point in 1989, it lent $3.3 billion of its $20 billion in assets to just 22 customers—much of it secured only by vague personal guarantees or BCCI stock.

BCCI also mocked the trust that clients place in their bankers, the audit reports showed. It regularly diverted customers' deposits to cover other shaky bank operations. It falsified records to hide its actions. It freely commingled customers' money with its own. It made unauthorized loans to itself in customers' names without their knowledge.

And BCCI stayed one step ahead of its auditors and international regulators by creating a "special duties" department, the responsibilities of which included falsifying documents, creating fictional financial back-

See BCCI, A10, Col. 1

BCCI, From A1

grounds for fake clients and opening bogus accounts.

Finally, in early 1990, some BCCI executives and its auditing firm, Price Waterhouse, woke up to the bank's way of doing business. A special task force of four BCCI executives, assigned to examine the unraveling financial disaster and report to BCCI's board, bluntly expressed its "considerable surprise and disappointment at such obvious flaws in basic banking procedures."

The task force said if the bank did not clean up these practices, the auditors could not issue a clean bill of health in BCCI's annual public report.

"Without this, there is now a grave and real danger of a serious 'run' on the bank, worldwide, resulting in an uncontrolled situation which would even close the entire group with serious consequences to the 1.3 million customers, the $17-billion-plus deposits, the over $2 billion due to correspondent banks as well the future of over 14,000 employees, all of which will be in serious jeopardy," the task force said.

Last month, the task force proved prescient. Citing widespread and continuing fraud, banking regulators seized the banking giant, froze its assets and promised to begin liquidating the institution and its operations in more than 70 countries.

The action touched off a worldwide uproar as depositors in Europe and Asia sought access to their money and lawyers gathered in New York and London courts to argue over which creditors would be paid first.

Two weeks ago the scandal widened when BCCI's former top two officers, Agha Hasan Abedi and Swaleh Naqvi, were indicted in New York on fraud charges. Abedi is in Pakistan and Naqvi is in Abu Dhabi while authorities wrestle over extradition questions that must be resolved before they can stand trial.

BCCI's former chief financial officer and the man who headed the task force, Masihur Rahman, told a Senate subcommittee last week that only Abedi, Naqvi and a handful of other top officials at BCCI knew of the abuses at the bank. However, he also said management supervision was so lax that low-level BCCI officials were allowed to make mistakes that cost the bank millions of dollars and exposed it to criminal prosecution.

The audit reports, released last week, showed how BCCI used its coffers to help its friends and its shareholders, many of whom are related to the ruling families of the United Arab Emirates and Saudi Arabia. The bank lent hundreds of millions of dollars without obtaining loan agreements or other documentation. For example, the task force said the history of loans to one BCCI shareholder, A.R. Khalil, "makes really sorry reading."

Khalil, the auditors pointed out, had not been "in contact" with the bank since 1985 and had not paid interest on his debts for years. Nonetheless, Khalil's borrowings kept increasing each year, reaching $150 million by the end of 1989.

"Mr. Khalil is a high net-worth Saudi Arabian businessman," the task force's report said. "The task force feels that he should be urgently contacted to unwind his position with the BCC group."

Most of Khalil's loans were secured by shares in the holding company that owns Washington-based First American Bankshares, while about 20 percent were unsecured, the auditors said.

The Federal Reserve Board alleged last month that BCCI, with headquarters in Abu Dhabi, had acquired secret control of First American's holding-company stock through such loans to Khalil and others. Because the loans had never been repaid—if the loans were genuine at all—the Fed alleges that BCCI owns the stock.

The Fed has ordered BCCI to sell its illegal stake in First American and fined BCCI $200 million for alleged violations of U.S. banking law.

Investigations continue into whether First American's top officers, Chairman Clark M. Clifford and President Robert A. Altman, knew of BCCI's role in First American. Both men have said they, not BCCI, ran First American.

A Depressing Finding

It is hard to tell, investigators conceded, whether BCCI intended to operate illegally when Abedi founded it with Arab and American money in 1972 or whether it went bad later. But by the late 1970s, the audit reports make clear, sour loans and other deepening financial problems accelerated the bank's plunge into extraordinary—and apparently illegal—solutions.

Rather than set aside reserves to cover the growing losses, which would expose their problems to public scrutiny, BCCI's management juggled its books "to create the image of success," according to a Price Waterhouse audit report prepared for the Bank of England, a report which led to the BCCI shutdown last month. "They apparently believed that the disclosure of the full extent of the losses . . . would have jeopardised the very existence of the bank."

"There is insufficient information available with which to recreate the bank's accounts," Price Waterhouse said. "But on the basis of the losses which have been concealed it would appear that the bank has generated significant losses over the last decade and may never have been profitable in its entire history."

At the end, according to investigators, BCCI may have been trying to cover up losses of more than $5 billion.

Perhaps the most devastating loans were those to the Gulf Group, a London-based shipping company founded by three Pakistani-born brothers—Abbas Gokal, Mustafa Gokal and Murtaza Gokal. Gulf Group grew with the Middle Eastern oil industry, at one point owning more than 100 ships and chartering 140 more, according to the audit documents.

The Gulf Group borrowed heavily from BCCI to fund its expansion, but the company ran into trouble in the late 1970s and 1980s when its attempts to diversify fizzled and oil prices subsequently sank.

The problems of Gulf Group were BCCI's as well. In 1981, according to Price Waterhouse, Gulf Group had $254 million in outstanding BCCI loans, more than half the bank's total consolidated capital of $462 million.

"The bank believed that the failure of Gulf Group would have crystallised large losses which would have eroded the bank's capital base and put its very survival in doubt," Price Waterhouse said.

To hide the troubled loans from auditors and regulators, BCCI juggled funds in the Gulf Group's accounts, but "the position of the bank was so compromised" that "more complicated manipulation was necessary," Price Waterhouse said.

By the mid-1980s, BCCI's Cayman Islands subsidiary began to take money from other depositors and shovel it into Gulf Group accounts. The subsidiary then covered the missing funds by shifting money from still other accounts.

Sometimes, the auditors said, the bank would create new depositors out of whole cloth—with documentation from the "special duties" department—to make it appear that additional funds were available to BCCI to shift into delinquent Gulf Group accounts.

"This was a full-time occupation which involved the manufacture of documentation, inflation of account turnover, concealment of funds flow, etc," according to the report.

It wasn't until March 1990, however, that Price Waterhouse, in its capacity as BCCI's regular auditor, suggested that the bank take a hard look at Gulf Group, listing 47 subsidiaries to which BCCI had lent $191 million, but "for which we have seen no loan agreements."

The special task force closely examined the Gulf Group loans, concluding that matters were even worse: Altogether, 71 Gulf Group subsidiaries, most of them shell companies, had received loans. Many of the loans were "parked" at BCCI subsidiaries to make them harder to trace. And Price Waterhouse found that many of the Gulf Group's assets had previously been "mortgaged to other banks in priority to BCCI."

The Gulf Group's total loan exposure was $705.53 million, the task force said. Investigators noted "common patterns of initiation, activity, fund flow, weak documentation and vague explanations." The evaluation: "This part of the bank's activity is perhaps the most depressing part of our findings."

Fooling the Auditors

For Price Waterhouse, which had audited BCCI's Cayman Islands subsidiary for years and had acted as the bank's sole external auditor since 1987, preparing the Bank of England report may have proved to be something of an embarrassment.

Rahman, BCCI's chief financial officer until he quit in disgust after heading the special task force, blamed Price Waterhouse in Senate testimony last week for failing to spot danger signs and warn bank officials before disaster struck. In one 1985 fiasco, Rahman testified, BCCI's treasury department allowed its exposure from the speculative investment of bank funds to run as high as $11 billion—virtually the entire assets of the bank—because no one was watching the transactions.

This adventure cost BCCI $430 million in four months, and "if the guidelines had been maintained, and if Price Waterhouse had been doing anywhere near their job, there is no way this . . . could have happened," Rahman said.

Price Waterhouse said in its 45-page report to the Bank of England that "much of the information contained in this report is based on records which have previously been concealed from us, as auditors."

Whatever Price Waterhouse's responsibility for failing to detect the problems earlier, its auditors became more aggressive in early 1990. Assisting Rahman's task force, the accountants uncovered one can of worms after another.

The Price Waterhouse report for the Bank of England, which was made available last week to The Washington Post, is a draft that uses code names to identify BCCI and other companies. Customer names are blacked out. But earlier Price Waterhouse reports, released by the Senate subcommittee on terrorism, narcotics and foreign operations when Rahman testified last week, named names.

Price Waterhouse said, for example, that Faisal Saud Al Fulaij, a Kuwaiti businessman and First American investor, held $147.9 million in BCCI loans with "very little performance on any of these accounts" and "generally no loan agreements, customer instructions or promissory notes supporting this lending." Another Price Waterhouse report found accounting transactions in the Cayman Islands branch "false and deceitful."

The task force, for its part, noted that BCCI's efforts to reconcile questions about its First American Bankshares loans had foundered. Five shareholders had confirmed their holdings, the task force said. Two shareholders, identified as "the ruler of Fujairah and ruler of Ajman," both in the United Arab Emirates, refused to confirm $294 million in loans. The task force recommended that BCCI write off their loans and keep the First American shares that secured some of the borrowings. Customer A.R. Khalil, meanwhile, could not be reached at all.

The 1985 trading debacle, a watershed "disaster," according to Rahman, was simply the final spasm in an eight-year catastrophe in which BCCI's treasury department lost $849 million speculating in certificates of deposit, treasury bonds, foreign currency and other financial instruments.

The general manager of the treasury department covered up the losses, Price Waterhouse found, by routinely reporting profits. Sometimes, the treasury department simply failed to report the losses at all: They were booked "against client accounts, bogus loans or the other unorthodox forms of funding," Price Waterhouse said. And in another ploy, the bank induced major customers to confirm false fund levels in their accounts to auditors in exchange for preferred treatment.

The general manager's name is blacked out in the Price Waterhouse report, but Rahman identified him as Ziauddin Akbar, who he said, was "gently" allowed to resign "with car and benefits." Rahman said Akbar eventually reappeared as a director of Capcom, a brokerage company that had common shareholders and a line of credit from BCCI. Price Waterhouse said BCCI paid Akbar $32 million in "blackmail" to keep him quiet.

To recapitalize, the bank took $150 million from a BCCI employee pension fund held at the International Credit and Investment Company, a BCCI Cayman Islands subsidiary that it used as a kind of "bank within a bank." This, Rahman testified, was "shocking news."

Invisible Accounts

As BCCI's financial condition worsened, the bank turned to even more elaborate schemes, the audits show. It accepted deposits, but did not record them on the bank's books, instead applying the money directly to other cash-poor bank operations. When the customer demanded his money, the bank would shift it from somewhere else. Price Waterhouse said BCCI held $569 million in unrecorded deposits by the end of 1990.

As end-of-year audits approached, BCCI officials moved money from account to account to make it appear that nonperforming loans were actually earning interest. Bank officials also shifted money into an account just before auditors checked it—then shifted it elsewhere after the auditors had moved on.

In some cases, the bank was almost brazen about the way it abused customers' funds. Perhaps most notable was the case of a customer with the code name "Tumbleweed" in the Price Waterhouse report to the Bank of England. The Wall Street Journal and Financial Times of London have reported that Tumbleweed was Faisal Islamic Bank of Egypt, headed by Prince Mohammed bin-Faisal al-Saud of the Saudi ruling family.

Tumbleweed began doing business with BCCI in the late 1970s and by 1982 had $171 million on deposit, an amount that grew somewhat over the next few years. Tumbleweed instructed BCCI to invest the money in commodities, in accordance with Islamic law, which basically forbids Western-style interest-earning investments.

However, Price Waterhouse reported, "We have seen no evidence to suggest that the bank actually entered any commodity contracts." Instead, BCCI put Tumbleweed's money to its own use as yet another unrecorded deposit.

Tumbleweed funds were used to cover a loan related to the takeover of First American Bankshares, to "recreate" another customers' missing deposits of $62 million and to make it appear that interest was being paid on various of the bank's bad loans, Price Waterhouse said.

If Tumbleweed wanted access to the money, BCCI replenished the account, Price Waterhouse said. But whenever auditors came around the account would be emptied—all but invisible on the bank's books so that the auditors would not attempt to check the amount with the depositor.

Price Waterhouse said BCCI's liability to Tumbleweed totals $358 million, making it one of BCCI's biggest creditors and perhaps the largest single source of the unrecorded deposit funds manipulated by BCCI over the past decade.

But it was not the only one. In 1984 BCCI set up an Islamic Banking Unit in London to solicit deposits from Islamic investors, Price Waterhouse said. The business was highly successful—at its peak in 1989 the Islamic Banking Unit had $1.4 billion in deposits.

But some of the money was improperly shifted into other accounts to cover losses, then made up with new deposits from the Islamic customers, Price Waterhouse said. For example, $30 million was placed in an account in BCCI's Grand Cayman branch known as "Account 500" that was "used for the purpose of fraudulently routing funds," Price Waterhouse said.

Even when BCCI carried out the commodity transactions for Islamic Banking Unit customers, Price Waterhouse said, it listed the bulk of the funds on an "off-balance-sheet" basis, so that they did not show up on the BCCI books—reducing the company's assets and liabilities by more than $800 million each in 1989.

"It is apparent that the senior management of [BCCI] have abused their responsibilities to depositors, shareholders, investors, regulators and to the bank itself," the Price Waterhouse report said. "From the scale and complexity of the deception it is clear that most of the senior management . . . were or should have been aware of certain elements of the fraud."

Staff researcher Lucy Shackelford and staff writer Stuart Auerbach, reporting from London, contributed to this report.