C H A P T E R 15

SOME OF THE MAJOR CORPORATE GOVERNANCE FAILURES IN DEVELOPED WORLD

15.1 THE BANK OF CREDIT AND COMMERCE INTERNATIONAL SCANDAL (BCCI)

Background

15.1-1 A Pakistani financier, Agha Hasan Abedi, founded the Bank of Credit and Commerce International (BCCI), an international bank, in 1972. It was registered in Luxembourg and its principal shareholders were in Abu Dhabi. Within one decade of its operation, it became seventh largest private bank in the world with 300 or so branches in over 70 countries. Unlike any ordinary bank, BCCI since its inception had a complex web of entities consisting of affiliates, subsidiaries, banks-within-banks, insider dealings and nominee relationships.

The BCCI activities were primarily in US dollars as it recycled the dollar earnings of Organization of Petroleum Exporting Countries (OPEC) members.

15.1-2 Description of Crisis

(*i*) In July 1991 regulators in seven countries seized the assets of the Bank of Credit and Commerce International (BCCI).

(*ii*) Regulators in Great Britain uncovered evidence of massive fraud spread across many nations. Investigators in the US revealed that BCCI had been "set up deliberately to avoid centralized regulatory review"[1]. Losses to depositors and investors of BCCI were estimated to be equal to about seventy percent of its assets.

(*iii*) It is now believed that BCCI was not as profitable as it was being shown by its financial statements since 1972. Reserves for bad loans were inadequate. Its books of account showed fictitious loans which resulted in substantial fictitious profits. Substantial loans were being made to "insiders".

Major Governance Issues

15.1-3 Banking fraud of such a massive scale cannot happen without serious corporate governance lapses. Some of these are as follows:

(*i*) ***Absence of a Central regulating bank*** : The BCCI was structured as a web of relationships spread across many countries. Surprisingly, it was also not regulated by the central bank of any country. Moreover, its two holding companies were based in Luxembourg and the Cayman Islands and in both jurisdictions banking regulation was rather weak.

(*ii*) ***Faulty lending practices*** : The modern banking good practices emphasise the use of an "arm's lengths" creditworthiness criteria for choosing whom to lend. But senior management at the BCCI had marked preference for relationship banking and, thus, exposed the bank to a lot of risk.

(*iii*) ***Unethical business practices*** : Investigations revealed that BCCI was involved in host of unethical practices - paying kickbacks and bribes to officials in most locations; income tax evasion; arms trafficking; massive money laundering ; illegally gained the controlling interest in a major American bank - to name a few.

1. *Kerry, John. The BCCI Affair: A Report to the Committee on Foreign Relations. Lulu.com. p. 60*

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