Kabul Bank Scandal: Challenges, Progress and the Way Forward

INTRODUCTION

Kabul Bank was established in 2004 and quickly became one of the largest financial institutions in Afghanistan. It achieved this, in part, by securing an annual contract to pay the salaries of 80 percent of government employees (USD 1.8 billion each year, upon which the bank is estimated to have earned approximately USD 10 million in interest annually) and by attracting almost USD 1.3 billion of deposits from the public. Kabul Bank was initially viewed as an extremely reliable institution among the general Afghan population and offered the promise of providing modern banking services to their customers. However, the Kabul Bank crisis in September, 2010 due to embezzlement, mismanagement, and inadequate supervision by the Financial Supervision Department (FSD) of the Afghan central bank, or Da Afghanistan Bank (DAB), shook the foundations of, and people’s trust in, the entire banking system in Afghanistan. When Kabul Bank’s problems became evident in 2010, the bank’s customers, fearing a collapse of the bank, withdrew USD 180 million within two days. As a result, the Afghan government was forced to provide a USD 825 million bailout fund for Kabul Bank, for which the Ministry of Finance of Afghanistan (MoF) agreed to provide to DAB an amount of more than USD 800 million (Afn 41.3 billion) over eight years out of domestic tax revenues (this bailout, therefore, will effectively be paid for by the Afghan public). These payments from the MoF started in the November 2010 (last quarter of 1389) and will continue up to November 2018 (last quarter of 1397), according to an agreement made between MoF and DAB. As of August, 11, 2015, the MoF has paid about USD 140 million (Afn 7.317 billion) to DAB out of the more than USD 800 million (Afn 41.3 billion) required for the Kabul Bank bailout.

KABUL BANK CASE REVISITED

The Kabul Bank case was largely ignored by the former government, with very little progress in recovering funds embezzled from Kabul Bank or in prosecuting those responsible. Only USD 175.2 million money was recovered from 2010 until about the end of former government in 2014. The lack of attention, and therefore progress, on this case during the previous government’s administration is believed to have been the result of strong political influence exerted by both Kabul Bank’s shareholders and the Bank’s debtors.

Dr. Ashraf Ghani, however, by Presidential decree, reopened the inquiry into Kabul Bank’s fraud case on his second day in office. As of August, 2015, substantial progress has been made in relation to the recovery of Kabul Bank funds and the prosecution of those responsible for the banks near collapse. According to KBR, the total recovered asset was USD 228 million by February 16, 2015. However, according to recent published reports, the government has
stated that USD 437 million has been recovered since 2010 out of a total amount believed to have been embezzled from Kabul Bank of USD 987 million (this estimate has risen progressively since 2010 and may ultimately exceed USD 1 billion).

Total recoveries include cash, unsold properties, and the settlement of debts incurred by debtors.\textsuperscript{10} In order to recover some of the remaining money from the Bank’s debtors, the names of 155 debtors have been turned over by the Kabul Bank Receivership (KBR) to the Attorney General’s Office (AGO).\textsuperscript{11} In order to collect funds due from Kabul Bank’s debtors, the AGO has posted a formal letter to the relevant authorities requesting that these individuals be banned from traveling abroad. The AGO has also initiated action to freeze the assets of these debtors and to bring formal prosecutions against a number of individuals.\textsuperscript{12}

While the new government has made progress in relation to recovery of embezzled funds from Kabul Bank and in the prosecution of those involved, there is still much more room for the government to investigate this case in order to obtain further recoveries and to bring additional prosecutions. This effort, however, will not be successful without considerable diligence and integrity on the part of the investigators.

Given the sums of money involved, it can be expected that considerable pressure will be brought to bear against those involved in bringing actions against the individuals involved in this case. Such pressure may also consist of financial inducements – bribery – to prevent action being taken against individuals in some instances. This was apparently the case in June of this year when it was disclosed, on the basis of an investigation by the National Directorate of Security (NDS) and law enforcement personnel, that both the Director and the Deputy Director of the KBR were arrested and charged with accepting USD 100,000 of bribes from a debtor of Kabul Bank.\textsuperscript{13}

\section*{ISSUES IN THE BANKING SECTOR}

Looking more to the future, however, what is needed now is a major effort (in parallel with the Kabul Bank investigation) to improve the integrity of public financial management and the commercial banking sector by strengthening banking supervision and reforms at DAB. This was the commitment of the Afghan government at the Tokyo Conference in July 2012, and is consistent with the commitment of the new government to seriously tackle corruption in Afghanistan.\textsuperscript{14}

The problems encountered by Kabul Bank in 2010 were clearly the result of fraud and embezzlement on the part of a number of the bank’s shareholders and management. It was also due, however, to inadequate supervision by the Financial Supervision Department of DAB and the failure by the FSD to enforce existing, though not entirely adequate, rules and regulations. This lack of financial oversight, not only of Kabul Bank but of the entire banking sector, is due to lack of financial supervision expertise on the part of the FSD of DAB.\textsuperscript{15} The FSD has been weak in performing its essential oversight role and in identifying and rectifying the weaknesses in the banking sector that led to the collapse of Kabul Bank. Such weaknesses in the banking sector include a failure to follow prudential policies and procedures relating to asset/liability management, credit assessment, loan collateral requirements and lending limitations related to single borrowers or sectors, to conflicts of interest or to ‘politically exposed persons. Other weaknesses of the banking sector which have been highlighted include a lack of adequate accounting expertise and a failure to follow international accounting principles, weak governance procedures and organizational structures and ongoing regulatory violations.\textsuperscript{16}

A number of international financial institutions, such as the International Monetary Fund (IMF) and the World Bank, as well as various U.S. government agencies, have worked on building the technical capacity of the FSD of DAB in recent years, but still there is more technical capacity building required to enable the FSD to apply international-standard financial tools and methods.\textsuperscript{17} Likewise, very significant policies
and integrity tools must be applied in the banking system to strengthen integrity and fight corruption.

In June 2012, the Afghan government committed with the Financial Action Task Force (FATF) to promote banking integrity in Afghanistan through establishing and implementing a new set of policies and tools, but in February 2015, the FATF determined that the DAB had not implemented the committed action plan.18 Were the DAB to implement the action plan recommended by the FATF together with establishing and implementing new international standard tools and mechanisms for promoting banking stability and financial health, it would be a major step towards banking integrity and stability in Afghanistan.

According to Transparency International, there are many effective tools for combating corruption in the banking sector and for enhancing financial institution stability. Such tools include: monitoring adherence to the laws and regulations, protection of whistleblowers, and anti-bribery rules which include a comprehensive code of conduct, building incentives for integrity into remuneration packages, and careful management of conflicts of interest. These measures, however, will only be effective when these tools are accompanied by appropriate supervisory monitoring, transparency and accountability, and punishment for illegal acts.19 Therefore, the DAB should identify the missing policies and mechanisms and establish them. One example would be a “Whistleblower Law” for the protection of whistle-blowers which can be a strong tool to in fighting corruption but which has not yet been established in Afghanistan.20

In consideration of the findings about Kabul Bank case, Integrity Watch Afghanistan urges the Afghan Government to continue to seriously investigate the Kabul Bank case and specially to follow up with the cases of the 155 identified debtors of the bank and to ensure that all outstanding debts are fully settled. Integrity Watch also calls on the new government to strengthen banking sector regulation, to strengthen the technical capacity of the FSD, to apply international “best practice” to prevent bribery and other types of corruption, and to implement the action plan committed to with the FATF to prevent any future financial crisis in the Afghan banking sector.

RECOMMENDATIONS

Recommendations on Kabul Bank case:

- The Attorney General Office should fully investigate the cases of the 155 Kabul Bank borrowers who have been identified and take such action as is necessary to persuade them to pay their debts. Security for the KBR’s staff should be ensured in order to enable them make further progress on asset recoveries.
- The government should recover all stolen assets of Kabul Bank both within Afghanistan, based on a continued comprehensive investigation, and overseas, by seeking the assistance of all countries to which funds were illegally transferred;
- The government should request asset information from each of those countries to which money was sent illegally or where assets of suspected or confirmed Kabul Bank felons are found, by providing complete and required data to the requested countries in a timely fashion.
- The KBR should establish a proper mechanism for public access to information of Kabul Bank case progress. This mechanism should ensure clear and detailed information about the progress to ensure transparency by regular reporting to the media and civil society watchdogs.
Recommendations on Banking Integrity in Afghanistan:

- The FSD of DAB should seek further training from the World Bank, the IMF, or other international institutions or governments willing to assist, in order to improve their technical skills and to obtain the required tools and methods for the supervision of financial institutions.
- The DAB should start implementation of the action plan committed to with the FAFT in June, 2012, as soon as possible and identify and address any gaps in existing banking rules and regulations which might facilitate bribery or other forms of corruption.
- The DAB should work with or encourage Civil Society Organizations to establish a Whistleblower Law to protect the rights of whistleblowers and instill a culture of integrity in banking, and other sectors in Afghanistan.
- The DAB should ensure proper implementation of the Anti-Money Laundering Law for identifying, tracing and freezing terrorist assets. The DAB should also establish and implement adequate procedures for the confiscation of assets related to money laundering, and establish and implement effective controls for cross-border cash transactions.
- The financial institutions internal transparency, accountability and integrity should be improved. This should be through proper rule of law, and bribery rules which include codes of conduct, public promises, building incentives for integrity in remuneration packages, and careful management of conflicts of interest.

About Integrity Watch Afghanistan

Integrity Watch is an Afghan civil society organization committed to increase transparency, accountability, and integrity in Afghanistan.

The mission of Integrity Watch is to put corruption under the spotlight through community monitoring, research, and advocacy. We mobilize and train communities to monitor infrastructure projects, public services, courts, and extractives industries. We develop community monitoring tools, provide policy-oriented research, facilitate policy dialogue, and advocate for integrity, transparency, and accountability in Afghanistan.

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