

WXYZ secured loans

4.17 By June 1985 the level of fictitious profits funded by Z Akbar's adjustments was estimated to be over \$500 million. There also appears to have been a need to service delinquent loans in the books of Sandstorm (and Fork) at this time. As a result loans of \$226 million supposedly secured on the shares in WXYZ were drawn down in June 1985 in the names of:

	\$ m
Khalil	47
Fulaij	31
Shorafa	37
██████████	10
██████████ - numbered A/C	68
██████████	8
Dubai	11
Dubai - Crescent	14
	226

4.18 These funds were applied in part to refinance the accumulated losses of the Treasury division (\$126 million) with the remainder being applied to certain borrower accounts, including Gulf Group (\$50 million) and Nabel Pharaon's account at Fork (\$11 million). At the same time (25 June 1985) an amount of \$68 million was paid by [Treasury] to Brenchase Limited, a subsidiary of Capcom, a company [subsequently] controlled by Z Akbar, for an unknown purpose.

Other utilisations

4.19 From 1983 to 1986 Sandstorm appears to have had an informal agreement with State Bank of India (SBI) to secure loans given by the latter to Sandstorm nominees. Such funds were used by Treasury to service loans in an attempt to reduce the need for year end provisioning against delinquent accounts.

4.20 The Fork managed funds have not been capable of identification by us, while the Fork loans were drawn down in early 1985 by arrangement with HM Kazmi. We have been unable to identify Fork loans of \$190 million. The deposits and CD's placed by Emirates and BCP were utilised by Akbar without authorisation, but, we are informed, have subsequently been repaid.

Applications

4.21 We have been unable to analyse the \$348 million application of funds used to service loans and make investments in early 1986 as noted above. From certain records that do exist at 31 December 1984 the principal application of funds appears to have been as follows:

	\$ m
- provide cash to fund WXYZ share acquisitions, often in the name of nominees, particularly Shorafa, Khalil and Kamal Adham.	82
- provide cash to fund share acquisitions in Sandstorm Holdings in the name of nominees, particularly Kamal Adham, Khalil and GR Pharaon.	115
- provide cash to fund purchase of capital notes in the name of Khalil.	8
- investments in Credit and Commerce Insurance, SDCC and others.	25
- Other adjustments of bad loans.	120
- Unidentified	18
<div style="border: 1px solid black; border-radius: 50%; width: 40px; height: 40px; display: flex; align-items: center; justify-content: center; margin: 0 auto;">5</div>	368
- Unidentified changes between 31 December 1984 and 1986	(20)
	348

Brokers

4.22 The main brokers used by Treasury division were:

Refco
 Capital Commodity Dealers Ltd ('Capcom')
 Rudolf Wolff
 Bear Steans

4.23 The investigation team has seen circumstantial evidence that these brokers did not always trade with Treasury at arms length, and may have facilitated Akbar in manipulating profits. In particular Rudolf Wolff had a separate office to deal with Sandstorm and appears to have allowed Sandstorm to have a significant overdrawn balance at 31 December 1984 (\$40 million), which was possibly used to conceal losses/'park' liabilities at the 1984 year end.

4.24 Capcom was established in 1984 and rapidly became one of the most significant of the brokers used by Treasury. Its initial shareholders were dominated by major customers of Sandstorm, including Khalil and Kamal Adham, and some 70% of its share capital was registered in the names of people for whom Z Akbar was retained as adviser. Akbar joined Capcom on leaving Sandstorm in 1986, as did [REDACTED] and subsequently became a shareholder and director. Despite an apparent cessation of trading links with Capcom at the instigation of S Naqvi apparently on the advice from the then group auditors, two payments of \$50 million were made to Capcom in March 1986 out of [external funds] for which no liability for repayment was recorded.

SECTION 5: GULF GROUP

Background

- 5.1 We understand that the Group's banking relationship with the Gulf Group began in 1972 when it placed relatively large deposits with Sandstorm in Luxembourg and London. There is little tangible evidence of other business until 1976 at which time trade finance lines and shipping loans were opened by the Group. Even at this time the scale of the bank's lending to the Gulf Group was significant in relation to its capital base, and the relationship became one of interdependence. A summary of the history of the Gulf lending in relation to the capital base of Sandstorm is shown at Appendix I. There is evidence that the Gokal brothers used this position as a lever to obtain short-term funding and repayment of non Sandstorm bank debt.
- 5.2 As a result of the large exposure guidelines imposed by the Bank of England in 1977, the accounts were moved to Grand Cayman, and in 1978 when it became apparent that the Gulf Group was in financial difficulty S Naqvi and Hashim Shaikh took direct responsibility for the accounts. It appears that account manipulation began at this stage, and to this end a "special duties" department was set up to oversee these accounts. This was a full-time occupation which involved the manufacture of documentation, inflation of account turnover, concealment of funds flow etc and involved some 750 accounts over a fifteen year period. Turnover in the period was some \$15 billion.
- 5.3 Management in collusion with Gulf used sophisticated methods of deception to conceal funds flows including:
- * use of Gulf 'bank' accounts which received funds and then redistributed them around a number of accounts (particularly 1978 to 1983).
 - * transfers between Gulf locations in different parts of the world to create turnover and imply debt servicing, particularly just before year ends.
 - * conduit accounts at external banks, under the control of Sandstorm officers (largely after 1986).
 - * funds transfers through BCP and nostro accounts at various Sandstorm branches.
 - * use of excessive interest and charges to provide profits.
- 5.4 The bank believed that the failure of the Gulf Group would have crystallised large losses which would have eroded the bank's capital base and put its very survival in doubt. To avert liquidation of the Gulf Group it would appear that Sandstorm worked very closely with the Gulf Group management to ensure that third party bank liabilities, many of which were rescheduled in 1984 to 1986, were met as they fell due.
- 5.5 By the early 1980's the position of the bank was so compromised by its reliance on the Gulf Group, that more complicated manipulation was necessary. This involved the use of external funds managed by Fork entities. In part this was achieved by loans drawn down in Fork with the funds routed to Sandstorm, with such loans being repaid by short-term offshore accounts being drawdown in Sandstorm. In addition Fork appears to have utilised certain external funds available to it. Such funding was most significant in the period 1984 to 1986.

Analysis of funding

5.6 Bank employees working with Mr Naqvi have now recreated a detailed analysis of the external funding utilised within the Gulf Group accounts as follows:

	Drawdowns \$ m	Repayments \$ m	Interest \$ m	Outstandings 31/12/90 \$ m
1981 - 1983	160	72	130	218
1984	222	-	13	235
1985	345	185	90	250
1986	300	237	97	160
1987	138	15	42	165
1988	63	15	23	71
1989	21	-	-	21
	1,249	524	395	1,120
Net drawdowns	725			

5.7 This analysis has not been capable of verification and must therefore be treated with caution, but gives an indication of the likely scale of the manipulation of the exposure.

5.8 According to the bank's records the application of the net external funding (excluding interest) was as follows:

	<u>\$ m</u>
Reduction in Gulf liabilities to third parties	457
Reduction in Gulf liability to Sandstorm	186
Liabilities of other borrowers to Sandstorm	<u>82</u>
	<u>725</u>

5.9 The routing of funds appears to have been through the following entities:

	<u>\$ m</u>
Sandstorm Affiliates	
BCP Zurich	226
BCP Luxembourg	164
BCC Grand Cayman	168
BCC London	57
BCCI Spain	92
NBO	95
Other	<u>25</u>
	<u>827</u>
Conduit accounts	203
Yet to be identified	<u>219</u>
	<u>1,249</u>

- 5.10 The above analyses have yet to be substantiated but give a general outline of what appears to have transpired.

Offshore accounts

- 5.11 In more recent years the "special duties" department were involved in fabricating information in respect of the 'offshore accounts'. This included the creation of profiles of the beneficial owners, financial information, false instruction letters etc. The relationship of these particular accounts with the Gulf Group was finally acknowledged by Sandstorm and the Gokals as a result of the task force investigation in early 1990 and Gulf assumed responsibility for 73 offshore accounts with an exposure of \$264 million at 31 December 1989.

SECTION 6: WXYZ

Background

- 6.1 It is alleged that Sandstorm has acquired a 58.6% interest, currently through eight nominees, in WXYZ the ultimate holding company of the First American Bank (FAB), the largest banking group in the Washington area with cross state banking licences to operate in seven states.
- 6.2 This interest appears to have been obtained through Sandstorm or its affiliated companies granting loans to certain prominent Middle Eastern individuals with which to subscribe for shares in WXYZ, such that **Nacvi** or **Abedi** indemnified the shareholders against any liability for the loans disbursed in their names, in return for which the shareholders gave Sandstorm, through a variety of share dealing and attorney arrangements, authority to buy and sell shares in WXYZ on their behalf. These indemnities were usually in the name of Fork.
- 6.3 The legality and effect of the various nominee and indemnity arrangements is clearly uncertain and a matter on which legal advice will need to be sought in order to ascertain the ultimate beneficial ownership, but preliminary legal opinion would suggest that the registered shareholders do appear to have been nominees.
- 6.4 Sandstorm's former management have represented to us that the arrangements were in the form of a 'merchant banking' transaction in that it always acted as a 'sleeping partner', at no time using any voting rights or exercising any controlling influence over the management of First American. This appears to have generally been the case although we have seen evidence to the effect that **AH Abedi** was consulted by Clark Clifford in the recruitment of a senior executive for FAB, and certain other personnel issues.

History of operations in the US

- 6.5 In the early years of its operation Sandstorm operated through a number of branches and agency operations. Management however perceived that if Sandstorm was to achieve the status of a global banking organisation in line with **Abedi's** vision, it needed subsidiary operations in the United States. To this end a number of unsuccessful attempts were made to acquire a bank in New York.
- 6.6 Through **Abedi's** contacts with Bert Lance, FAB, at that time FGB, was identified as a suitable acquisition target and in the period from 27 December 1977 to 10 February 1978 some one million shares in FGB, representing 18% of the ordinary capital were acquired on behalf of Sandstorm in the open market. Sandstorm contended that these shares were purchased on behalf of certain investors for whom it acted as investment advisor. We have, however, seen evidence to suggest that this was not the case and that the four investors were used to keep individual ownership below 5% and to ensure that Sandstorm's name did not appear.
- 6.7 The investors were:

Sheikh Kamal Adham
Faisal Fulajj
Sheikh Sultan bin Zayed (subsequently sold to SKA)
A Darwish (on behalf of **Sh Mohammed bin Zayed**)

Ownership of WXYZ

- 6.8 After various federal and state banking and regulatory approvals, agreements with the SEC and FGB, a tender offer for the remaining FGB shares was made by First American Corporation (FAC) on 2 March 1982, and control of FGB was secured by WXYZ.
- 6.9 The initial capital contribution into WXYZ (including the original investors' FGB shareholding) was \$180 million being 100,000 shares at \$1,800 each subscribed as follows:

	No of Shares	\$ m	%
Kamal Adham	19,050	34.3	19.1
A Darwish	13,720	24.7	13.7
Fulaij	7,180	12.9	7.2
ADIA	8,240	14.8	8.2
Stock (Dubai)	8,240	14.8	8.2
Crescent (Dubai)	8,240	14.8	8.2
AR Khalil	8,240	14.8	8.2
Mashriq	7,660	13.8	7.7
Sh Naomi	7,070	12.7	7.1
Shorafa	6,480	11.7	6.5
Qabazard	2,940	5.3	2.9
Gulf Investment Real Estate Co.	1,470	2.6	1.5
Real Estate Development Co	880	1.6	0.9
Jawhary	590	1.1	0.6
	100,000	180.0	100

- 6.10 Since these initial subscriptions there have been a number of rights issues by WXYZ as set out below:

	No of Shares (000's)	Price \$'000	Amount \$ m	Main purpose
02.03.82	100.0	1.8	180	
18.08.82	16.7	1.8	30	Class A shares
22.12.83	39.4	1.9	75	FAB, NY
25.07.86	67.7	2.2	150	NBG
17.08.87	47.3	2.4	115	NBG
18.07.89	18.0	2.8	50	Repay loan from BAIL
	289.1		600	

6.11 In so far as the eight shareholders who would appear to be nominees for Sandstorm or Fork are concerned, almost all of their initial and subsequent subscriptions for rights issues have been funded by disbursements from Sandstorm. Most have been funded from the nominated WXYZ accounts with a few, particularly in the early 1980's, from other accounts, including the Treasury pool accounts.

6.12 At 31 December 1990 of the fifteen registered shareholders, eight appear to hold their shares as nominees as follows:

	<u>No of Shares</u>	<u>%</u>	<u>Loan balance \$ m</u>
Possible nominees:			
Adham	36,493	12.6	170
Fulaij	26,439	9.2	268
Shorafa	28,748	9.9	210
Mashriq	27,986	9.7	451
Hammoud	18,200	6.3	79
Naomi	16,824	5.9	100
AR Khalil	13,250	4.6	133
Jawhary	1,465	0.5	6

159,405

58.6

1,417

Burford	26,837	9.3
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Other shareholders

Adham Corporation	7,410	2.6
ADIA	19,141	6.6
Sh Khalifa	28,741	9.9
Sh Zayed	33,994	11.8
C Clifford	2,395	0.8
R Altman	1,197	0.4

92,878

32.1

Total issued shares	289,120	100
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6.13 The shares held by Burford represent the shares repurchased from Sh Khalid bin Mahfouz under the terms of a buy-back agreement nominally with Mashriq and guaranteed by Sandstorm Overseas. This repurchase was effected through payments to Mahfouz in October 1989 and June 1990 totalling approximately \$190 million, funded by S Naqvi from various sources.

6.14 The amounts having been paid, although in consideration for shares, were debited to new loan accounts in **Manfouz's** name. Given the method by which this repurchase was effected, there is considerable uncertainty as to the beneficial ownership of the shares in WXYZ registered in the name of **Burford** although we understand that steps have been initiated to transfer the shares to the Department of Private Affairs as compensation for a placement absorbed into Treasury some years ago.

6.15 The above loan balance reconciles to the amounts taken over by Company A as follows:

	\$ m
Loans as above	1,417
Adham Corporation	15
WXYZ Debenture	18
Total to be assigned to Company A	1,450

Nominee arrangements

6.16 The evidence of the nominee relationships varies but typically includes one or more of the following:

- * Hold harmless letters
- * Signed but blank share transfer deeds
- * Signed but undated and blank promissory notes
- * Share deposit agreements
- * Letters or agreements governing the description of WXYZ shares
- * Powers of Attorney
- * Agreements covering the payment of fees to shareholders.

6.17 These documents are often in the name of Fork Overseas or Holdings, albeit sometimes signed by **S Naqvi**. The effect of these arrangements essentially appears to be that the account holders were indemnified against any liability for the loans but have no entitlement to any profits accruing from the underlying investment in WXYZ.

6.18 The nominee shareholders appear to have received fees in respect of their services, only some of which we have been able to trace:

Fulajj	\$100,000 pa	1986 - 1989
	\$606,000	on 23 August 1990
Shorafa	\$300,000	on 5 August 1985
	\$341,000 pa	in 1986 - 1990
Sh Sharqi	\$500,000	in August 1985
	\$390,000 pa	in 1986 - 1990
	\$111,000 pa	in 1988 - 1990
	\$42,000	in 1990
AR Khalil	\$1 to \$2 million pa for use of his name for Treasury trading purposes (uncorroborated)	
	\$15 million in July 1987 (Source not identified)	
M Hammoud	\$1 million pa in 1986 - 1990 (uncorroborated)	

6.19 In addition, payments of \$15.8 million and \$6.5 million respectively were paid to Sh Kamal Adham and Sh Naomi, supposedly in consideration for their original subscription of shares in WXYZ plus rolled up interest, notwithstanding that the shares continued to be registered in their names.

Use of WXYZ accounts for other purposes

6.20 Sandstorm management have used the security offered by the investment in WXYZ, as a means to:

- (1) disburse funds for totally unrelated purposes, in particular to adjust unrelated loan accounts to avoid the need to book provisions.
- (2) generate substantial amounts of fictitious income to enhance Sandstorm's reported profits.

6.21 This has been facilitated by the fact that the investment has increased in value over time, allowing capacity for extra loan drawdowns made possible because the account holders were indemnified against any liability for the loans. In addition a substantial number of new shares were issued by way of rights issues at net asset value thereby providing excess borrowing capacity, which was also utilised for other purposes.

6.22 The total amount of loans, supposedly secured on the shares of WXYZ, at 29 December 1990, the effective date at which they were transferred to Company A by means of a sub-participation agreement concluded on 22 May 1991, of \$1.45 billion, noted above, was made up as follows:

	\$ m
Equity capital subscriptions relating to nominee shareholders	307
Other WXYZ capital contributions	, 39
	346
Servicing of non WXYZ loan accounts	599
Servicing interest on external borrowings	57
Other disbursements	89
Less: receipts from non WXYZ accounts	(214)
	531
Interest and account charges	573
Total	1,450

6.23 As far as the WXYZ exposures were concerned, by virtue of the nominee arrangements and the fact that Sandstorm held signed share deposit agreements and transfer deeds, the shares in WXYZ were regarded as a pool of security with frequent informal cross pledging of security, again supporting the view that the shares were held in a nominee capacity.

6.24 Non WXYZ disbursements may be analysed by borrower as follows:

	\$ m
Sh Kamal Adham	15.5
Faisal Fulajj	161.4
Sh Sharqi	206.0
Shorafa	130.5
AR Khalil	47.0
Sh Naomi	26.0
Hammoud	12.0
Jawhary	1.0
	599.4

6.25 These were disbursed as follows:



	Date	\$ m	<u>Borrower</u>
Adjustment of non WXYZ accounts	June 1985	191	Various
Repayment of SNCB loan	Sept 1990	58	Shorafa
Repayment of SNCB loan	Oct 1990	138	Mashriq
Repayment of SNCB loan	Oct 1990	130	Fulajj
Repayment of SNCB loan	Oct 1990	78	Mashriq
Various		4	
		599	

6.26 The adjustments in 1985 occurred in the period 25 - 28 June when amounts totalling \$191 million drawn down in the names of Khalil, Shorafa, Fulajj, Sharqi and Naomi together with additional amounts drawn down in the accounts of the Ruler of Dubai (\$ 25 million), Sh Sharqi (\$10 million) and SDCC (\$5 million), were paid to Hashim Shaikh (\$89 million) to adjust a number of Gulf Group accounts and to Z Akbar (\$142 million) to adjust various Treasury pool accounts. Notwithstanding that these drawdowns had nothing to do with the borrowers concerned, confirmation letters of account balances continued to be received by us as auditors.

6.27 In September/October 1990 four loans totalling \$404 million were drawn down in the names of certain of the WXYZ borrowers to repay four loans previously granted by SNCB to Sandstorm Overseas which had not been properly authorised. These were not recorded in the books but had been used to service various Sandstorm loan accounts between July 1986 and April 1989. They were in part secured on 20% of the shares in WXYZ and cash collateral placed with SNCB Bahrain. Notwithstanding that the funds placed with SNCB were there as security for these loans, Sandstorm management represented to us that these were bona fide bank placements, which were confirmed as such to us by SNCB. The collusion of SNCB and its owner Sheikh Khalid bin Mahfouz in the fraud perpetrated on Sandstorm appears to have been a major factor in allowing it to go undetected.

Interest and charges

6.28 Interest was levied on the accounts at broadly commercial rates (1.5% to 2.0% over US\$ LIBOR) and in addition, to boost income further, significant management charges and fees were also levied. These totalled some \$150 million in the eight years to 31 December 1990, and to give the appearance that the nominee shareholders were agreeable to the charges, letters drafted by Imran Imam, indicating acceptance were periodically obtained and provided to the auditors.

6.29 The total income booked in respect of the WXYZ loan accounts was \$573 million and is a material sum to Sandstorm's purported profitability over the last decade. If it is found that the bank does have a beneficial interest in the shares, classification of the balances as loans and advances would not be appropriate and alternative accounting treatment would be required.

Sandstorm Personnel

6.30 Control over the WXYZ accounts was exercised by S Naqvi from London, who determined the uses to which the various loan accounts were put. Naqvi informs us that it was not until 1985 that these accounts were manipulated for other purposes.

6.31 Mr Naqvi was initially assisted by Z Akbar and, from 1983, Mr Imran Imam who exercised control over the accounts on a day to day basis and initiated many of the fraudulent transfers of funds and book entries. In addition because of Fork's involvement in the nominee relationships and frequent transfers of loan balances between Sandstorm and Fork, Mr HM Kazmi was closely involved. Otherwise, there is no clear evidence that the other staff who were involved in giving or receiving instructions, were aware of the true nature of the accounts or Sandstorm's relationship with the account holders.

6.32 Generally the borrowers provided audit confirmations however it is now clear that hold harmless letters were also despatched, and that there was an orchestrated attempt by the senior management of Sandstorm, with the collusion of major customers and a third party bank, to deceive the auditors.

SECTION 7: UNRECORDED DEPOSITS - TUMBLEWEED AND OTHERS

Tumbleweed

- 7.1 Sandstorm's relationship with Tumbleweed dates back to the late 1970's when inter bank acceptances were taken by Overseas' Egyptian branches. When in 1982 Overseas sold its branches to the newly formed affiliate, BCC Misr, the sale did not include the transfer of Tumbleweed deposits of \$171 million as its size would have given local capital adequacy problems and because Tumbleweed wanted more confidentiality. Accordingly, the placements were transferred to Grand Cayman, although the customer relationship continued to be maintained by BCC Misr. The dealing operation in relation to Tumbleweed was performed at BCC Misr by an employee of Overseas, with transactions notified to London who determined the accounting to be effected in Grand Cayman.
- 7.2 The nature of these transactions was formalised in 1983 when a contract between Tumbleweed and Overseas was signed stating that these funds were to be invested in commodities in accordance with Islamic Law. Although prices for spot purchase and forward sale of commodities are always quoted on each deal we have seen no evidence to suggest that the bank actually entered any commodity contracts. Yields equate to term deposits.
- 7.3 We are told that there is an understanding between Sandstorm and Tumbleweed such that if Tumbleweed needs to withdraw funds at short notice it can do so interest free without breaking a deposit. At a later date Tumbleweed will reciprocate by placing an equal amount interest free for the same period. This agreement was apparently particularly beneficial to Tumbleweed in the Egyptian banking crisis in 1989 when two \$20 million interest free deposits were made and the Group arranged shipment of dollars to Egypt to enable Tumbleweed to meet its customers needs.
- 7.4 Although the banking relationship is still maintained by BCC Misr the account has been controlled, since the resignation of Z Akbar, by Mr S Naqvi's central team. Since 1988 the bank have employed a former governor of Tumbleweed as a consultant at a retainer of \$75,000 per annum paid through Fork.
- 7.5 From the time that the account was transferred to Grand Cayman in 1982 it appears that all funds from Tumbleweed passed through the Treasury pool accounts and were an integral part of the manipulation of funds within Treasury up to the resignation of Z Akbar in February 1986. Over this period interest paid to Tumbleweed on its placements was not expensed but instead debited to the same pool accounts. From 1 March 1986 separate pool accounts for all Tumbleweed transactions were established, although as previously, interest continued to be debited to the pool account rather than the profit and loss account.
- 7.6 Initially on the closure of the Treasury pool account it appears that an attempt was made to reinstate Tumbleweed's deposits, and \$199 million was injected into the Tumbleweed account in August 1986 [from funds under management with Fork], although within a few months these funds had again been utilised to service loans and make certain payments, as follows:

	\$ m
Fork Holdings - servicing of loans via BCP, Fork and SDCC; and payment of interest on borrowings from ADIA and FULDA in connection with repurchase of shares from Sh Mafhouz	70
Delta Bank Cairo - SDCC	32
- Gulf Group	15
Repayment of a Fulaij WXYZ related loan	30
Repayment of CD's of Fork and Emirates 'utilised' by Treasury	14
Untraced items	38
	199

7.7 In reviewing the Tumbleweed pool account we noted a number of payments to reinstate otherwise unrecorded deposits as follows:

State Bank of India	53
Saudi Arabian Fertiliser Company	18
██████████	25
Ministry of Finance - Cameroon	5
██████████	2

7.8 The balance on the Tumbleweed account in the books of Grand Cayman has since 1986 fluctuated between \$100 million overdrawn and \$50 million in credit. We have been told that the account was manipulated to ensure that the balance was zero or insignificant at 30 September and generally at 31 December each year in order to avoid it being chosen for confirmation by the external auditors. This was the case in 1986, 1987 and 1989. In 1988 a balance of \$11.3 million debit was circularised and confirmed by Tumbleweed; but this had again been manipulated to equal an interest free placement Sandstorm had made as part of the back-to-back arrangements.

7.9 In analysing the transactions between Sandstorm and Tumbleweed over the last eight years we have reviewed over 3,000 transactions and agreed them to deal slips or telex confirmations. In addition, of the supposed 37 outstanding deals at 27 September 1990 confirmed to Mr Naqvi, we have traced 85% by value to the original receipt of funds or the list of deals transferred at 31 October 1982.

7.10 Whilst there are unusual features about the Tumbleweed account - it appears from the Tumbleweed financial statements that some 25% of its total assets are placed with Sandstorm, and some \$170 million relates back to pre-1982 - it does appear that there is a significant liability to Tumbleweed which has not been recorded in the books. We have now received confirmation from Tumbleweed of outstanding transactions at 31 December 1990 totalling \$358 million in US Dollars not recorded in the books and \$ 39 million in other currencies which are recorded in the books.

7.11 [redacted] and his company, [redacted] have been long standing customers of Sandstorm since 1982. The relationship has been managed by Bahrain branch although the funds were booked in Grand Cayman, and instructions to roll-over or repay deposits have usually been sent directly from [redacted] to London [which entity].

7.12 Prior to March 1986 [redacted] deposits appear to have been credited to the Treasury pool account. When recalled both principal and interest were debited to the pool account. It would appear that the liability for such deposits was extinguished with the exception of three deposits, which were recreated in Grand Cayman in June 1986 following Akbar's resignation and the closure of the Treasury pool account. The recreation of these deposits totalling approximately \$62 million appears to have been achieved by using funds managed by Fork Investments.

7.13 These accounts were rolled over and properly accounted for from June 1986 until September 1987 when \$65 million was transferred to Credit Suisse and then onto Grand Cayman. \$56 million was used to repay a bogus loan in [redacted] name which had been used to repay borrowings from Fork drawdown in an attempt to reinstate the Tumbleweed accounts. The remaining \$9 million was part of an amount of \$12 million credited to the Tumbleweed account to reduce the account balance at 30 September 1987. Having utilised these deposits certain part repayments to [redacted] in November 1987 had to be funded by the creation of overdraft accounts in Grand Cayman which were subsequently repaid by funds from Fork entities.

7.14 At 31 December 1990 the balances on the three accounts in question were:

		<u>\$ m</u>	<u>Maturity</u>
Term deposit	1	15.7	15.5.91
Term deposit	2	27.3	08.1.91
Term deposit	3	9.5	06.3.91
		52.5	

7.15 [All were rolled - over] on maturity, and have now been confirmed by the customer.

Miscellaneous unrecorded deposits

7.16 The remainder of the unrecorded deposits reported to us by Mr Iqbal are made up as follows:

	\$ m
Dr GR Pharaon	10.4
[REDACTED]	16.6
BCP Luxembourg	9.6
Arab Livestock Co.	5.3
[REDACTED]	0.2
	42.1
Dr GR Pharaon	

7.17 This account purportedly relates to a deposit in Bahrain by Dr Pharaon in April 1989 the funds being received from BAI, which was subsequently transferred to an account at BCP Geneva via First American. [Account holder unknown]. A further \$1.2 million was transferred for an unknown purpose to a Turks and Caicos Company, North American Finance and Investment, controlled by Mr Kazmi of Fork.

7.18 As yet we have been unable to establish whether the bank has an unrecorded liability in respect of these transactions.

[REDACTED]

7.19 This potential liability appears to relate to a liability of Fork (Overseas) to [REDACTED] in respect of certain repo transactions. In total through a complicated series of transactions \$35 million, apparently sourced from [REDACTED] (\$15 million), as above, and Tumbleweed (\$20 million), passed through SDCC to KIFCO (\$10 million) and a Fork routing account at SNCB (\$25 million), and has most probably been used for loan servicing.

7.20 Whilst there appears to be a liability to [REDACTED] it is by no means clear whether it is a liability of Sandstorm or Fork.

BCP Luxembourg

7.21 This amount relates to an overdrawn account in the name of Fork Overseas, which despite its name appears to have been used as a 'pooling' account within the Sandstorm Group.

7.22 The balance thus relates to unfunded utilisations:

		3 m
MM Hammoud:	funds transferred to reduce loans at Fork Overseas	2.0
IBU:	funds used to repay a deposit of QIB accepted by IBU and placed with Fork Holdings	5.0
Fork account 500 at SNCB :	funds transferred to Fork Holdings and subsequently routed to Saudi Cairo Bank, Jeddah apparently to service loans in the name of Kamal Adham	2.0
Interest		0.6
		9.6



7.23 Again whilst it is clear that funds from this BCP account has been 'utilised' for unauthorised purposes it is by no means clear whether the liability is solely that of Sandstorm.

Arab Livestock Company (ALSCO)

7.24 This amount relates to a deposit by ALSCO in Bahrain, which was 'utilised' for other purposes. Although the amount was subsequently reinstated this was done using funds from Fork's pool account 500 with SNCB hence it appears that if there is any unrecorded liability it is to Fork.



7.25 This is a another Bahrain deposit which was 'utilised' for other purposes.

SECTION 3: UNRECORDED DEPOSITS - ISLAMIC BANKING

Introduction

- 8.1 Sandstorm SA would seem to have commenced Islamic banking activities in its UK Region on behalf of certain Islamic customers in June 1984. Initial activity is believed to have been low building to a level of around \$[50] million at the time that the current records commenced in May 1986. Thereafter volumes grew significantly and from 1 January 1989 all these transactions have been routed through a separate Islamic Banking Unit ("IBU"). At its peak of activity at the end of 1989 amounts placed with IBU by Islamic customers for Islamic investment transactions totalled some \$1.4 billion equivalent in seven different currencies.
- 8.2 The most common type of Islamic banking instrument is a Murabaha deal. This involves the purchase of a commodity and the immediate sale of that commodity with deferred receipt of the sale proceeds for a period determined by the Islamic customer. This eliminates any risk pertaining to holding the commodity and leaves the cost of the deferred payment to generate a higher selling price than purchase price. Not surprisingly the mark up usually bears a close relationship to prevailing interest rates. There is a risk to the Islamic customer that the counterparty will not pay on the due date, however it seems common practice for the Islamic customer to seek to avoid this as well by obtaining a bank guarantee/letter of credit securing the recovery of funds.

Sandstorm's approach to Islamic banking

- 8.3 All funds received by Sandstorm SA from Islamic customers for investment purposes are applied in the manner outlined above with Sandstorm acting as agent and for the vast majority of transactions the necessary guarantee is provided by Sandstorm SA. By issuing a guarantee Sandstorm inherits the risk of counterparty failure. To avoid this Sandstorm undertakes two further commodity deals, the mirror image of those undertaken on behalf of the Islamic customer, thus cancelling the forward sale transactions with forward purchase transactions. The resulting free funds are then on placed within the BCC Group, affiliated entities or on the money markets to earn a rate of interest at least equal to the guaranteed mark-up for the period of the original deferred payment period.
- 8.4 The effect of Sandstorm's own commodity deals and on placement of funds can give the impression that the whole transaction is no more than one of taking deposits from these Islamic customers, but this is not the case. In respect of the Islamic customer Sandstorm has acted as investment manager. As principal it has issued a guarantee and covered the risk by entering into its own contracts with brokers and making matching placements. Problems have arisen however on the accounting for transactions undertaken by Sandstorm as principal.

Funds placed outside the BCC Group

- 8.5 The majority of funds on placed by IBU went to Sandstorm (Overseas) in Grand Cayman or branches within UK Region. However, between 1986 and 1990 funds were on placed by UK Region with other affiliated Sandstorm entities.

- 8.6 UK management initially informed us that all these other placements were done with Fork (Overseas), by reference to instructions from S Naqvi regarding an overall level of placements identified for this institution of some \$80 to \$100 million. There is however no written evidence relating to this instruction. We have established that placements were also made into accounts controlled either by Fork Holdings, or BCC Bahrain, on behalf of Fork Holdings. UK management say that they were not aware of this. The accounts in question are represented by Mr Kazmi to be Fork Holdings client accounts, albeit under the control of S Naqvi.
- 8.7 The following amounts were received from Islamic customers and on placed by UK Region with Fork (Overseas), Fork Holdings and BCC Bahrain at 31 December 1989 and 31 December 1990:

	<u>31 December</u> <u>1989</u> \$'000	<u>31 December</u> <u>1990</u> \$'000
Fork (Overseas)	46,502	-
Fork Holdings	50,485	o/s
BCC Bahrain for Fork Holdings	<u>30,000</u>	<u>o/s</u>
Total	<u>126,987</u>	<u>84,451</u>



- **Funds placed with Fork (Overseas)**

Placements with Fork (Overseas) outstanding at 31 December 1989, were done through the transfer of funds from a UK Region nostro account to a number of accounts held by Fork (Overseas) at BCC Grand Cayman. Although no confirmation was received from Fork (Overseas) when the funds were placed, Sandstorm SA UK Region notified this institution of the transfer of funds and terms of the placements.

- **Funds placed with Fork Holdings**

The make up of the funds received from Islamic customers which were supposedly placed with Fork Holdings, with interest to 31 December 1990, were as follows:

	<u>Placement date</u>	<u>\$ m</u>
Al Rahji Banking and Investment and Corporation	16.1.90	10.0
Interest		0.8
		<u>10.8</u>

Catar Islamic Bank

29.1.90	5.0
26.3.90	3.5
07.3.90	2.5
13.3.90	3.3
13.3.90	5.1
26.3.90	4.8
Interest	2.1
	32.3

Dubai Islamic Bank

27.12.89	10.0	
01.3.89	30.0	(Note)
Interest	2.4	
	42.4	
	84.5	

Note: This amount was on-placed with BCC Bahrain which then placed the funds with BCP Luxembourg.

Amounts placed with Fork Holdings were initially made in December 1989 for the credit of an account number 101458.500 at Saudi National Commerce Bank, Bahrain. This is a client account belonging to Fork Holdings.

Further amounts totalling \$35.4 million were placed through this account in January 1990 and March 1990. We understand that no further funds were placed via this account after March 1990.

UK Region did not confirm these placements with Fork Holdings or receive any confirmations from them.

Fork Holdings defaulted on the repayment of all placements due in May 1990, June 1990 and October 1990. The original Islamic investments to which these placements were matched were repaid by UK Region to Qatar Islamic Bank, Al Rajhi Banking Investment Corporation and Dubai Islamic Bank on the appropriate due dates. Total funds outstanding as a result of the non repayment from Fork Holdings (principal plus interest) amounted to \$[84]million at 31 December 1990. We understand that these amounts have not been repaid by Fork Holdings to date.

Funds placed with BCC Bahrain

Three deposits of \$10 million each which were placed via BCC Bahrain in March 1989. These amounts were rolled over monthly to match the monthly roll over of the underlying Islamic investment. However, when repayment was called in October 1990 the funds were not forthcoming. Once again the original Islamic investment was repaid forthwith. Total funds of \$ [] million remains outstanding to Sandstorm SA UK

Region at 31 December 1990. We understand these amounts have not been repaid to date.

- 8.8 The inappropriateness of the on placements to Fork (Holdings) and SCC Bahrain is emphasised by the fact that the manager of IBU (S Doha) withheld or manipulated all third party confirmations from Islamic customers relating to these transactions from the external auditors at the time of the 31 December 1989 audit of UK Region. A total value of \$80.5 million. [redacted] informs us that he had no knowledge of this and that S Doha must have been clearly taking instructions from S Naqvi.

Application of certain on placements

- 8.9 Funds on placed to BCC Grand Cayman or Fork (Overseas) were usually put in a deposit account in the name of the original Islamic customer who had provided the funds for investment. In some cases however it seems that the on placements with Grand Cayman were made into deposit accounts of certain third party customers. Those deposit accounts were then held out to be the deposit security for certain loans made to those third party customers. In the two instances that have been identified the third party who 'benefitted' from this deception was the Virani Group with false loan security of \$ 17 million.

Destination of Funds

- 8.10 The amount of \$30 million on-placed with BCC Bahrain is believed to have been transferred to an account with Credit Suisse; (and then probably onwards to SNCB account 500). Otherwise all the other amounts were received into the SNCB account 500 in the name of Fork Holdings and we have confirmed this by reference to bank statements. This is one of the accounts under the control of S Naqvi and his central team used for the purposes of fraudulently routing funds.
- 8.11 Mr Kazmi of Fork acknowledges that the funds were received through the SNCB account of Fork Holdings but as they were then routed back to Sandstorm or elsewhere on the instructions of Mr S Naqvi, he does not believe that Fork has any liability to Sandstorm UK Region in respect of these amounts placed by IBU.

3.12 The funds appear to have then been utilised by S Nacvi and his team as follows:

	\$ m
Sh Kamal Adham - amount used as repayment in January 1990 of a \$5.5 million loan in the name of Kamal Adham in connection with WXYZ.	5.8
Interest on nominee loans at SNCB in the names of	
Mashriq Holdings	6.4
Faisal Fulaj	6.1
	12.5
<p>These loans were secured by a placement from Sandstorm with SNCB and relate to the financing of WXYZ shares.</p>	
Purchase of shares from Fork Foundation and Fork Staff Benefit Fund in the name of Sh Zaiyai as nominee.	4.0
Transferred via Fork and BCP to Bahrain to repay interest and principal on unrecorded deposits.	
ALSCO	4.0
Alisson Est	1.2
	2.1
	7.3
Various servicing of loans within BCP and Fork (not yet corroborated).	7.7
SDCC (purpose as yet unknown).	10.6
Gulf Group - apparently transferred via Granite and Cedar in March 1989 (not yet corroborated).	11.5
MM Hammoud - loan servicing of account in Sandstorm Cyprus in March 1989.	3.0
Balance - used generally in SNCB 500 account pool utilised by Sandstorm and Fork.	17.8
	81.2

Accounting for Islamic banking transactions

- 8.13 Prior to August 1990, UK Region accounted for all aspects of the Islamic commodity investments as if they acted as agent and therefore no part of the series of transactions was reflected on balance sheet. The on placements to Grand Cayman, UK Region and Fork (Overseas) were reflected in the accounts of those entities as third party deposits rather than intra group deposits.
- 8.14 Since however certain parts of the series of transactions are actually originated by Sandstorm, namely its own commodity deals and on placement of funds, the appropriate accounting treatment is to reflect a due to brokers credit balance and a placement debit balance.
- 8.15 In Sandstorm SA's accounts for the year ended 31 December 1989 the appropriate accounting treatment was reflected for known Islamic investments on placed in Grand Cayman, UK and Fork (Overseas). However this was not the case in the UK Region's own financial records and returns.
- 8.16 Since August 1990 UK Region have reflected credit and debit balances in respect of Islamic banking transactions on placed to the above locations although the credit has been identified as a deposit rather than a due to brokers.

Disclosure in the Prudential Returns

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Prior to August 1990

- 8.17 As a consequence of UK Region's accounting policy which treated all aspects of Islamic banking as off-balance sheet except for funds on placed to UK Region, the prudential returns submitted by UK Region to the Bank of England during this period showed a significant understatement of assets and liabilities. At 31 December 1989 for example assets were understated by \$ 802.4 million due from banks and liabilities understated by \$802 million due to brokers, although as noted above adjustment was made in the legal accounts of Sandstorm SA. In addition \$176.3 million of deposits should have been classified as due to brokers (being amounts received and used within the UK Region itself).

From August 1990

- 8.18 In August 1990, at our insistence management decided to transfer the entire portfolio of investments from Islamic customers into the books of UK Region except for investments which were actually held by brokers and guaranteed by third party standby letters of credit (ie genuinely off-balance sheet). In practice this still excluded the transactions that had been on placed with Fork Holdings and BCC Bahrain and two other amounts on placed with Bank of New York, London and Nederlandsche Middenstands bank NV, London. The impact on the prudential returns was a continuing but smaller understatement of assets and liabilities which at 31 December 1990 amounted to \$ 106.9 million and a misclassification of \$ 441.4 million as deposits rather than due to brokers at the same date. In addition, because of their classification as deposits the Islamic customers with the four largest aggregate investments were also disclosed in the B7 return as depositors with more than 5% of total deposits.

- 8.19 The amounts placed with Fork Holdings and SCC Bahrain amounting to \$84.5 million at 31 December 1990 were correctly reflected in the books of UK Region from 27 March 1991. Funds totalling \$ 22.5 million placed with two other institutions noted above are still not reflected in the books of UK Region.

Accounting for the shortfall in repayment of placements

- 8.20 The accounting adopted for the shortfall of funds was even more inappropriate. Rather than recognising a debt from Fork (Holdings), UK Region used loan accounts opened for Al Rajhi Banking Investment Corporation and Qatar Islamic Bank to "disguise" the recording of amounts due from Fork Holdings. As a result, credit facilities and relevant loan accounts authorised by BCC Central Credit Committee for these banks were effectively used by UK Region for purposes other than for those for which they were actually approved.
- 8.21 To "disguise" the amounts due from BCC Bahrain a loan account in the name of Dubai Islamic Bank was opened by UK Region in September 1990 to record investments repaid by UK Region to this customer but not recovered from BCC Bahrain. This credit facility for Dubai Islamic Bank was not authorised by BCC Central Credit Committee.
- 8.22 The loan accounts were then subsequently adjusted by crediting them with new funds received from the same Islamic customers up to the amount of the shortfall, rather than crediting those new funds to the liabilities side of the balance sheet, thereby, falsely understating assets and liabilities.

5

Disclosure in the Prudential Returns

- 8.23 The impact of these accounting entries on the amounts disclosed in the prudential returns was an understatement of both assets and liabilities. At 31 December 1990 assets should have included a sundry debtor for \$ 84.5 million being the amounts due from Fork Holdings, and liabilities a due to brokers of a similar amount, although the recoverability from Fork is uncertain.
- 8.24 Those Islamic investments shown in the B7 return as large deposits, whilst not correctly classified as deposits, would also have been understated by a total of \$ 84.5 million.

Management control

- 8.25 The extent of the errors and deceptions raises enormous concerns about how management control over the Islamic activities was exercised.
- 8.26 IBU is and has been under the executive control of B Chowdry for some considerable time even before he became regional general manager. His knowledge or lack of knowledge as to the events outlined above demonstrates a lack of effective management with respect to this area of business.

8.27 With respect to the placement of funds with Fork Holdings and BCC Bahrain, B Chowdry represents that he was acting under instruction from S Naqvi. There is however no documentation supporting instructions given by S Naqvi or instructions given by B Chowdry to IBU. Furthermore, B Chowdry represents that at the time of the transactions he was led to believe by S Naqvi and others that the funds were being placed with Fork (Overseas). There is however no documentation supporting notification by UK Region to Fork (Overseas) or any other entity in respect of funds placed through BCC Bahrain and Saudi National Commerce Bank, Bahrain. The only documentation available, according to UK Region management, is a memorandum sent by Mr Doha, (former manager of the Islamic Banking Unit) to Mr HM Kazmi, (Fork Foundation, based at 100 Leadenhall Street) outlining details of the funds so placed. B Chowdry claims that the routing of placements (ie through Grand Cayman, BCC Bahrain, Saudi National Commercial Bank) was determined and notified by S Naqvi or Mr Kazmi. However, there is no written evidence to support this statement.

8.28 Mr B Chowdry represents that he is seeking recovery of the debt from BCC Central office in Abu Dhabi. With respect to the misuse of on placements as security for third party loans and advances B Chowdry represents that he had no knowledge of this until it was recently identified and that the manager of IBU must have acted under direct instruction probably from Mr Haque, the account officer for the Virani Group.

8.29 In relation to the general accounting for these transactions B Chowdry has now recognised that the original accounting treatment was incorrect although it should be noted that the bank placed reliance for some time on legal advice that lent support to their earlier practice. However the precise accounting classifications for Islamic transactions that have been outlined above still need to be adopted.

8.30 With respect to the accounting practices adopted to cover up the non repayment of certain on placements B Chowdry acknowledges that this was inappropriate but represents that whilst against his better judgement he was again acting under instruction from S Naqvi. The knowledge of other members of the UK Management Committee with respect to these transactions is unclear, but it seems unlikely that these entries went unnoticed by the UK Region's credit department.

Conclusion

8.31 From a customers point of view all Islamic investment transactions have been properly executed and funds repaid on the due date. UK Region's approach to covering its own guarantee risk whilst acceptable was not adequately researched from an accounting view point and was misguided with respect to where funds were ultimately placed.

8.32 The resulting catalogue of errors with regard to the non repayment of some placements and the misuse of other placements as security reflects at the very least a lack of any proper independent management control in UK Region. The accounting adopted for the non repayment is indefensible and lends weight to the conclusion that UK management have acted irresponsibly in allowing the events outlined above to occur. Whether UK management and particularly B Chowdry and Mr Doha have acted in good faith under instruction from senior officers within BCC Group has been impossible to determine but it is difficult to imagine that every transaction could go through unchallenged by them.

SANDSTORM

APPENDIX I

HISTORY OF GULF GROUP EXPOSURE

		Recorded Balance sheet Exposure \$ m	Sandstorm Consolidated Capital \$ m
31 December	1977	80	113
	1978	110	171
	1979	180	226
	1980	183	292
	1981	254	462
	1982	221	641
	1983	211	808
	1984	195	1,009
	1985	246	1,190
	1986	370	1,508
	1987	437	1,469
	1988	597	1,417
	1989	705	1,075

7.10 Whilst there are unusual features about the Tumbleweed account - it appears from the Tumbleweed financial statements that some 25% of its total assets are placed with Sandstorm, and some \$170 million relates back to pre-1982 - it does appear that there is a significant liability to Tumbleweed which has not been recorded in the books. We have now received confirmation from Tumbleweed of outstanding transactions at 31 December 1990 totalling \$358 million in US Dollars not recorded in the books and \$ 39 million in other currencies which are recorded in the books.

██████████

7.11 ██████████ and his company, ██████████ have been long standing customers of Sandstorm since 1982. The relationship has been managed by Bahrain branch although the funds were booked in Grand Cayman, and instructions to roll-over or repay deposits have usually been sent directly from ██████████ to London [which entity].

7.12 Prior to March 1986 ██████████ deposits appear to have been credited to the Treasury pool account. When recalled both principal and interest were debited to the pool account. It would appear that the liability for such deposits was extinguished with the exception of three deposits, which were recreated in Grand Cayman in June 1986 following Akbar's resignation and the closure of the Treasury pool account. The recreation of these deposits totalling approximately \$62 million appears to have been achieved by using funds managed by Fork Investments.

7.13 These accounts were rolled over and properly accounted for from June 1986 until September 1987 when \$65 million was transferred to Credit Suisse and then onto Grand Cayman; \$56 million was used to repay a bogus loan in ██████████ name which had been used to repay borrowings from Fork drawdown in an attempt to reinstate the Tumbleweed accounts. The remaining \$9 million was part of an amount of \$12 million credited to the Tumbleweed account to reduce the account balance at 30 September 1987. Having utilised these deposits certain part repayments to ██████████ in November 1987 had to be funded by the creation of overdraft accounts in Grand Cayman which were subsequently repaid by funds from Fork entities.

7.14 At 31 December 1990 the balances on the three accounts in question were:

		<u>\$ m</u>	<u>Maturity</u>
Term deposit	1	15.7	15.5.91
Term deposit	2	27.3	08.1.91
Term deposit	3	9.5	06.3.91
		<hr style="width: 50%; margin: 0 auto;"/>	
		52.5	
		<hr style="width: 50%; margin: 0 auto;"/>	

7.15 [All were rolled - over] on maturity, and have now been confirmed by the customer.

