

14. Elite capture of Kabul Bank

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Afghanistan is entering the most critical period since the overthrow of Taliban back in 2001. The North Atlantic Treaty Organization (NATO) has announced withdrawal of international forces by 2014, and a sharp reduction is expected in funding for development programmes and support for the Government of Afghanistan (GOA). This has led to increasing fear of renewed internal fighting, and major uncertainty if there will be an orderly shift of presidential power as President Karzai's term should end in April 2014 (International Crisis Group, 2012). There are increasing concerns over the high level of corruption and the large amounts of cash being brought abroad as the Afghan elite prepare to secure their financial future.

The overall objective of combating terror, building peace and winning Afghan 'hearts and minds' has, since 2001, frequently come to overshadow normal development and governance priorities. Key international actors have based their strategy on the presumed loyalty of a small Afghan military and political elite, seeing that as instrumental in securing Afghan support to the international mission. These Afghans have been able to make use of their position to secure generous benefits from the international assistance, and from the opportunities emerging from an economic liberalisation policy that formed part of the peace-building package. The sale of state property, tendering of large security and engineering contracts and a process to tender out major mineral and energy resources left those with political and military connections ideally placed to maximize personal and family income.

This resonates with the literature on peace building and corruption where it has been observed (Cheng, 2012) that:

while post-conflict environments appear to be especially prone to corruption, and while corruption can compromise peace-building efforts, fighting corruption is not the only objective of peace-building actors – nor is it necessarily the most important one. Enabling corruption might be a price peace builders

have to pay to ensure the participation of warring factions in a peace agreement and to end large-scale violence.

The author (*ibid.*: 11) concludes that:

in most peace-building concepts there is an implicit trade-off whereby corruption is tolerated in the short term in order to end violence and aid stability, but the foundation for long-term development of state institutions are undermined as the capacity and legitimacy of the state suffer damage.

To be able to capitalize on such short-term opportunities and maintain their influence over the state apparatus, the Afghan elite was in need of access to stable sources of cash. This coincided with the interest of elements in the Afghan banking sector in political alliances to secure access to a continuous cash flow and political backing for their operations. The case of the Kabul Bank fraud illustrates how this was accomplished in a situation where the importance of building peace through an international military operation took precedence over addressing corruption. And where, consequently, the international community and the Afghan population had to foot the bill for a USD 920 million fraud.

Three decades of conflict and massive funding for military operations, the buying of alliances, and humanitarian assistance for victims of war, has left Afghanistan vulnerable to corruption. Since the overthrow of the Taliban regime in 2001 it has been evident that corruption has emerged as a major obstacle to Afghan state-building and the peace-building process. This has been confirmed over the last years through national corruption surveys undertaken by Integrity Watch Afghanistan (2013). The surveys document that corruption not only reduces the scale and impact of development programmes but also the trust the population hold in the GOA and in those elected to govern. Since I have worked for international non-governmental organizations (NGOs) in Afghanistan during the 1980s and '90s, and as researcher and evaluator during the last decade, I have been able to follow these developments closely. Over the last few years, Kabul has been ripe with stories of how key persons in the government have embezzled large sums, and how they have protected each other. Local businessmen conveyed stories of rigged tender processes, and how they had been warned against submitting bids for larger contracts that would compete with companies linked to powerful individuals. Independent media has exposed different forms of corrupt practices, though largely without any consequences for those involved. It was only when the Washington Post exposed the Kabul Bank case in February 2010 that the extent of the political corruption was exposed and

became an issue of more general concern. Although several overview articles have been written, which this chapter draws on,¹ and an independent committee has released its report on the case, there are still signs that those responsible will not be held accountable due to their political affiliations (Independent Joint Anti-corruption Monitoring and Evaluation Committee, 2012).

14.1 CREATIVE BANKING

Kabul Bank had a rather unlikely start when it was established back in 2004. The co-founders ending up as Chairman and CEO of the bank were Sherkhan Farnood, a technical operator trusted with the printing of banknotes for one of the Afghan Islamic resistance parties, and Khalilullah Ferozi, an internationally renowned poker player with experience from operating the Shaheen Exchange, a *Hawala* banking system operating out of Moscow and later Dubai. Kabul Bank was formally registered with the Afghan Central Bank (Da Afghanistan Bank, DAB), as is the banking requirement, and expanded its presence rapidly throughout Afghanistan with 68 branches in all of Afghanistan's provinces. A major reason for such an expansion was that Kabul Bank managed to secure a USD 1.8 billion annual contract to pay (with international funding through the Afghan Reconstruction Trust Fund) the salaries for about 80 per cent of the employees of the Afghan government. It is estimated that the bank earned up to USD 10 million a year in interest for holding the salaries (Filkins, 2011). Moreover, it managed through effective advertising to receive about USD 1.3 billion as deposits from the Afghan public, making it the largest Afghan private bank (Huffman, 2011).

However, the owners did not intend to rest on their achievements or comply with international and national banking regulations. They rather opted to secure for themselves political connections in the Afghan government to fully utilize the financial opportunities that the bank provided them. In this endeavour they were rather innovative and approached the brothers of President Karzai and First Vice-President Fahim, both active in the Afghan business sector. According to an explanation provided by Mahmoud Karzai, in 2007 he was provided with about USD 6 million in cash, as a gift, from Kabul Bank's Chairman Farnood to buy 7.5 per cent shares in Kabul Bank. This secured for him, and in the same way the vice-president's brother Abdul Haseen Fahim, seats on the board of Kabul Bank. The result was a political affiliation that shielded the bank from government 'interference', but it came at a high financial cost.

The two board members drew on the bank's financial resources to finance their own investments, including the buying up of privatized state property and for having 'cash at hand' when larger procurement processes required companies to provide financial guarantees. What were termed 'loans' to these board members were in reality interest free 'grants' without a repayment schedule or any collateral. Discussions broadcast on Afghan television following the disclosure of the scam suggest that 'grants' for purchases that turned profitable were repaid by the two board members, though if investments failed it was left to Kabul Bank to shoulder the financial losses.

What finally 'broke the camel's back' in 2010 were a series of property investments made by Kabul Bank in Dubai's elite neighbourhood Palm Jumeirah. Houses and flats were offered for the Afghan political elite on 'grant terms'. Some were registered to the CEO of Kabul Bank and some to his wife, while, in reality, they were used by members of the Afghan elite or those they wanted to befriend. One property was held by the former vice-president, Ahmed Zia Masood. According to the US Embassy in Kabul, he was stopped by officials of the United Arab Emirates in 2009 for entering the country with USD 52 million in cash in his luggage. The same authorities had reported that Kabul Bank Chairman Farnood owned 39 properties in Dubai (Steele and Boone, 2010). When the real estate crash came in 2008, these property investments, estimated at USD 160 million, become a major liability for Kabul Bank.

14.2 THE ELECTION GAME

This setback did not prevent Kabul Bank's leadership from trying to secure further influence in Afghan political circles. The presidential elections in 2009, where President Karzai was re-elected after massive election fraud, was seen as an opportunity for them to secure their political influence (Bijlert, 2009, 2010). President Karzai's election team and campaign was headed by Finance Minister Omar Zakilwal, and included several other ministers. Zakilwal publicly acknowledged that they received a contribution from Kabul Bank, and that he personally forwarded a briefcase with cash to the campaign team. He believed the contribution was about USD 0.2 million. This amount, or any other contribution from Kabul Bank, is not registered as required by the Independent Election Commission. Neither does the amount match information provided by other campaign staff or Kabul Bank CEO. The latter has repeatedly told journalists that Kabul Bank provided President Karzai's campaign with up to USD 14 million. Afghan officials moreover

allege that money from Kabul Bank was on a number of occasions used by the Karzai government to bribe parliamentarians to secure their votes in cases of importance to the government.

14.3 REAL MONEY FOR FAKE COMPANIES

How did Kabul Bank come to all this cash, and how could their activities go undetected despite an international audit? Journalists, such as Michael Huffman, who have looked into the case have found an intriguing arrangement. Two hundred fake companies had been established by Farnood and Ferozi, and these were granted loans from Kabul Bank. The loans were transferred to the Shaheen Exchange in Dubai and from this company returned back to individuals in Afghanistan through the use of fake names, possibly addressed to a person employed by the real recipient. There were two sets of books, one fake set in Kabul that was made available for the auditors and one real set held by Shaheen Exchange in Dubai.

Both the Chairman and the CEO were actively using Kabul Bank funds in violation of Afghan banking law. All property purchases in Dubai were illegal as banking investments were not allowed outside of Afghanistan. Equally illegal were the purchase and direct running of Afghan businesses by bank officials and board members. One telling example is that of the airline Pamir Air, of which Farnood was the chairman. Their operating license was only revoked in March 2011 following an air crash killing 44 people. The crash investigation revealed that the plane's registration had been forged to avoid safety inspections (Huffman, 2011).

14.4 THE SCANDAL IS OUT

But underneath the polished surface and marketing campaigns, major disagreements were developing between the Chairman Farnood and CEO Ferozi. The Afghan Parliament, the High Office of Oversight and Anti-Corruption, and gradually too the DAB took an increasing interest in Kabul Bank, especially after a 2009 audit report on 'nonperforming loans and loan losses'. In February 2010, Abdul Qadir Fitrat, Director of DAB (Afghan Central Bank), requested that the US Treasury Department conduct a forensic audit of the two largest private banks: Kabul Bank and Azizi Bank. Further pressure emerged as international newspapers, during the same month, revealed the failed investments in Dubai, and the extent of capital taken out of the country via Kabul airport (including by

Pamir Air). Pressure was building on DAB to take a more active role towards Kabul Bank, but they were reportedly hesitant to fully engage due to the expected protection provided through Kabul Bank's political connections. It was Chairman Farnood that finally informed US authorities in July 2010 about the bank's difficult financial situation and the magnitude of the scam. This was possibly done to protect himself, as it was evident that the bank would no longer be able to maintain their operations in the same manner (Huffman, 2011: 9). This raised major concerns in the US camp, to the extent that US (and NATO) Commander General Patraeus called in July for a meeting with President Karzai and Director Fitrat to discuss the financial state of Kabul Bank. Fitrat went on to the Parliament to ask for a USD 200 million 'safety net trust fund for private banks'. While the news was still not public in Afghanistan, pressure was growing on Kabul Bank management. On 30 August Director Fitrat demanded the resignation of Farnood and Ferozi, and appointed DAB's chief financial advisor to oversee Kabul Bank.

This caused panic among Kabul Bank's customers. They lined up to withdraw their deposits: USD 180 million was withdrawn in just 2 days, despite denials from bank staff and even the Finance Minister that there was no reason for concern. Mehmod Karzai denied that losses were as high as the alleged USD 300 million, while President Karzai blamed the media for its negative coverage of the financial situation of Kabul Bank.

The reality could not be hidden and the Afghan government ended up providing a USD 820 million bailout grant for Kabul Bank. This amount confirmed that the extent of the fraud was far beyond what was expected, and later estimates ended up at USD 930 million.

14.5 IMF PRESSURE

Uncertainty over the Afghan government's will to address corruption led, in turn, the International Monetary Fund (IMF) to refuse renewal of the Extended Credit Facility Programme in September 2010, the function of which is to ensure that Afghanistan's financial sector is sound. Their terms were clear. The Afghan government was required to conduct a forensic audit of Kabul Bank and Azizi Bank, to reform their banking and lending laws, to prosecute the officials responsible for Kabul Bank fraud, place the bank under receivership and devise an acceptable plan to recapitalize the government's reserves for the USD 820 million bailout. International development partners added pressure by halting their scheduled transfers to Afghanistan. Despite such pressure, responses were slow on the Afghan side. Karzai tried to avoid having USAID fund the

forensic audit as that would provide them the right to insights into the findings. Kabul Bank was only dissolved as a legal entity in April 2011, but with parts of it immediately re-established as 'New Kabul Bank'. Farnood and Fitrat were finally arrested in June 2011, a year after the scandal broke, but released in September the same year without having to stand trial. In October 2011, the Afghan Parliament passed a bill to recapitalize the government's reserves over a period of 8 years, effectively passing on the cost to Afghan taxpayers (and international donors).

14.6 PROTECTIVE POLITICS

When names of those involved emerged and the extent of the fraud became publicly known in April 2011, efforts to protect the president, his family and associates began. For the Afghan government the problem was no longer those who had committed the fraud, it was rather, as they narrated: those who had not detected it early enough or acted upon the information they possessed.

President Karzai announced in April 2011 that the bank would be placed under receivership and that its management could be prosecuted. But, he further informed that the remaining shareholders were offered an amnesty and would be excused if they repaid their loans within 1 month (this was later extended to 3 years). In effect, he was letting his and his vice-president's brother off the hook. Karzai's argument was that the blame had to be placed on the foreign advisors that had provided DAB with inaccurate information, and the auditors (a Pakistani auditing company) that had failed to detect the fraud. He was at this stage expressing his opinion that the fault was not with DAB: they had only been inexperienced.

This statement from the president and the continued pressure from the IMF and other development partners emboldened DAB Governor Fitrat. In late April, he exposed to the Afghan Parliament the names of the top eight shareholders in Kabul Bank and that of two businessmen involved in the fraud. He also informed the parliament that as many as 103 ministers and members of parliament had received money from Kabul Bank. He, however, did not oppose the amnesty President Karzai had announced, but urged the collaboration of the 'grantees' in reclaiming the funds. He noted that Mahmoud Karzai and Abdul Haseen Fahim had a partial repayment agreement with the government, and informed the parliament that he had requested that the government confiscate shareholders' property and set up a special court to try them for the fraud.

The public announcement of the names of the two brothers and the extent of their involvement made Governor Fitrat a threat to President Karzai and his circle. They appointed a commission to review the Kabul Bank case, headed by Azizullah Lodin, the Chairman of the Afghan High Office of Oversight and Anti-Corruption. Their report, released on 29 May 2011, placed the blame for the fraud on DAB due to 'their weak monitoring'. The same report acquitted the shareholders of any wrongdoing, though excluding Chairman Farnood and CEO Ferozi. Chairman Lodin referred in his presentation of the report to the fraud as a 'minor incident' that the donors should not use as a pretext for withholding financial support to Afghanistan.

The IMF maintained the pressure, however, much to the dismay of Finance Minister Zakilwal – who argued that the international community 'were playing politics'. The mounting pressure on Governor Fitrat forced him to flee to the United States. He claimed to know of an assassination plot arranged by the Afghan government and announced his resignation from the governor position. He categorically rejected his own part in the Kabul Bank fraud, but provided further details of the involvement of and benefits taken by the Karzai family.

From this point, it was up to Karzai. He became increasingly negative towards the international community and played up pro-Afghan and anti-Western rhetoric. He ordered, or accepted, that Farnood and Ferozi should be released from custody in September 2011, and did not give in to all demands from the IMF and the other donors. They finally approved a new agreement by November 2011 involving a watered-down list of demands. Almost a year later, on 30 October 2012, President Karzai chaired a government meeting that made the following decision: 'The Ministry of Foreign Affairs and Attorney General Office were tasked to effectively follow up with the United States the issue of the extradition of Abdul Qadir Fitrat, the former DAB governor, who is also accused in the Kabul Bank issue' (Government of Afghanistan, 2012).

This decision fits into a narrative of national pride and independence and the opposition of international pressure. Though, at the same time, Karzai demonstrates to his fellow Afghans his influence over the state. It is not the judicial system but the president who decides who should be taken to court or not, or extradited to stand trial – seemingly with limited evidence. He signalled to his fellow Afghans: do not dare to challenge us; we will use the state against you. This is not least important at a time when Karzai and his vice-presidents are working hard to secure their influence after the 2014 presidential elections, possibly with another Karzai brother or close ally as the new president.

The verdict of the Special Tribunal on the Kabul Bank case announced in early March 2013 does little to increase trust in the willingness of the Afghan government to take corruption seriously. According to Smith (2013), charges against Farnood and Ferozi for money laundering and embezzlement were dropped. They were therefore only sentenced to 5 years in prison, or potentially in 'house detention'. Farnood was ordered to repay USD 279 million and Ferozi USD 531 million, but few believe this money will be paid. Equally disturbing to Smith is the fact that no shareholders but several employees of DAB were sentenced, leading to a comment that 'the similarity of the sentences meted out to the architects and beneficiaries of the fraud with the penalties against officials in the central bank makes a mockery of the judicial process as well' (Smith, 2013).

14.7 POLICY IMPLICATIONS

The policy implications of the Kabul Bank case might be grave in this vulnerable transition period, and beyond. One of the key points in the declaration from the Tokyo conference, signed between donors and the GOA in June 2012, is a requirement that the Afghan government must do its utmost to reduce corruption. This is regarded as the foundation for further international development funding. Donors can demand a strict adherence of the Tokyo Declaration if they observe that the present and future Afghan government is not paying serious attention to corruption issues. This is an opportunity key development partners, such as the United States and UK, might make use of when they no longer have to consider whether such actions could pose increased security risks to their soldiers.

It is not only the Karzai family that received generous support from Kabul Bank: so did other candidates for the presidency and members of the parliament. Thus, the large majority of the present Afghan elite will try to avoid any further attention on the Kabul Bank case. It is impossible for Afghan elite politicians to promote a serious anti-corruption campaign; none of their citizens will believe them. Ironically, this might strengthen support for the Taliban, who curbed both corruption and drug production when in power and chased most of those now holding office out of Afghanistan in the mid-1990s.

When the United States and NATO made themselves dependent on the same elite to overthrow the Taliban in 2001 and to 'build the new Afghan state', in effect they entered a partnership that laid the foundation for malpractices. The elite felt that NATO and the United States depended on

them to 'fight terror', a position that emboldened them to make use of all the possibilities to enrich themselves. One obvious lesson is that when military strategies overrule principles of state-building and good governance, this opens up endless opportunities for elite capture and corruption.

Another lesson for peace-building theory is that the Kabul Bank case confirms that efforts to 'buy' short-term peace with political and military elites will not benefit longer-term peace building. On the contrary, the Afghan case demonstrates that it will ruin the foundation for a functional and broadly accepted state. A state and governance structure is needed that can gain and maintain the trust of the population as Afghans are left to cope with their future – and pay the bill for fraud – as the international military withdraws.

NOTES

1. See, for example, Huffman (2011).

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