CASE STUDY
BANK OF CREDIT AND COMMERCE INTERNATIONAL (BCCI)

Regional Workshop on Cross-Border Supervision
Javier de la Cruz González
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INTRODUCTION

• Bank of Credit and Commerce International (BCCI) is one of the best examples of the practical difficulties that an international bank can pose to supervisors in terms of its cross-border supervision and resolution when adequate supervisory policies have not been effectively defined and implemented in advance.

• BCCI is also a very complete case, as there are many factors present and many lessons to be learned from it, both for home and host countries supervisors.

• As such, BCCI case includes does not only cross-border supervision issues in a strict sense, but also other significant issues derived from individual and consolidated supervision that have very important consequences in the international context.
INTRODUCTION

• It must be observed that, although many lessons learned from it have been worldwide incorporated since then to regulations and supervisory practices, there are still some significant pending issues to be solved, especially in practical terms.

• In fact, SIFIs (Systematically Important Financial Institutions), even if well structured and supervised, currently pose significant problems to supervisors, as the Financial Stability Board (FSB) acknowledges and tries to address.

• In this sense, even if the concept was not used at that time, it can be perfectly said that BCCI was a SIFI, although a sort of evil one in too many aspects.
PRELIMINARY REMARKS

• This case study has been elaborated using just public information, so as to prevent any legal issues based on the potential breach of confidentiality duties. However, it must also be said that most important issues have been already made public, so this fact does not really imply any significant restriction.

• Furthermore, the case is presented on purpose in a very simplified way, so as to focus attention on the really important aspects, without being distracted by irrelevant details (“not seeing the forest because of the trees”).

• Finally, even if too many behaviors and decisions made at that time were wrong, the object of this case is not to criticize them, even less to specifically point out culprits, but to learn from them so as to avoid repeating the same mistakes.
SIMPLIFIED STRUCTURE

BCCI OVERSEAS (GRAND CAYMAN)

2 PAKISTANI TOP MANAGERS

ABU DHABI & OTHER SHAREHOLDERS

NOMINEES

BCCI HOLDINGS

BCCI SA (LUXEMBOURG)

BCCI HONG KONG

UK BRANCHES

BCCI SPAIN

FRANCE BRANCH

HQ AND LARGE (RETAIL) BUSINESS IN THE UK

INTRAGROUP TRANSACTIONS PARALELL BANKS

PROMINENT NOMINEES

F.A.M. USA

BCCI BRAZIL

ABU DHABI & OTHER SHAREHOLDERS

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BUSINESS

2 PAKISTANI TOP MANAGERS

ABU DHABI & OTHER SHAREHOLDERS

NOMINEES

BCCI OVERSEAS (GRAND CAYMAN)

BCCI HOLDINGS

BCCI SA (LUXEMBOURG)

UK BRANCHES

BCCI HONG KONG

BCCI SPAIN

FRANCE BRANCH

BCCI BRAZIL

F.A.M. USA

PROMINENT NOMINEES

NO VIABLE BUSINESS: LACK OF PROFITABILITY, INVOLVED IN ML AND OTHER CRIMINAL ACTIVITIES
CONTROL

2 PAKISTANI TOP MANAGERS

ABU DHABI & OTHER SHAREHOLDERS

BCCI HOLDINGS

BCCI OVERSEAS (GRAND CAYMAN)

BCCI HOLDINGS

BCCI OVERSEAS (GRAND CAYMAN)

BCCI HONG KONG

BCCI BRAZIL

BCCI HONG KONG

BCCI HONG KONG

BCCI BRAZIL

BCCI HOLDINGS

BCCI SA (LUXEMBOURG)

BCCI SPAIN

FRANCE BRANCH

UK BRANCHES

F.A.M. USA

REAL CONTROL BY THE MANAGEMENT, NOT THE SHAREHOLDERS

PROMINENT NOMINEES

NOMINEES

BCCI OVERSEAS (GRAND CAYMAN)
CORPORATE GOVERNANCE

2 PAKISTANI TOP MANAGERS

ABU DHABI & OTHER SHAREHOLDERS

NOMINEES

BCCI HOLDINGS

BCCI OVERSEAS (GRAND CAYMAN)

BCCI OVERSEAS (GRAND CAYMAN)

BCCI HONG KONG

UK BRANCHES

BCCI SA (LUXEMBOURG)

BCCI BRAZIL

FRANCE BRANCH

PROMINENT NOMINEES

F.A.M. USA

VERY POOR CORPORATE GOVERNANCE:
INVASIVE TOP MANAGERS
TIGHT COMPARTMENTS
EXTERNAL AUDITORS

2 PAKISTANI TOP MANAGERS

ABU DHABI & OTHER SHAREHOLDERS

NOMINEES

BCCI OVERSEAS (GRAND CAYMAN)

BCCI HOLDINGS

BCCI SA (LUXEMBOURG)

BCCI HONG KONG

UK BRANCHES

BCCI BRAZIL

FRANCE BRANCH

PROMINENT NOMINEES

TWO EXTERNAL AUDITORS: NO ONE HAD A GLOBAL PICTURE
SUPERVISION

- 2 PAKISTANI TOP MANAGERS
- ABU DHABI & OTHER SHAREHOLDERS
- NOMINEES

BCCI OVERSEAS (GRAND CAYMAN)

BCCI HOLDINGS

BCCI SA (LUXEMBOURG)

- BCCI HONG KONG
- BCCI BRAZIL
- BCCI USA
- UK BRANCHES
- FAM USA
- BCCI SPAIN
- FRANCE BRANCH

PROMINENT NOMINEES

NO CONSOLIDATED SUPERVISOR
GENERAL SUPERVISORY CONCERNS

• There is no consolidated supervisor worldwide:
  – The group structure is designed to avoid effective consolidated supervision.
  – National interests are different and probably opposed.
  – The group has no lender of last resort.
  – No supervisor wants to be responsible for the full group.

• The group is not transparent and its real situation is not clear at all:
  – Nominees are used to hide ownership and control.
  – Capital is more nominal than real: shares financing, hidden losses...
  – Intra-group transactions are significant.
  – There are two external auditors.
GENERAL SUPERVISORY CONCERNS

• Business is not sustainable:
  – Business is mainly oriented to (international) growth, not to profitability (Ponzi scheme?).
  – The group is heavily involved in ML and other criminal activities.

• Control and corporate governance is weak:
  – Shareholders are passive, if real.
  – Top managers fully control the group.
  – Departments are tight compartments.
NATIONAL CHARACTERISTICS

• **LUX:** No significant local business, main business in the UK.
• **UK:** Headquarters and large (retail) business.
• **France:** Small branch, no significant retail business.
• **Spain:** Very small bank in local terms.
• **Hong Kong:** Small bank in domestic terms.
• **Grand Cayman:** Financial haven.
• **Brazil:** Prominent local persons used as nominees.
• **USA:** Prominent local persons used as nominees.
• **Abu Dhabi:** Limited capital contributions theoretically risk-free.
NATIONAL SUPERVISORS POSITION

• **LUX** - Unable (unconcerned) to effectively supervise BCCI Luxembourg worldwide:
  
  – No significant business in Luxembourg (safe?).
  – Main business in the UK, affected by British banking secrecy regulations.
  – Reliant on other national supervisors, mainly BoE.

• **UK**: Unsafe position, trying to avoid the problem (be other supervisor(s) problem):
  
  – Formally reliant on IML (Luxembourg supervisor).
  – Fears of being accused of racism and financial exclusion of Pakistani community in the UK.
  – Uncomfortable as branch supervisors.
NATIONAL SUPERVISORS POSITION

• **France** – Not really concerned about BCCI Luxembourg branch:
  
  – Small branch, no significant retail business.
  – Reliant on other national supervisors.

• **Spain** – Feeling BCCI Spain is under control:
  
  – Very small bank in local terms.
  – Intra-group transactions almost forbidden (ring-fencing).
  – Strong capital and liquidity requirements.
NATIONAL SUPERVISORS POSITION

• **Hong Kong** – Feeling BCCIHK is under control:
  – Small bank in domestic terms.
  – Well supervised locally.

• **Grand Cayman** – We are supposed to formally care...
  – Financial havens supervision is nominal, almost by definition.
  – Business is international.

• **USA** – Don’t want BBCI in the USA...
  – Prominent persons used as nominees.
  – No real cooperation from other supervisors.
NATIONAL SUPERVISORS POSITION

• **Brazil** – Not really conscious of BCCI control:
  - Prominent local persons used as nominees.
  - Shares funding well disguised in Panama.

• **Abu Dhabi** – Not really conscious of having its leaders being used as international show case figures:
  - Capital contributions were limited and theoretically risk-free.
  - BCCI solved its (personal) financial needs very well.
NATIONAL SUPERVISORS POSITION

• Summary:

  – Very different national positions and interests.
  
  – Nobody wanted to assume responsibility for the full group.
  
  – Lack of coordinated action.
  
  – BCCI took advantage of it.
LUXEMBOURG ASKS FOR HELP!

• IML feels uncomfortable and asks for supervisors coordination.

• The first College of Supervisors is created with an initial limited number of national supervisors (Luxembourg, United Kingdom, Grand Cayman, Hong Kong and Spain).

• The idea is nice, but insufficient:
  – Exchange of information and opinions is relatively limited, because of different national interests and legal uncertainties (no legal framework at the time).
  – It is difficult and lengthy to adopt coordinated actions, even for investigation of significant unclear issues (e.g.: capital contributions and financing).
  – Nobody wants to be the lead regulator and nobody wants to be directed.
COLLEGE OF SUPERVISORS

• Progress is made, although limited:
  – Requirement of a single external auditor for the full group worldwide.
  – General awareness that the group is in deep trouble.
  – Potential creation of a Central Treasury unit in the group.

• Future lines are explored (not decided), as the creation of 3 banking subgroups (UK, Abu Dhabi and Hong Kong).

• New members are added (broader scope or responsibility dilution?)
RESOLUTION

• US decision to indict BCCI for massive fraud was the real trigger for international action (not supervisory concerns).

• National supervisors coordinated the closure of local banks forming part of BCCI to be done the same day at the same time.

• Hong Kong decided not to close their bank at that time, thinking that it was viable, but had to change their decision very quickly.
From that point on, evolution was different from one place to another.

In those places where an effective ring-fence was already in place (e.g.: Spain), bank resolution was orderly conducted and no significant losses resulted.

In other places, financial losses and turmoil were significant and a long legal process was envisaged with little chance of recovering money.

However, in the end, recovery was significant, around 75%, as compensations were obtained from different sources (Abu Dhabi, Price Waterhouse...). Bank of England was sued, but without success.
COMPARISON TO SIFIs

• BCCI was a SIFI, although the term was not used at that time.

• However, even though BCCI was clearly an evil SIFI, some lessons learned are applicable to modern SIFIs:
  
  – SIFIs must be supervised on a consolidated basis and have an effective lender of last resort.
  
  – Adequate group structures are crucial for an effective consolidated supervision and business and legal structures cannot differ significantly.
  
  – Effective supervisory policies based on mutual interest must be in place in advance to prevent crisis (licensing, lead regulators, colleges of supervisors...).
  
  – Resolution is still a too costly and uncertain option.

• Is really there a solution for troubled SIFIs or the issue is not to have SIFIs?
SIFIs

Top 25 Global Banks: Total Assets To Home Country GDP

www.zerohedge.com
source: JP Morgan
SUGGESTED READINGS

• There is a lot of public information about BCCI, mostly available on the internet.

• The following documents can be highlighted in terms of being relatively complete and reliable sources:

  – "The BCCI Affair", Report to the Committee on Foreign Relations, United States Senate.

  – Inquiry into the Supervision of the Bank of Credit and Commerce International (House of Commons Paper, United Kingdom).