

د اداری فساد پر وړاندې د څارنې او ارزونې  
خپلواکه او گډه کمیټه



کمیټه مستقل مشترک نظارت و ارزیابی  
مبارزه با فساد اداری

**INDEPENDENT JOINT ANTI-CORRUPTION  
MONITORING AND EVALUATION COMMITTEE**

# **REPORT OF THE PUBLIC INQUIRY INTO THE KABUL BANK CRISIS**

**Kabul, Afghanistan**

**November 15, 2012**

## Message from the Committee

The importance of the collapse of Kabul Bank cannot be overstated. At the time of its failure, Kabul Bank was a central institution in the lives of millions of Afghans, and for many represented their first experience with formal banking structures.

Kabul Bank was the largest banking service provider in Afghanistan with an extensive network of branches and services that included the distribution of a substantial majority of salaries on behalf of the Government of the Islamic Republic of Afghanistan. Its failure and subsequent bail-out represents approximately five to six percent of Afghanistan's gross domestic product, making Kabul Bank one of the largest banking failures in the world.

Every citizen in Afghanistan will bear the cost of the hundreds of millions of dollars required to secure deposits and the tens of millions of dollars required to deal with the aftermath. This is real money from the annual budget of the government that could be much better spent on other priorities such as education, health care, infrastructure, or security.

The cost of the Kabul Bank crisis should not only be understood in monetary terms, as the breach of trust in financial and government institutions also has a social cost. This cost undermines the government and international community's efforts to build viable institutions in Afghanistan.

Despite its importance, the story of what happened at Kabul Bank and the role of the government and international community has never been fully told. Nor has there been a comprehensive effort to identify changes that are required to ensure that such an event never happens again and to ensure that those responsible for the crisis face real consequences for their actions.

The report of the public inquiry into the Kabul Bank crisis is intended to provide a full account of the Kabul Bank crisis and the adequacy of government and international response. It is also intended to provide practical recommendations to mitigate the possibility of something similar happening in the future. Many of the issues and recommendations identified in relation to the Kabul Bank crisis are indicative of broader systemic challenges to good governance and effective justice in Afghanistan.

The lessons from Kabul Bank must be learned and broadly applied; otherwise history is doomed to be repeated.

Sincerely,

Drago Kos, Chair  
Independent Joint Anti-Corruption Monitoring and Evaluation Committee

## Acknowledgements

Compiling an in-depth report on the complex issues presented by the Kabul Bank crisis cannot be done by one person. The Kabul Bank public inquiry was carried out with the extensive support of the Independent Joint Anti-Corruption Monitoring and Evaluation Committee Secretariat and short-term international experts. Over 15 individuals were engaged in various aspects of research and analysis, including international and national lawyers, and experts in banking, finance, audit, and law enforcement.

An inquiry of this nature also requires the participation and cooperation of a broad group of institutions and individuals with knowledge related to the Kabul Bank crisis. The Kabul Bank public inquiry received cooperation from a number of individuals and organizations, including:

AF Ferguson (PricewaterhouseCoopers)	Kabul Bank Conservator
Afghanistan Investment Support Agency	Kabul Bank Receivership
New Kabul Bank	Kabul Bank Special Tribunal
Da Afghanistan Bank	Kabul Bank shareholders
United Kingdom Department for International Development	Kroll
ex-Chairman of Kabul Bank	Ministry of Finance
ex-Governor of Da Afghanistan Bank	National Directorate of Security
ex-Head of the Kabul Bank Audit Committee	Office of the President of Afghanistan
Financial Disputes Resolution Commission	Serious Organized Crime Agency (UK)
Financial Transactions and Reports Analysis Centre of Afghanistan	United States Agency for International Development
International Monetary Fund	United States Treasury Department
Interpol	World Bank

In particular, the Committee would like to acknowledge the Kabul Bank forensic audit conducted by Kroll, which was relied on extensively for the forensic accounting elements of this report.

Unfortunately, a small number of organizations declined to participate in the inquiry, the most central being the Afghan High Office of Oversight. Despite the lack of participation, the Committee was able to secure enough information to fill in any gaps. It is our hope that those organizations that did not participate take the results of our inquiry more seriously than they did the process.

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## Executive Summary

### ***The importance of Kabul Bank***

Kabul Bank was a trusted institution that millions of Afghans relied on to receive their salaries and to secure their savings. The collapse of the Bank resulted in wide-spread panic and civil disorder in the short-term, but the long-term results are even more damaging. Overall economic growth and development of national financial markets go hand-in-hand. Well functioning financial markets supply the economy with necessary external sources of financing, channel savings to productive uses and stimulate investment and growth. When a financial crisis occurs there is a significant loss of output and welfare.

The collapse of Kabul Bank triggered a financial crisis in Afghanistan that will impose significant fiscal costs on the country. This cost will be absorbed by the government's budget, thereby depriving Afghans of important services and programs. Most of this money has been redirected for the benefit of a few individuals who perpetrated and participated in a fraud with reckless disregard for the country and the people of Afghanistan. Moreover, the crisis led to a loss of confidence in an already fragile financial system.

One of the main objectives of this public inquiry is to contribute to the process of restoring the health of the Afghan financial system and the process of rebuilding public confidence. Raising public awareness is crucial in such a process, as it is the main force in ensuring that lessons learned are shared among all stakeholders and policy makers, and necessary action is taken to prevent similar events in the future.

To date, there has never been a full public accounting of how Kabul Bank was allowed to operate fraudulently over a number of years and why the response has failed to substantially recover misappropriated funds or deliver justice. While there are contributing factors specific to the Afghanistan banking sector, the most important reasons for this state of affairs are indicators of broader systemic failures in Afghanistan's governance and justice systems that will necessarily manifest themselves in other contexts if not addressed.

### ***The context for banking in Afghanistan***

Kabul Bank was established in 2004 at a time when Afghanistan's banking sector was greatly underdeveloped. The overthrow of the Taliban in 2001 resulted in an influx of international aid, expanded public services, and companies of various sizes, all of which required banking services to support their operations. The growth in demand for financial services drastically outstripped the capacity to effectively regulate and supervise the industry, resulting in vulnerabilities that were exploited by participants in the Kabul Bank fraud.

Afghanistan's banking laws were fairly comprehensive during the period of Kabul Bank's fraudulent activity. Banking laws were passed in 2003 based on international best practices and provided for appropriate governance structures, operational requirements, liquidity ratios, supervision and enforcement. However, the inadequate implementation of these laws – for a variety of reasons that include low capacity, lack of due diligence, and political influence – allowed Kabul Bank to initiate and perpetrate its fraudulent activities much longer than it should have been allowed.

In the environment of an emerging banking industry and nascent regulatory oversight, the founder and ex-Chairman of Kabul Bank and other Kabul Bank management and

shareholders misused the bank for their own personal enrichment and the benefit of a small group of related companies. Kabul Bank was nothing but a fraud perpetrated against depositors, and ultimately all Afghans; and weak institutions and political realities in Afghanistan offered the perfect environment to operate.

### ***Illicit activities of Kabul Bank***

Kabul Bank's controlling shareholders, key supervisors and managers led a sophisticated operation of fraudulent lending and embezzlement predominantly through a loan-book scheme. This resulted in Kabul Bank being deprived of approximately \$935 million funded mostly from customer's deposits. The loan-book scheme provided funds through proxy borrowers without repayment; fabricated company documents and financial statements; and used information technology systems that allowed Kabul Bank to maintain one set of financial records to satisfy regulators, and another to keep track of the real distribution of bank funds. Shareholders, related individuals and companies, and politically exposed people were the ultimate beneficiaries of this arrangement. Over 92 percent of Kabul Bank's loan-book – or approximately \$861 million – was for the benefit of 19 related parties (companies and individuals). Except for the initial investment of \$5 million, all shareholder acquisitions and transfers were ultimately funded by money from Kabul Bank.

Kabul Bank's Credit Department opened loan accounts for proxy borrowers on instruction from senior management, and forged supporting documents including applications, financial statements, and registrations, and employed fake business stamps to lend authenticity to the documents. Many financial statements were forged by Afghan accounting firms, seemingly established for the sole purpose of producing fraudulent documents to support loan files.

Loan funds were transferred shortly after an account was opened (in some cases even before the supporting documents were completed) through fake SWIFT messages and invoices created by Kabul Bank's Credit Department itself. Actual disbursements were made through electronic payments or cash from the Bank's vault. The funds eventually made their way to the true beneficiaries, were used to acquire assets for management, or were withdrawn in cash. Electronic transfers had the appearance of being transferred to overseas suppliers, or for other legitimate purposes. Some cash was transferred through the Kabul Airport using Pamir Airways, which was owned by shareholders related to Kabul Bank. Repayment of loans was rare, and most often new loans were created to provide the appearance of repayment.

Other Kabul Bank funds were misappropriated through non-loan disbursements that included excessive expenses, investments in related businesses, fake capital injections, advance payments of rent and salaries, unjustifiable bonuses, salaries paid to non-existent employees, inflated costs for assets, payment for fake assets, and political contributions.

### ***Failure of regulatory and supervisory efforts***

There were several opportunities for various national and international bodies to detect and prevent Kabul Bank's fraudulent activities. The collective failure of banking oversight and enforcement is one of the many contributing factors that allowed hundreds of millions of dollars to be diverted from important Afghan priorities to the personal bank accounts and business enterprises of a few individuals, including the Bank's shareholders and management.

The earliest opportunity was presented at the licensing stage where it appears that the personal, financial and criminal backgrounds of shareholders, supervisors and managers were not sufficiently reviewed. The Kabul Bank promoters submitted a business plan, articles of association, and some personal and financial disclosures, presenting a picture of competent management with decades of banking experience. However, Da Afghanistan Bank only reviewed the ex-Chairman's suitability because he was the only shareholder with sufficiently large shareholdings. The suitability of other shareholders was not extensively reviewed. In conducting their background check, Da Afghanistan Bank submitted names to the Ministry of Interior in April 2004, which were cleared in September 2004, several months after Kabul Bank had begun to operate. It is unclear how extensively the Ministry of Interior's background check was, but it is unlikely that a criminal check at this time would have identified the founder and ex-Chairman as a fugitive from the Russian Federation because this information had not been shared through Interpol until well after the licensing of Kabul Bank.

Kabul Bank's illicit activities commenced soon after its licensing, but regulatory and law enforcement agencies did not effectively intervene. The capacity of Da Afghanistan Bank to regulate and supervise banks at this time was low. It was not until 2007 – over two-years since Kabul Bank was licensed – that onsite examinations of banks were conducted in Afghanistan. However, throughout the period between 2007 and September 2010, Da Afghanistan Bank carried out four general examinations of Kabul Bank, undertook three special examinations, and took enforcement measures or corrective actions four times.

Supervisory efforts consistently identified regulatory violations related to governance, loan files, and promotional incentives to gain new depositors. None of these efforts identified the extensive fraud occurring at the Bank, partially due to the sophistication of the Bank's attempts to hide the fraud and partially due to Da Afghanistan Bank's lack of capacity and failure to use investigative techniques. Additionally, several efforts to take enforcement action against the Bank were met with interference and were not implemented, including an attempt by Da Afghanistan Bank to limit incentive programs to attract depositors and an attempt by the Financial Transactions and Reports Analysis Centre of Afghanistan to issue a fine.

International support was required to bridge the gap between Da Afghanistan Bank's capacity and requisite levels of supervision leading to the design of programs to develop financial regulatory and supervisory capacity. This international assistance predominantly came in the form of the United States Agency for International Development's Economic Growth and Governance Initiative which ran from 2005-2011. However, the program was not capable of developing sufficient capacity at Da Afghanistan Bank to detect the fraud at Kabul Bank, nor did the program's implementing partners – Bearing Point and later Deloitte – detect the fraud or act sufficiently upon fraud indicators.

### ***Independent auditors of Kabul Bank***

An additional component of the oversight function is the requirement for Afghan banks to have annual independent audits. From the beginning, Kabul Bank seemed to be insistent on having two particular firms from Dubai conduct its audits. The first, Alliot Gulf Limited was initially presented to Da Afghanistan Bank and rejected due to a lack of experience in conducting bank audits. Kabul Bank then received approval to use KPMG, but informed Da

Afghanistan Bank several months later that KPMG was no longer available, and again sought to have Alliot Gulf approved, which was sternly rejected by Da Afghanistan Bank.

Kabul Bank submitted the company Behl, Lad and Al Sayegh, which Da Afghanistan Bank finally approved to conduct the first year's audit, seemingly because it was already extremely late. This conclusion is supported by the fact that Da Afghanistan Bank initially rejected the firm for Kabul Bank's second annual audit, but eventually approved it based on additional information provided by Kabul Bank. Behl, Lad and Al Sayegh continued to serve as the independent auditors of Kabul Bank until Da Afghanistan Bank directed all banks in Afghanistan to select an independent auditor from a list of the five major auditing firms approved by Da Afghanistan Bank. Subsequently, Kabul Bank used AF Ferguson, a firm under the umbrella of PricewaterhouseCoopers.

The independent audits of Kabul Bank make it clear that the Bank's management were responsible for developing financial statements, and that the audit firms were responsible for satisfying themselves of the accuracy of those statements and delivering opinions on that basis. None of the audit reports of Kabul Bank identified any substantive issues with the Bank, and all made positive statements about the Bank's compliance with banking law and internal policies. These clean assessments are difficult to understand in the context of examinations conducted by Da Afghanistan Bank, which consistently identified breaches of other banking law and Kabul Bank policies. It is also worth noting that the audit reports provided by Behl, Lad and Al Sayegh were less detailed than those carried out by AF Ferguson. However, AF Ferguson did not appear to follow-up on, or pursue additional details related to, several items that were worth reviewing further.

#### ***Initial reports of fraud at Kabul Bank***

In late October 2009, the National Directorate of Security notified Da Afghanistan Bank that they received information that Kabul Bank funds were being used to purchase property in Dubai; and that the Bank was processing large transactions to related persons, had insufficient cash capital and liquidity, and was offering impossibly high interest rates to high-valued customers to attract deposits. The High Office of Oversight was also provided this information, but the Attorney General's Office was not because the National Directorate of Security deemed the information to be insufficient to open a criminal investigation.

A United States Embassy cable to the State Department in Washington, DC from the same time in October 2009 refers to money flowing from Kabul Airport through Pamir Airways, and several properties owned by prominent Afghans suggesting that they were extracting as much wealth as possible while conditions permitted. Although there is no evidence that the Embassy was exchanging information with Afghan authorities, the timing of the two events suggests that they may have had a common source. Da Afghanistan Bank attempted to investigate the allegations received from the National Directorate of Security through a general examination scheduled to start on January 11, 2010, but did not detect the activities.

#### ***Illicit activities at Kabul Bank go public – oversight and investigative bodies are put on notice***

A February 2010 Washington Post article exposed illicit activities at Kabul Bank. Two days after the story broke the ex-Governor of Da Afghanistan Bank met with the International Monetary Fund and agreed that a forensic audit of Kabul Bank was necessary. It was decided that the ex-Governor would write to the United States Treasury Department seeking

technical assistance to undertake the audit. In initial consultations, the United States Treasury Department reportedly agreed to support the forensic audit, but wanted assurances that the President of Afghanistan was in agreement. The ex-Governor made several unsuccessful attempts to meet the President to secure his approval, and having failed, sent a request for technical assistance to the United States Treasury Department on March 29, 2010. The following month, on April 21, 2010 Treasury officials met with the ex-Governor of Da Afghanistan Bank to discuss the audit request.

Despite receiving the formal request, the United States Treasury Department was still reluctant to fund the forensic audit without presidential approval and the ex-Governor continued to make efforts to see the Afghan President. The President affirmed his support for the audit request in a May 10, 2010 meeting with United States Treasury officials, but it was not until September 2010 – days after the Kabul Bank crisis broke – that the tender process was completed. However, the contract with the successful firm was rejected by the Afghan President because the audit report would be issued to the United States government under United States law. This hurdle was a deal-breaker for the Afghan government, and in November 2010 it initiated its own tender process, which was ultimately supported financially by the United Kingdom's Department for International Development and the Canadian International Development Agency.

### ***Kabul Bank is exposed and depositors react***

By late July 2010, the shareholders of Kabul Bank had reportedly split into two groups, with one led by the ex-Chief Executive Officer being close to forcing the ex-Chairman out of the Bank. The ex-Chairman exposed the Kabul Bank fraud to the United States government in July 2010 rather than lose control of the Bank he founded. The United States government advised Da Afghanistan Bank of the fraud in early August and by the end of August, the ex-Governor had secured the resignation of the ex-Chairman and the ex-Chief Executive Officer and appointed a new Chief Executive Officer.

Word of the removal of the ex-Chairman and the ex-Chief Executive Officer quickly became public and resulted in widespread panic, a run on the Bank by depositors, and public disorder. Kabul Bank had become a national crisis and the Afghan economy was brought to the brink of collapse. Initially the Afghan government sought to assure the public through public statements, but the crisis proved too difficult to contain until the government took the extraordinary step of guaranteeing all depositor funds. This – coupled with the closure of the Bank for the Islamic holiday of Eid-ul-fiter – had the intended effect of restoring calm and Kabul Bank was put into conservatorship on September 5, 2010.

### ***The response from national and international organizations***

On August 31, 2010, the United States Treasury Department deployed a quick response team comprised of three banking experts to provide technical support to Da Afghanistan Bank. After the crisis broke, the United States Agency for International Development quickly created a committee composed of the United States Treasury, the International Monetary Fund, the World Bank, and Deloitte to develop a strategy to deal with the crisis. Receivership was identified early as the only option to rectify the issues at Kabul Bank and to recover missing funds. This option was also recommended in the conservator's October 2010 report, but it did not have the initial support of the Afghan government due to fears of causing another run on the Bank and the belief that the Bank could be rehabilitated.

From September 2010 – April 2011 the parties were deadlocked on what to do. Additionally, the Afghanistan government did not agree with essential elements of the International Monetary Fund's proposed Extended Credit Facility Program, which coincidentally expired in September and had not yet been renewed. The existence of an Extended Credit Facility Program is used by donors as a benchmark to ensure that the governments they support are financially responsible and many donors will not contribute funds to countries without a program. Contentious elements of the proposed program included a forensic audit, receivership, an independent review of the Kabul Bank crisis, and criminal prosecution.

It was not until it became clear in April 2011 that the absence of a program was affecting donor funds that the Afghan government agreed to the key International Monetary Fund demands. In early April 2011, the President announced that he would allow Kabul Bank to be put into receivership, which would have the affect of extinguishing shareholder rights and vesting the powers of shareholders, supervisors, and management in the receiver. The President also announced that he was establishing an investigative commission to review the causes of the Kabul Bank crisis to be led by the head of the High Office of Oversight. The Investigative Commission Evaluation of the Kabul Bank Crisis issued its report in May 2011 after six-weeks of work. The report was critical of Da Afghanistan Bank and held them greatly responsible for the crisis due to their failure to provide effective oversight.

Da Afghanistan Bank became a focus of the Investigative Commission in mid-April, when the ex-Governor appeared before Parliament and publicly named the outstanding debtors of Kabul Bank, including the brothers of the President and the First Vice-President. The ex-Governor had also been undertaking efforts to freeze assets of Kabul Bank shareholders, which elicited angry responses from some shareholders. In this environment, the ex-Governor fled to the United States in June 2011 and tendered his resignation citing the undermining of Da Afghanistan Bank through political interference; the rejection of legislation prohibiting shareholders from interfering in bank management; the politicization of the forensic audit of Kabul Bank; and the failure of law enforcement agencies to support the central bank in bringing pressure on large borrowers and insiders.

### ***Receivership and the recovery of misappropriated funds***

The role of the receiver is to attempt to identify and recover assets of the bank from the debtors. Approximately \$861 million has been extended to 19 related individuals and businesses, including a \$270.3 million liability for the ex-Chairman, a \$94.3 million liability for the ex-Chief Executive Officer, two politically exposed people with liabilities of \$74.1 million and another eight related individuals with liabilities between \$39.0 million and \$1.7 million, totalling \$136.4 million. Liability for loans to seven related companies with ownership groups composed of Kabul Bank shareholders, politically exposed people, and related persons amounted to \$287.7 million.

As of the end of August 2012<sup>1</sup>, Kabul Bank receivership has recovered \$128.3 million in cash from repayment or the sale of assets; and has taken control of assets with a book value of \$190.6 million, though the actual sale of these assets is expected to generate just over \$100 million.

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<sup>1</sup> The receiver is expected to issue an updated report at the end of November 2012.

Issues that cannot be resolved by receivership are referred to the Financial Disputes Resolution Commission for resolution, subject to appeal to the Special Tribunal of the Supreme Court on Kabul Bank. To date, the Financial Disputes Resolution Commission has determined numerous issues related to Kabul Bank, the most substantial of these being the determination of beneficial ownership of the related company Gas Group and corresponding liability for \$121 million. The Financial Disputes Resolution Commission is also considering the issue of liability for loans used to purchase shares, which represents over \$100 million of outstanding liabilities.

The effort of receivership to recover Kabul Bank funds has encountered a number of problems, which include disputes amongst shareholders regarding their actual ownership of companies that received loans; disagreement over liability for loans provided by Kabul Bank to purchase shares; the failure of the Attorney General's Office to seek international legal assistance in identifying assets of indebted individuals and companies; political interference in the independent mandates of the receiver and the Financial Disputes Resolution Commission; interference from justice sector organizations; and receivership's reluctance to effectively exercise its independent powers in deference to an advisory committee.

### ***Response from law enforcement and related organizations***

The Washington Post article of February 2010 motivated Da Afghanistan Bank to take additional action to detect the fraud at Kabul Bank. However, there was no substantive response from the police, the Attorney General's Office, or the High Office of Oversight.

Even if law enforcement bodies did not have the grounds to conduct independent investigations in February 2010, they clearly did in September 2010 when the Kabul Bank crisis broke or November 2010 when the ex-Governor of Da Afghanistan Bank wrote to the Attorney General requesting a criminal investigation. However, political decisions were made by high-ranking officials at the Attorney General's Office and the working levels did not aggressively pursue an investigation. It was not until the Attorney General's Office joined the Investigative Commission Evaluation of the Kabul Bank Crisis in April 2011 that a substantial investigation was undertaken, which was over one-year from the time of the Washington Post article, eight-months after the Kabul Bank crisis that exposed fraud, and five-months after a request was sent by the ex-Governor of Da Afghanistan Bank.

Criminal indictments were prepared by prosecutors from the Attorney General's Office around the time that the Investigative Commission completed its work in May 2011. However, the indictment was not issued until over one-year later in June 2012 and included individuals from Kabul Bank's supervision, management, information technology, credit and audit departments; and Da Afghanistan Bank employees who were accused of conducting their duties negligently. The indictment did not include officials from accounting firms that created false documents for Kabul Bank, airline employees that smuggled money out of Afghanistan, or shareholders who received funds from loans at zero-interest, apparently without the intention of repayment. Information received during the inquiry indicates that the final decision about who to indict was made at the political level in the spring of 2011 by a high-ranking committee and that prosecutors from the Attorney General's Office were called in to amend the indictment to conform to the decisions taken.

Although there are legitimate capacity issues at the Attorney General's Office that certainly contributed to the delay in investigation, the major factor impeding the criminal investigation

process is political interference resulting in reluctance to pursue charges against some of the participants of the Kabul Bank fraud.

### ***Special Tribunal of the Supreme Court***

The Special Tribunal was created in April 2012 to provide a dedicated forum for the resolution of criminal and civil issues related to Kabul Bank. The Tribunal has all of the regular powers of the Supreme Court and provides an appeal function for decisions of the Financial Disputes Resolution Commission, and serves as the primary court for criminal cases brought by the Attorney General's Office. To date, the Tribunal has not received any cases on appeal from the Financial Disputes Resolution Commission, but has received the criminal indictment from the Attorney General.

Contrary to the law, the criminal indictment has not proceeded very far before the Tribunal, as the Tribunal originally decided to deal with the criminal case after all civil matters were settled, which will take several months at least. Recently this impasse ended when the first hearings in the criminal case were held in November 2012. However, up until this time the Special Tribunal has spent its time responding to petitions from some of Kabul Bank's management and shareholders seeking resolution of issues that should be brought to receivership in the first instance.

Instead of dealing with the criminal indictment in accordance with the law the Tribunal busied itself with attempting to sort out issues related to the recovery of Kabul Bank funds. This includes issuing *ad-hoc* instructions to the Kabul Bank receivership and New Kabul Bank, and conducting extra-judicial investigations into issues other than the case before it, such as off-the-record meetings with accused individuals and potential witnesses; and meetings with shareholders to encourage them to repay amounts owed. Furthermore, the Tribunal will try all individuals together despite the clear differences in their cases, which could prejudice some accused and interfere with their ability to present a proper defence.

These activities of the Tribunal are well outside legal norms of criminal procedure and appear to violate the rights of the accused to a fair and expeditious hearing of the charges. Concerns with impartiality have also been raised after a June 26, 2012 interview where the head of the Tribunal commented to the media about the status of loan recovery from some politically exposed people, an issue which could be raised formally before the Tribunal at a future time.

### ***Government commitments to reform***

The International Monetary Fund's 2011 Extended Credit Facility Program for Afghanistan includes several commitments to comprehensive reform of the government's regulation and oversight of the financial services industry and capacity to detect and pursue illegal activities. The program includes government commitments to banking reform; capacity building in supervision, detection and investigation; and strategies to enhance recoveries from losses at Kabul Bank. To date, success in achieving these benchmarks has been mixed.

### ***Recommendations***

The issues that allowed fraud at Kabul Bank to continue and the insufficiency of the response from the civil recovery and the criminal justice system relate to issues that permeate many aspects of Afghan society, government, and public institutions, namely, incapacity, nepotism, entitlement, and political interference.

Based on the events that led to the Kabul Bank crisis, and the subsequent response, the Independent Joint Anti-Corruption Monitoring and Evaluation Committee has developed numerous recommendations in the areas of governance, regulatory supervision and enforcement, criminal investigation, judicial proceedings, recoveries, the sale of New Kabul Bank, and monitoring of the implementation of the public inquiry's recommendations.

Most important of these recommendations is the need to have institutions in Afghanistan exercise their independent mandates, without deference to or interference from political office; and for the impunity that exists in Afghanistan to come to an end by fully prosecuting all perpetrators and participants of the Kabul Bank fraud. These are the strongest measures that the Afghan government can take to help secure a future of strong government and adherence to law.

## I. Introduction

### a.) The importance of Kabul Bank

In August 2010 it became public that Kabul Bank had incurred significant losses and that the ex-Chairman and ex-Chief Executive Officer had been removed from their positions at the Bank. There was widespread concern that the Bank did not have the funds to pay deposits resulting in a run on the Bank and broader civil disorder. In response, the Government of the Islamic Republic of Afghanistan announced that it would guarantee deposits by providing the Bank with hundreds of millions of dollars to meet its financial obligations. The reasons for Kabul Bank's losses – and the ensuing crisis – include fraud, weak regulation and oversight, impunity, and political interference.

The collapse of Kabul Bank is of profound importance to Afghanistan and the international community. Kabul Bank had well over a million depositors representing a substantial majority of employed Afghans and a large portion of the Afghan public service. In addition, just before its collapse the Bank held 34 percent of total bank assets in Afghanistan, while the second largest institution accounted for less than 13 percent. The money required to guarantee the Bank's liabilities was secured from Afghanistan's reserves, which will be paid back from the annual budget over eight years, thereby distributing the cost of the crisis to all Afghans. Given the Bank's size the fiscal cost of its rescue is significant, being between five and six percent of Afghanistan's gross domestic product. The recovery of the Bank's assets is thus a very important process, not only as a factor of reducing the final fiscal cost, but also as a significant test of legitimacy of Afghan institutions. Furthermore, the breadth of illicit activities at Kabul Bank and beyond, the inadequacy of internal and external governance and oversight, political interference, and the environment of impunity that still exists today are all indicators of broader systemic issues facing Afghanistan. The failure to address these affects the legitimacy and sustainability of the current democratic system.

Despite investigations and audits conducted by a variety of national and international agencies there has never been a full public assessment of the facts related to the establishment of Kabul Bank, the activities that led to its collapse, and the adequacy of the response to the crisis. In recognition of the importance of understanding the crisis, the International Monetary Fund and the Afghan government included benchmarks related to Kabul Bank as objectives for the 2011 Extended Credit Facility Program for Afghanistan. The Extended Credit Facility Program forms the basis on which international donors assure themselves of the financial management of the country, and failure to meet its benchmarks can result in the withholding of international assistance.

The call to resolve issues related to Kabul Bank has also been reflected in several of the Independent Joint Anti-Corruption Monitoring and Evaluation Committee's earlier benchmarks, which recommend that the Afghan government conduct investigations into Kabul Bank, enhance investigative capacities, freeze and seize assets, bring the perpetrators to justice, conduct further forensic audits, and prohibit political interference of public bodies.

### b.) The Independent Joint Anti-Corruption Monitoring and Evaluation Committee is asked to conduct a public inquiry into the Kabul Bank crisis

The 2011 Extended Credit Facility Program states that it is desirable for the Independent Joint Anti-Corruption Monitoring and Evaluation Committee to conduct a public inquiry into

the Kabul Bank collapse aimed at making recommendations to address the failings that may have occurred. Specifically the Extended Credit Facility Program Action Plan states that:

14. An independent in-depth public inquiry into the Kabul Bank crisis will be launched, with terms of reference to be agreed with International Monetary Fund staff. The inquiry will cover the period from the licensing of Kabul Bank to February 2012 and will focus on the appropriateness, effectiveness, and timeliness of the response of the government, the central bank, and the justice system for the purposes of safeguarding the financial sector, deal with governance issues, and implement Afghan law . . . The goal is to increase awareness, transparency and draw lessons that could be used to protect the financial sector and prevent similar events in the future.

and includes the following structural benchmark which must be met by September 30, 2012:

The Joint Independent Anti-Corruption Monitoring and Evaluation Committee conduct an in-depth public inquiry to examine the events leading to the Kabul Bank crisis, starting with the inception of the bank, and look into the operations of the bank, activities of its shareholders, the role of supervisory and auditing bodies, and the subsequent effectiveness of the government and the criminal justice system in dealing with any crimes committed.

The Minister of Finance made an official request to the Committee on the behalf of the Afghan government in a June 2, 2012 letter (Annex I).

### **c.) Who is the Independent Joint Anti-Corruption Monitoring and Evaluation Committee?**

The Independent Joint Anti-Corruption Monitoring and Evaluation Committee was created in March 2010 after the need for independent monitoring and evaluation of anti-corruption efforts was identified at a series of international conferences. The Afghan government invited the international community to form a joint Afghan / international monitoring and evaluation committee to provide policy advice and to monitor and evaluate progress against specific benchmarks.

The Committee's terms of reference provide the mandate to identify effective development criteria for institutions; to monitor and evaluate anti-corruption activities at the national level, of international organizations, and of donor aid; and to report to the President, Parliament, the people and the international community.

The Committee is wholly independent from the Afghanistan government and the international community. This independence ensures that it is capable of carrying-out its mandate in a transparent manner without undue influence.

The current membership is:

#### **Afghan Appointees**

Mohammad Yasin Osmani  
His Excellency Zakem Shah  
Dr. Yama Torabi

#### **International Appointees**

Drago Kos (Slovenia)  
Eva Joly (France/Norway)  
Lt Gen. Hasan Mashhud Chowdhury (Bangladesh)

To date, the Committee had six quarterly missions in Afghanistan, issued two six-month reports and over 70 recommendations and benchmarks related to governance, prevention and law enforcement. A majority of recommendations have been implemented by the Afghan government and international community.

#### **d.) What is a public inquiry?**

A public inquiry is an independent and transparent review where there is a need to determine the facts of an event in order to restore confidence in public institutions or to develop recommendations so that similar occurrences can be avoided in the future. A public inquiry is not a criminal investigation and cannot make criminal findings or assign liability.

Unlike in the criminal context, factual findings of the Committee are based on a balance of probabilities or preponderance of evidence according to the best analysis and judgment of the Committee and do not carry any significance in the criminal or civil context.

## **II. Methodology and Sources**

The Kabul Bank inquiry was led by a member of the Independent Joint Anti-Corruption Monitoring and Evaluation Committee designated to direct the inquiry and make key decisions. The inquiry was supported by the Committee's permanent Secretariat in Kabul which was responsible for administering all aspects of the inquiry, with expertise covering law and governance, banking, finance, audit, and law enforcement. The short timeframe required the Committee to carry out its work expeditiously and the inquiry was split into two phases – fact finding (information collection); and recommendation development (policy).

#### **a.) Phase I – Fact finding**

The first phase of the inquiry involved the collection and analysis of existing reports and documents (see Annex IV for a complete list of documents considered), as it made little sense for the Committee to duplicate the efforts of various audits, forensic reviews, and reports already in existence. Instead, the Committee consolidated findings to provide a foundation for the report, which was supplemented by interviews and analysis of source documents.

The Committee found a number of key reports and documents extremely credible and have relied on them extensively in establishing the factual base for the events related to the collapse of Kabul Bank. The foundational report is the forensic audit conducted by a reputable international firm under contract with Da Afghanistan Bank. The forensic audit was developed with the full cooperation of Da Afghanistan Bank, the Ministry of Finance and Kabul Bank and was supported by a significant number of fact-finding interviews with a wide range of relevant individuals and organizations, including multiple former employees of Kabul Bank; and a review of sample loan files, accounting records, and Shaheen Currency Exchange records in Dubai.

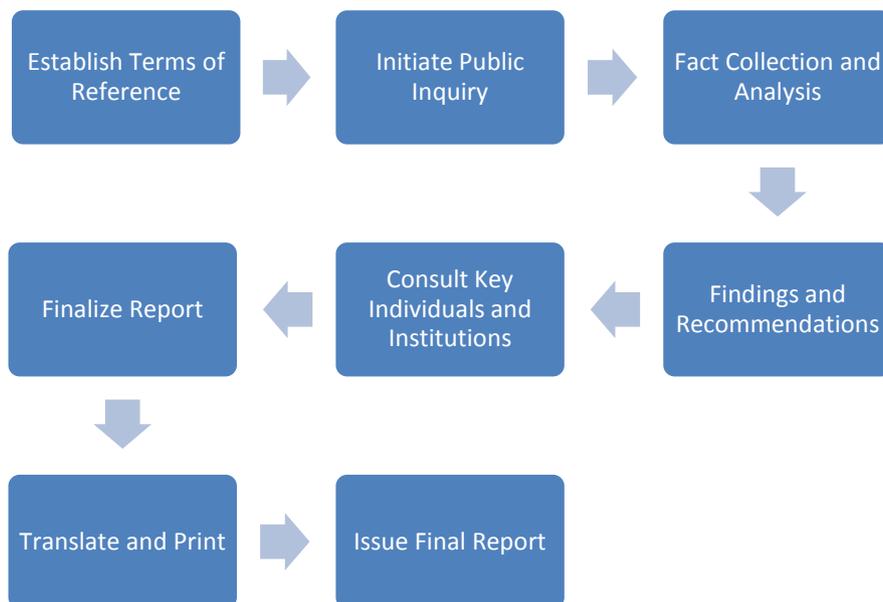
The Committee obtained supplementary information from a large number of source documents and dozens of interviews with a variety of national and international organizations and individuals.

#### **b.) Phase II – Recommendation development**

The documents and interviews from the first phase of the inquiry provided a solid foundation for a preliminary factual report and the identification of areas suitable for recommendations. The report and recommendations were drafted at the end of September 2012 and subsequently key participants and stakeholders were consulted to solicit feedback. Many

insightful comments were received from key participants, which were incorporated into the final recommendations.

### c.) Procedure map



## III. Factual Review

### a.) Overview of banking regulation

The banking sector in Afghanistan is governed by a series of laws and regulations that are central when assessing the collapse of Kabul Bank. Most pertinent are the *Law of Banking in Afghanistan*, which sets out the licensing of banks, their organization, operation, and ownership, and banking oversight and enforcement; the *Law of Da Afghanistan Bank*, which establishes Da Afghanistan Bank as the central bank of Afghanistan and independent body responsible for regulating and supervising the banking industry; the *Money Laundering and Proceeds of Crime Law*, which creates crimes for the concealed movement of money and establishes requirements associated with the identity of account holders; and a series of regulations created under these laws.

### b.) Licensing of banks in Afghanistan

#### **Regulatory overview**

All banks require a banking license issued by Da Afghanistan Bank and applications must be accompanied by a business plan; by-laws; information related to management, committee members, and shareholders; and policies for risk management, anti-money laundering and internal control, among other information. Da Afghanistan Bank may conduct financial, criminal, personal and professional background checks of applicants, shareholders, administrators, and all persons and legal entities associated with them.

Licenses will only be issued to companies registered under Afghan law that have an initial paid-in capital of at least \$5 million, which is the minimum amount of net assets that the bank must maintain. Companies may make a preliminary application, which allows a prospective bank to receive capital contributions to attain the \$5 million requirement. A final application

with all supporting documents can be made once the company is registered and the minimum amount of capital is paid.

When assessing an application, Da Afghanistan Bank must consider whether the founders are familiar with banking regulation, and have the experience and competence to direct the bank in a safe and sound manner; and whether the proposed members of the required boards and committees are fit and proper. The general conditions for issuing a license include sufficient capital; shareholder influence that does not threaten sound and prudent management; fit and proper owners and administrators; and an adequate business plan, financial projections, internal control and risk management procedures. A license may be revoked when there is insufficient capital; the bank can no longer fulfil its credit obligations; the bank operates in an unsound or imprudent manner; or the bank has engaged in criminal activities.

### ***Licensing of Kabul Bank***

A preliminary application to establish Kabul Bank was made on December 28, 2003 by the ex-Chairman of Kabul Bank and four other shareholders. The application included required documents, such as articles of association with information on shares, shareholder meetings, boards of directors, capitalization, and accounting; and a business plan detailing target customers, products and services, management structures, biographical information, share distribution, risk management, money laundering controls, financial projections, and liquidity and funds management. The business plan also highlighted that the promoters had Middle East operations that were well established since 1997 and had relationships with major international banks.

The ex-Chairman of Kabul Bank was originally named as both Chairman and Chief Executive Officer of the pre-bank company, with the other four original shareholders being named as directors. The Bank's proposed Board of Supervisors included a Chairman and Head of Audit and Credit with 37-years of banking experience from India and Dubai; a Director for Trade and Finance who had 36-years of experience in banking in Karachi and Dubai; and a Director for Operations and Administration who had 23-years of banking experience in the United Arab Emirates.

Proposed members of the Board of Management consisted of an individual with 23-years of banking experience predominantly in the United Arab Emirates and Oman; a University of Karachi graduate with 28-years of banking experience, predominantly in the United Arab Emirates; and an individual with 28-years of experience in Dubai. The proposed Chief Executive Officer was a person educated in India with 39-years of banking experience in the United Arab Emirates.

Although interviews of prospective candidates for key banking positions are required, it does not appear that interviews for all candidates were conducted, nor is there evidence of extensive criminal, financial, or personal background checks.

On April 21, 2004, Da Afghanistan Bank informed the ex-Chairman that Kabul Bank was approved for a preliminary license, allowing them to obtain a Private Investment License from the Afghanistan Investment Support Agency and to seek approval of the investment from the High Commission on Investment. On June 3, 2004, Kabul Bank was registered with the Afghanistan Investment Support Agency with an initial paid share capital of \$5 million from

the five shareholders. On June 20, 2004 the shareholders agreed to limitations on related party transactions and to maintain the separateness of the bank and related persons. Finally, on June 22, 2004 the conditions of the preliminary license were met and a letter was sent approving the bank.

It is clear that full due diligence to the letter of the law was not conducted by Da Afghanistan Bank. However, due diligence may not have prevented Da Afghanistan Bank from issuing a license. The fact that the founder and ex-Chairman was being pursued in Russian Federation for illegal banking, money laundering, purchasing property for illegal use and organizing a crime syndicate, was not made available to Afghan authorities until well after the banking license was issued.

### ***Permits for Kabul Bank branch offices***

Bank branches in Afghanistan must also be approved by Da Afghanistan Bank and an application must include biographical information of the officers who will operate the branch. Da Afghanistan Bank may issue a permit after meeting the owners and proposed office administrators and being satisfied that, among other things, the office administrators are fit and proper. Approval may be denied on the same grounds as an application for a license, and may be revoked if the office conducts its activities in an unsound or imprudent manner, or engages in criminal activities.

During its operation, Kabul Bank was competing against other banks for new branches across Afghanistan. Da Afghanistan Bank received numerous requests for branches, which were approved or rejected based on a needs assessment for the proposed market. Da Afghanistan Bank sometimes tied the approval of branches to addressing banking violations. In one example Da Afghanistan Bank created conditions related to a fully functioning audit function, capital injection, liquidity, reduction of group loans, and the development of certain policies. However, Kabul Bank opened and operated some branches without a permit.

### **c.) Kabul Bank governance**

Banks in Afghanistan are required to have their charter approved by Da Afghanistan Bank and must be governed by by-laws. The General Meeting of Shareholders is the supreme decision making body of the bank and appoints the Board of Supervisors, the Management Board and the Audit Committee; and approves the annual reports and financial statements upon the recommendation of the Audit Committee.

The Board of Supervisors is responsible for supervision of administration and operations, the Management Board is responsible for carrying out day-to-day administration, and the Audit Committee is responsible for accounting controls and internal audits.

### ***Kabul Bank shareholders***

Kabul Bank was established in June 2004 by five shareholders, including the ex-Chairman of Kabul Bank. By the time that Kabul Bank was put into conservatorship, there were 16 shareholders. Only shareholders with qualifying holdings are required to pass the fit and proper test and to receive Da Afghanistan Bank approval. Since the ex-Chairman and the ex-Chief Executive Officer were the only ones with qualified holdings, other shareholders were not vetted. However, a January 9, 2008 letter from the Head of the Financial Supervision Department of Da Afghanistan Bank requested biographical and financial

information for all but four shareholders. This was followed up in March 2008 when the Department demanded that Kabul Bank submit the biographies or face serious action.

Throughout its time of operation, the Bank issued shares to new shareholders, and purportedly injected capital to maintain the capital balance required by law. Kabul Bank issued shares to raise capital in April 2006 in response to Da Afghanistan Bank direction. At this time, additional shares were issued to four new shareholders, including the ex-Chief Executive Officer who received a nine percent holding. These shares were bought using loans provided by Kabul Bank funds. Additional capital was provided by the nine Kabul Bank shareholders on June 24, 2006 and another capital injection was made before the year ended. Interestingly, a record of share transfers from this period indicates that a shareholder had sold all of his shares to the ex-Chairman and another shareholder for \$1.4 million in cash paid by the ex-Chairman.

In early 2007, nine new shareholders joined Kabul Bank ownership, which included the brothers of the President and the First Vice President. These exchanges resulted in the ex-Chairman giving up his majority shareholding, which becomes an important factor in the exposure of fraud at Kabul Bank. Later in August that year, a shareholder, who was also the Vice-President, and member of the Board of Directors resigned from all positions and sold all of his 2.03 percent holdings to the ex-Chairman ending all ties to Kabul Bank. Capital injections of \$7 million and \$6 million were purportedly made in September 2007 and December 2007 in response to a general examination conducted by Da Afghanistan Bank, with another \$3 million being made in March 2008.

There was another series of changes in Kabul Bank's shareholdings in late 2009, including the ex-Chief Executive Officer who increased his shareholdings to 28 percent. This exceeded the qualified holding threshold, thereby requiring the ex-Chief Executive Officer to provide educational, professional, and financial background data to Da Afghanistan Bank. Some information was provided on January 10, 2010, but there is no indication of any assessment being conducted.

Except for the initial investment of \$5 million, all shareholder acquisitions and transfers were ultimately funded by money from Kabul Bank. Many shareholders reportedly acknowledged that they were using proxy loans to create the illusion of making capital injections to maintain the capital adequacy ratios required by Da Afghanistan Bank. Some shareholders assert that they were induced to invest in Kabul Bank based on favourable projections presented by the ex-Chairman. Shareholders point to Kabul Bank's payment of tax on profits to support the assertion that the Bank misled them.

Former shareholders of Kabul Bank have indicated that no shareholder meetings were ever held, despite Kabul Bank reporting that they had. It is not clear whether shareholders really held annual general meetings, although various letters to Da Afghanistan Bank indicate that there were meetings on November 11, 2006; November 11, 2007; March 30, 2008; and December 23, 2009. There is also indication from a shareholder that they were aware of investments being made by the ex-Chairman in Dubai and related companies, viewing some of these transactions as being illegal. However, there is no evidence that any shareholder attempted to use the appropriate governance mechanisms under the banking law to address these concerns.

### ***Overview of required governance boards***

Banks are required to have a Board of Supervisors, a Management Board, and an Audit Committee with fit and proper members approved by Da Afghanistan Bank. Members cannot serve on another board or committee; or be related to an administrator of the bank and must ensure that their relationships with the bank are on terms consistent with people who are not board members.

To ensure that the personal interests of members of the Board of Supervisors and Management Board do not conflict with the best interests of the bank, the board should establish a written policy on loans and expenses granted to insiders; consult with the bank's legal advisors before approving transactions involving board members and document any approvals.

A majority of members of the Board of Supervisors must not be associated with the bank through ownership, management, or employment; and the board must hold regular monthly meetings. The Board of Supervisors is accountable to all shareholders and is responsible for supervising the bank; bringing certain infractions to the attention of Da Afghanistan Bank and its shareholders; and suspending members of Management Board and the Audit Committee who are incompatible with prudent management.

The Board is responsible for ensuring that operations are properly controlled, comply with policies and applicable laws; and are consistent with sound banking practices. The Board must adopt policies and procedures on all significant banking activities and must ensure that the Management Board implements the policies and procedures, as well as any corrective actions required by Da Afghanistan Bank. Banks are also required to develop programs for the prevention of money laundering.

Management Board is responsible for the management and execution of the bank's activities and must be made up of at least three members, typically the chief executive officer, chief operating officer and chief financial officer.

### ***Kabul Bank's Board of Supervisors***

Kabul Bank had a Board of Supervisors on paper, but many were shareholders of the Bank, sometimes making up a majority contrary to banking law. For example, in fiscal year 2006-2007, the Bank indicates that its Board of Directors comprises three shareholders compared to two non-shareholders. The annual report for this year states that there were 11 board meetings, one less than required by law.

At the time that Kabul Bank was established, Da Afghanistan Bank had only conducted the required background check on the ex-Chairman. In March 2008, Da Afghanistan Bank seemed to have conducted a review of the Kabul Bank file and noticed that they had not conducted due diligence on several Board of Supervisor members. Kabul Bank had sent a letter in late February 2008 requesting that Da Afghanistan Bank approve five new members of the Management Board and on March 1, 2008, Da Afghanistan Bank requested information for several other members of the board, which Kabul Bank provided on March 5, 2008.

After receiving the requested information, Da Afghanistan Bank scheduled interviews, but were notified in late March that the members who had not provided information had resigned

and therefore there was no need to interview them. Kabul Bank informed Da Afghanistan Bank that they had nominated the Deputy Chief Audit Officer to the Board of Supervisors and records indicate that he was interviewed along with the brother of the ex-Chief Executive Officer. This composition of the Board of Supervisors, with five members – two of whom were shareholders, and one of whom was a related person – was reported in the Bank's 2007 - 2008 annual report. The report also states that there were 10 meetings for the reporting year.

### ***Kabul Bank's Management Board***

On February 14, 2005, Kabul Bank appointed a new Chief Executive Officer who had gained his banking experience at a large bank in India and Da Afghanistan Bank requested an interview to determine whether he was fit and proper. In mid-2006, Kabul Bank advised Da Afghanistan Bank that the Chief Executive Officer was resigning due to personal reasons and that the Bank was appointing the former General Manager as the acting Chief Executive Officer.

In June 2006, Kabul Bank attempted to appoint the acting Chief Executive Officer as the Chief Executive Officer, but Da Afghanistan Bank deferred approval pending submission of mandatory policies within 90-days, including policies related to credit, anti-money-laundering, internal audit, and transactions with related persons. Subsequently Da Afghanistan Bank rejected the credit policy and requested that the Chairman attend the Governor's office to discuss the deficiencies with enforcement action being threatened if a new policy was not submitted within 30-days.

Kabul Bank's annual report for 2006 – 2007 indicated that the management team consisted of a Chief Executive Officer, a Deputy Chief Executive Officer, a Chief Advisor, an Advisor, a Chief Operations Officer, a Chief Credit Officer, a Chief Financial Officer, and a Chief Audit Officer. The Deputy Chief Executive Officer during this reporting period was also the second largest shareholder who was appointed to that position in 2007 after joining Kabul Bank in 2006 as the Chief Security Officer. However, the appointment from Chief Security Officer to Deputy Chief Executive Officer was not approved by Da Afghanistan Bank.

In April 2007 Da Afghanistan Bank indicates that they had warned Kabul Bank on several occasions that the Chief Security Officer was introducing himself and conducting activities as though he was the Deputy Chief Executive Officer without being approved by Da Afghanistan Bank, and was intervening in the processing of loans contrary to banking laws. This issue was raised in two other formal letters, one of which was sent in March 2007, but the Deputy Chief Executive Officer continued to act in that role. Da Afghanistan Bank indicated that they were raising this issue for the last time and would take serious measures if it continued. By May 2007, Da Afghanistan Bank's perspective inexplicably and drastically changed, as the Governor at the time informed Kabul Bank that it was within the discretion of the Chairman to appoint employees under the banking law so there was no need to interview the ex-Chief Executive Officer. Available information indicates that the decision was based on Kabul Bank's insistence that the ex-Chief Executive Officer would be effective at calling in loans, which was not a sufficient reason grounded in law. The Deputy Chief Executive Officer was promoted to Chief Executive Officer on July 10, 2008, with supporting documentation that indicates that he graduated from law in the Russian Federation and possessed over 16-years in business, finance, and banking. Da Afghanistan Bank did not interview the candidate at this time either.

Kabul Bank's annual report for the year 2007-2008 indicates that the Management Board met regularly and consisted of the same composition with the exception that the two advisors were moved to an Advisory Team outside of Management Board. Biographical information for the board was sent to Da Afghanistan Bank in December 2007, which included appointments to the managerial positions of Countrywide Banking Network Manager, Law Observation and Enforcement Manager, and General Credit Manager. In January 2008 Da Afghanistan Bank approved a new Chief Compliance Officer on a probationary period, requesting that he receive training and return for an interview; and recommending the assistance of an expert advisor in the field of compliance. This same approach was used by Da Afghanistan Bank for the position of Chief Risk Manager in March 2008.

In April 2010, Kabul Bank attempted to introduce a new Chief Operations Officer, but his appointment was rejected due to a lack of experience and accounting background.

### ***Kabul Bank's Audit Committee***

Audit Committee members are appointed by the General Meeting of Shareholders to establish accounting procedures and risk management controls, supervise compliance, and audit the bank's account.

The earliest reference to an Audit Committee at Kabul Bank comes on June 12, 2006, when Kabul Bank advised Da Afghanistan Bank that they established an audit committee with a list of corresponding duties. However, it was not until November 2007 that Kabul Bank sought approval of the appointment of the Head of the Audit Committee based on over 32-years of banking experience. Annual reports indicate that they met regularly, but there is no evidence that the Audit Committee performed any meaningful audits.

### ***Kabul Bank's discretionary boards***

Banking law in Afghanistan suggests that the Board of Supervisors should consider creating an internal audit committee to monitor compliance with board policies; and to monitor management's efforts to correct deficiencies discovered in an audit or a supervisory examination. This internal audit committee is a subset of the Board of Supervisors and is distinct from the Audit Committee. Kabul Bank received approval for their Head of Internal Audit appointment on July 26, 2006 based on the candidate's experience and performance at an interview. The Head of Internal Audit has been identified by many sources as one of the chief architects of the fraud at Kabul Bank, and was the point of contact for most of the Bank's interactions with regulators, rarely allowing others to speak or answer questions.

The banking law also suggests that a loan committee should be established to ensure that the bank's lending policies are adequate and that activities are conducted in accordance with bank policy and laws. The committee would also monitor loan portfolio quality.

Records indicate that Kabul Bank established a Risk Management Committee effective on January 1, 2008 under the leadership of a banker from Pakistan with 37-years experience. There are also references to a Credit Committee in Kabul Banks annual reports, but there is no other information available about this committee, other than a reference to the appointment of a Credit Manager in February 2008.

#### **d.) Regulatory framework for bank operations**

##### ***Identification of account holders***

Banks are prohibited from maintaining accounts for undisclosed persons and from providing services if they suspect money laundering or other criminal activity, with such incidents being reported to Da Afghanistan Bank.

##### ***Loans to related persons***

Banks must have the approval of Management Board or the Board of Supervisors before extending credit to related persons. Related persons include bank administrators, a related person by marriage, blood or kinship, or adopted child, any person who has a qualifying holding in a bank, and any enterprise in which any such person or the administrator has a qualifying holding, and any administrator of such person or enterprise.

Additionally, the law sets out requirements to ensure that decisions are not unduly influenced and to ensure that all facts related to the interest rate, financial information of the borrower, and verification of collateral, are all considered. Loans of this nature must be administered in the same manner as other loans and the Audit Committee must maintain a record of approvals, including dissenting signatures.

Further, credit cannot be extended to an administrator of the bank if the credit would cause the total amount of that person's credit to exceed 25 percent of his or her annual remuneration, or if the loan would result in the total outstanding to all related persons to exceed the unimpaired capital of the bank.

If credit has been provided to a related person in violation of the law, it must be repaid or else the members of the Management Board and Supervisory Board will be personally liable if they did not file an objection with the Audit Committee.

##### ***Limits on loans that exceed levels of unimpaired capital***

Banks are prohibited from granting credit if the total outstanding amount of all credits to that person would exceed 15 percent of the bank's unimpaired capital and reserves; or the total outstanding principal of loans and large credit risks would exceed the equivalent of 200 percent, of the bank's unimpaired capital and reserves. A bank administrator must notify Da Afghanistan Bank whenever they discover that the capital is less than required.

##### ***Anti-money laundering requirements***

Customers must produce identification when conducting business at a bank. When opening accounts for corporations, the required information includes a certificate of incorporation; and ownership information. If any doubt remains as to the true identity of the customer or beneficial owner, the bank must submit a suspicious transaction report to the Financial Transactions and Reports Analysis Centre of Afghanistan.

Banks should also determine whether a customer is a politically exposed person and obtain the Chief Executive Officer's approval for establishing such relationships; establish the source of funds; and conduct enhanced monitoring. Politically exposed persons must be rejected where the bank reasonably suspects that the funds may have stemmed from bribery, extortion, or other illegal activities.

Banks are required to identify and verify transactions equal to \$20,000 or more with evidence of the source of funds; or when there is a suspicion of money laundering. Large cash transactions and suspicious transaction reports must be filed with the Financial Transactions and Reports Analysis Centre of Afghanistan within one business day.

#### **e.) Kabul Bank operations**

##### ***Loan-book scheme***

###### Creation of Loan Files

Kabul Bank employees were directed by senior management to open and administer overdraft and loan accounts in the name of proxy borrowers supported by fabricated records and Know Your Customer forms that were processed without meeting the borrower. Loan files often did not have supporting evidence, lacked customer detail, and contained inconsistent information. Kabul Bank's Credit Department falsified supporting documents for loan files, including loan applications, company registrations, net worth statements and personal guarantees, and used over 100 corporate stamps for fake businesses to provide an appearance of authenticity. The department also knowingly received and used falsified financial statements and proof of inventory, including photographs of stock that were reused for multiple loan files of different businesses. Funds from loans were transferred shortly after the account was created and sometimes, the loan approval would be completed two to four weeks after the funds had already been withdrawn.

Several Kabul based accounting firms – Best Solutions Accounting, Naweed Sahar and Bhautash Mathur Auditing, Oriental Consultants, Max Accounting, Omed Now Accounting, and Jawed Nasir Accounting were reportedly created to fabricate and authenticate financial statements and were paid fees from the loan account of the fabricated company. It appears that this was done to satisfy Da Afghanistan Bank's requirement after a February 2007 examination report that Kabul Bank loan files include evidence of verified financial statements. The first payments of this nature were to Naweed Sahar Accounting Services in September 2007.

Accounting firms in Afghanistan must be registered with the Afghanistan Investment Support Agency, but there is no licensing or professional body tasked with regulating or overseeing the accounting industry and little oversight was exercised aside from a condition that the firm meet annual reporting requirements. The nature of this reporting and assessment conducted by the Afghanistan Investment Support Agency is not apparent.

###### Access to Loan Funds

Various methods were used to conceal the link between the proxy borrowers and true beneficiaries. Sometimes the entries gave the impression that funds were being transferred overseas by customers to suppliers supported by fake SWIFT messages and invoices from fake suppliers created by the Credit Department. Funds were ultimately deposited in accounts controlled by the true beneficiaries, used to acquire assets for management, or withdrawn in cash, with the vault manager occasionally instructed to provide cash to individuals.

Repayment of the principal or interest on loans was extremely rare, instead new loans were created in a similar fashion to give the impression of repayment allowing the Bank to

manipulate its non-performing asset report and reduce the impairment provision that would otherwise be required.

The loan-book scheme was managed through Kabul Bank's accounting systems with specific individuals being responsible for creating reports to allow management to monitor the true loan portfolio. The Bank used three core banking systems since it was established, the first of which allowed them to automatically allocate proxy loans to particular groups. A new system put in place in early 2010 did not have this function available and the Credit Department had to engage Information Technology Department and specialists in Dubai to identify a manual solution. The solution allowed front end users to create a shadow copy of the individual accounts assigned to a particular group, records of which were then maintained in a stand-alone table in the back-end of the system.

### The Shaheen Exchange

The Shaheen Exchange - in which the ex-Chairman of Kabul Bank had a 49 percent stake with an Emirates citizen retaining 51 percent - opened an account at Kabul Bank the month after the Bank was granted a banking license and had approximately 160 proxy loans assigned to it at the time of conservatorship. The exchange was used to launder disbursements; conceal beneficiaries; use depositors funds for illegitimate and risky business investments; satisfy loan repayment schedules; and to enable the Shaheen to operate as a Hawala.<sup>2</sup> Beneficiaries of money moved from Kabul Bank to the Shaheen Exchange include managers, shareholders, and politically exposed people.

The operations of the Shaheen Exchange and Kabul Bank were fully integrated with Shaheen staff placed at Kabul Bank and officers of the two companies in daily contact. The two enterprises operated as subsidiaries of a larger enterprise named Sherkhan Farnood General Trading LLC, which was established in Dubai in January 1996 and was 49 percent owned by the ex-Chairman of Kabul Bank and 51 percent owned by a resident of Dubai. The ex-Chairman managed Sherkhan Farnood General Trading from the same Dubai building that the Shaheen Exchange was located, which was the centre of all the ex-Chairman's business, including other Hawala's; Pamir Airways; and Dubai property management.

Sherkhan Farnood General Trading maintained a loan-book demonstrating funds from Kabul Bank in the form of Zahir Group loans. This implies that the ex-Chairman used the Zahir Group loans primarily for his own personal enrichment, in particular to build an extensive property portfolio in Dubai, which is estimated to amount \$151 million in principal.

### ***Other illicit transactions***

In addition to initiating and administering fraudulent loans, Kabul Bank management disbursed Bank funds as operating expenses for the benefit of outside businesses they controlled, or created fictitious assets to conceal illicit withdrawals. Kabul Bank non-loan disbursements are estimated to be \$66.2 million, including personal expenses (motor vehicles, residential rent, bonuses, travelling allowances, advance salary payments); related party business interests (Pamir pilots payment, Bakhtar TV Employee payments); and misappropriation of funds (false deposits, property purchases, fake capital injections).

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<sup>2</sup> Hawala is a money transfer system that does not require the actual transfer of funds. It is based on a network of money brokers in different locations who remit funds on behalf of one-another.

### ***Expenses, employment benefits, and related businesses***

Kabul Bank funds were also misused through the use of expense accounts and personal benefits. Travel expenses amounted to almost \$6 million over the life of Kabul Bank with most claims containing few details and no supporting receipts. Expenses were authorized by senior management, with the ex-Chief Executive Officer authorizing his own. Of the \$419,645 of travel expenses reviewed by the forensic audit of Kabul Bank, only one for \$1,168 related to genuine travel costs with a supporting invoice, and \$81,585 related to business trips or annual leave allowance for foreign staff. The remainder were for personal expenses or other non-legitimate purposes. Extrapolation indicates that \$5 million of \$6 million in expenses was illegitimate.

Another \$22.9 million was paid through the House Rent and Residential Rent expense accounts. Rental payments were sometimes made as rewards to employees for assisting management in fraudulent activities or used for rooms at several high-end hotels in Kabul, which were not used for Bank purposes. The Bank also acquired approximately 250 cars and motorcycles between 2005 and 2010 at a cost of \$8.44 million. Only 170 of these are recorded by Kabul Bank's transportation department, with only 65 having supporting documentation.

Advanced salary of \$240,000 was paid to the ex-Chief Executive Officer and \$336,000 to the ex-Deputy Chief Executive Officer over several years, the liability of which was later transferred to the Bank in 2009. Illegitimate performance bonuses of \$500,000 were also paid to the ex-Chairman and ex-Chief Executive Officer in December 2009, while \$2.2 million in loans were given to hundreds of Kabul Bank staff.

Other salaries were paid by Kabul Bank to unqualified employees, employees engaged in fraudulent activities, or those who simply did not work for the Bank. Many were relatives, or employed in related businesses. For example, the brother of the ex-Chief Executive Officer was being paid a yearly salary of \$96,092 and was granted four-years paid leave, but never worked at the Bank.

Money paid to employees of related businesses include 10 Pamir Airways pilots who were paid \$320,000 in salaries between March 2008 and November 2010 under the description "Pilots of Cash Delivery", which is particularly suspicious given that Kabul Bank was suspected of laundering large amounts of cash through Kabul Airport. Payments of \$290,000 were also made to 117 employees of Bakhtar TV, which was jointly owned by the ex-Chairman and the ex-Chief Executive Officer.

Finally the Bank used Khurasan Security Company under an agreement that paid the company \$1.1 million per year for security, and provided for payment of taxes and overhead costs of the company, resulting in actual payments of approximately \$5 million per year. The ex-Chief Executive Officer was the President and 70 percent shareholder of Khurasan from September 2006 until June 2007 when he transferred his stake to his brother.

### ***Capital expenditures***

Several transactions were created to appear as though expenses were being incurred for capital expenses. A purported payment to a technology company for \$739,000 in August 2009 was paid via the Shaheen Exchange and transferred to the ex-Chief Executive Officer on the same day. Similar payments of \$1.5 million were purportedly made in October 2009

to construction companies, however, the same day deposits amounting to \$1.5 million were made to the ex-Chief Executive Officer. In December 2009, another \$1.5 million described as payments for the construction of containers, was fictitiously created to provide cash deposits for the ex-Chief Executive Officer. Finally, computers and vehicles were supposedly purchased in January 2010 resulting in \$381,000 of payments transferred directly to the ex-Chairman and ex-Chief Executive Officer.

There was also a cash shortfall of \$17.49 million as a result of fake deposits for the benefit of Shaheen current account; and a fictitious \$18 million increase in fixed assets.

### ***Political contributions***

In 2009, the ex-Governor of Da Afghanistan Bank advised all Chief Executive Officers of Afghan banks that they should refrain from making political contributions or becoming involved in election campaigns in any way. This letter was not enough to dissuade Kabul Bank, who reportedly provided millions of dollars to the campaign of at least one presidential candidate, in addition to dozens of cars, and payment of the entire media campaign, including billboards and television advertisements. Kabul Bank reportedly also made political contributions to between 30 and 40 parliamentarians.

Apart from the 2009 election campaigns, the forensic audit of Kabul Bank states that the ex-Chief Executive Officer acknowledged \$9.6 million worth of loans on behalf of politically exposed people and that there are seven individuals who owe the Bank \$3.1 million who have not been approached for recovery due to their political standing. Information provided also indicates that many politically exposed individuals received cash payments from the ex-Chief Executive Officer *ex-gratia* to build goodwill and political allies.

### **f.) Da Afghanistan Bank: Reporting, supervision and enforcement**

#### ***Reporting***

All banks must prepare quarterly and annual financial statements and must submit audited financial statements with an independent auditor's report. Banks must also include reports concerning their administration and operations to allow Da Afghanistan Bank to assess the financial condition of the bank and the bank's compliance with banking laws.

Kabul Bank's annual reports indicate that the Bank complied with all statutory and regulatory requirements and had adequate internal control mechanisms and systems in place. The Bank also reported that they took-on special responsibilities for the country by undertaking to distribute salary payments on behalf of the government free of charge. Capital adequacy regulations require banks to maintain minimum regulatory and core capital to risk weighted asset ratios. However, monthly reports indicate that Kabul Bank frequently fell below these requirements resulting in cash injections by shareholders funded by proxy loans.

A majority of Kabul Bank's reported income was derived from interest on loans and advances, which consistently represented over 80 percent of the Bank's total income. However, the interest income in the reported financials was grossly misstated and the vast majority of interest reported from customer loans was never received. When the unrealized interest on customer loans was adjusted, the Bank was operating with no meaningful income outside of deposits. Based on this, the Bank became insolvent shortly after inception and by the time of collapse it was carrying negative equity in excess of \$750 million.

### ***Supervision and enforcement measures***

Adherence to banking standards and anti-money laundering requirements is monitored by Da Afghanistan Bank through onsite examinations of banks. Specific progressive enforcement measures and procedures are set out in the banking laws.

The first step is a Written Warning which can be issued when there is reasonable cause to believe that the solvency or the liquidity of a bank is threatened. The warning puts the bank on notice that it is operating in an unsound or imprudent manner or is violating a law or a regulation.

The second step is a Written Supervisory Order, which can be issued when a written warning does not elicit corrective action. This is a request to the bank's management board to present a plan with written commitments to take corrective action.

The third step is to develop a Plan to Take Corrective Action, which is a more severe and formal enforcement action. The plan to take corrective action is a formal written supervisory agreement to address any deficiencies, or unsound practices and must contain an analysis addressing the violations and deficiencies; specify corrective measures; and timeframes for periodic reports on progress.

On the termination of the specified time period, Da Afghanistan Bank will make a conclusion as to the further activity of the bank. In the event of failure to implement the plan, Da Afghanistan Bank has the right to take any enforcement measures, including an order to take prompt corrective action, placement into conservatorship, revocation of banking license and forced liquidation.

The fourth step is an Order to Take Prompt Corrective Action, which Da Afghanistan Bank may issue when it finds that a bank fails to carry out a plan of corrective action; or that the solvency or the liquidity of a bank is threatened. An Order to Take Prompt Corrective Action may require the bank to suspend borrowing or deposits; or remove the administrator. Da Afghanistan Bank may also impose a fine; order the bank to conduct an external audit; or remove an administrator. These are considered by the law as extraordinary measures to be considered in the most extreme cases of financial or operational distress and can be undertaken if the appointment of a conservator is imminent or if the bank has engaged in criminal activities that may jeopardize the financial standing of the bank.

### ***Kabul Bank supervision and enforcement***

Da Afghanistan Bank faced several challenges in supervising Afghanistan's banking system. In 2004, when Kabul Bank was established, the Afghan banking sector was very underdeveloped. In March 2004, three-years after the overthrow of the Taliban, total commercial bank assets were only \$261 million. However, the size of the financial system subsequently soared and by March 2008 total assets were almost \$1.7 billion, implying an average yearly growth rate in assets of over 50 percent. During that period the number of banks operating in Afghanistan grew from three to 16. Banking assets exceeded \$4 billion just before the collapse of Kabul Bank in 2010. The growth of the financial system imposed significant challenges on Da Afghanistan Bank and made its capacity to effectively regulate and supervise the industry the most important constraint for the effectiveness of the supervision process.

Afghanistan's banking laws were fairly comprehensive during the period of Kabul Bank's fraudulent activity. The International Monetary Fund provided technical assistance between October 2001 and May 2003 on restoring central banking services and setting up an emergency payment system. This period also saw the first activities in setting up licensing, regulation and supervision of banks. Banking laws were passed in 2003 based on international best practices and provided for appropriate governance structures, operational requirements, liquidity ratios, supervision and enforcement. By the time the legal framework was passed through the parliament, however, the supervisory capacity of the Da Afghanistan Bank had only begun to develop. As such, the supervisory function of the Financial Stability Department of Da Afghanistan Bank only became operational in 2005.

In addition, Da Afghanistan Bank's Financial Supervision Department faced severe human resources constraints. As of early 2008, the Supervision Department of Da Afghanistan Bank had just over 20 staff members without extensive training in banking supervision. Over a three-year period this gradually increased to more than 60 people with most possessing commerce degrees from outside of Afghanistan. The Supervision Department also initiated mandatory 90-day international training, increased inspections, and introduced a code of conduct during this period. At the time Kabul Bank went into conservatorship, Da Afghanistan Bank was responsible for regulating 17 commercial banks with approximately 320 branches with an underdeveloped supervision department.

Kabul Bank was founded in June 2004, but the first general onsite examination by Da Afghanistan Bank began in February 2007, after the loan-book scheme and other fraudulent activities at Kabul Bank were underway. This delay allowed the Bank to operate for an extended period without proper internal controls and supervisory mechanisms. In this regard, several irregularities were later discovered by Da Afghanistan Bank in relation to Kabul Bank's Board of Supervisors, management team, internal audit, and credit approval.

Despite the lack of general onsite examinations, Da Afghanistan Bank raised regulatory concerns with Kabul Bank as early as March 9, 2006 regarding the bank's policies, long term capital planning, and the need for growth in equity capital. They also noted that Kabul Bank had never fulfilled its promise to develop a capital plan and was aggressively marketing for deposits and then scrambling to locate capital.

During the three and a half year period between February 2007 and September 2010, Da Afghanistan Bank conducted four general examinations, undertook three special examinations, and took enforcement measures or corrective actions four times. Da Afghanistan Bank consistently raised concerns in several areas in their examinations and written warnings. The first was corporate governance, which implied that several of the so called lines of defence in the Bank's supervisory, internal control and risk management functions were not operational. The second was the process of managing loan files where several deficiencies have been observed in areas of loan approval process, impairment policy, compliance with internal policies and securing and monitoring of collateral. There were persistent concerns with liquidity as Kabul Bank was heavily reliant on volatile Bakht accounts<sup>3</sup> for necessary sources of funds. Finally, Da Afghanistan Bank raised concerns about the uncontrolled expansion of branches and branches that were opened without approval.

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<sup>3</sup> Bakht accounts are volatile short-term accounts used to attract depositors.

Despite these issues, Da Afghanistan Bank examinations did not identify fraudulent activities and Kabul Bank responded to most of the issues raised in enforcement orders with specific action giving the appearance of being responsive and demonstrating a desire to resolve issues and avoid future breaches. Targeted examinations were conducted by the Special Supervision Section of Da Afghanistan Bank to measure compliance, but they did not have sufficient authority to use investigative techniques to undertake full verification of the Banks responses and there was a reliance on the powers of the onsite examination team who would receive copies of the targeted examination.

The examination results and enforcement measures taken by Da Afghanistan Bank between 2007 and 2010 are detailed below.

#### February 2007 – Record of Examination

**Governance:** This examination noted that strategic planning was lacking and that the Board of Supervisors lacked independence and was not focused on monitoring operations. Management was required to provide a detailed operating and capital budgeting plan approved by the Board of Supervisors and to provide reports to the Board of Supervisors. As a result a strategic plan was submitted, an operating budget was sent to Da Afghanistan Bank, but a capital plan was not completed. As of July 2007 a compliance summary claims that required monthly reports were being submitted.

**Loan Files:** The examination noted that profits were being used for branch expansion as opposed to risk management. There were insufficient staff managing loan portfolios and credit analysis of loans was shallow or non-existent, with many files reading exactly the same. Credit files lacked documentation and were replete with errors and omissions. Loans to related groups or individuals exceeded 15 percent of regulatory capital and there was poor consideration of risk, little control or management of the loan portfolio, and a risk that loans were undertaken that were not in the interest of the bank.

Enforcement action required Kabul Bank to appoint an experienced senior credit officer or advisor; substantially reduce credit file errors and omissions; and submit an action plan to enhance credit risk policy, procedures to monitor working capital lines secured by inventory and to reduce control issues related to lending. This action resulted in an appointment of credit adviser, along with another senior individual, but the lack of borrower / authorized officials signatures and rapid credit application were still present on targeted examination. A Credit Risk Management Policy was approved by the Board of Supervisors in June 2007 and sent to Da Afghanistan Bank.

**Bakht Accounts:** It was noted that there was a rapid growth in assets, matched by growth in Bakht deposits which Da Afghanistan Bank considered to be uncontrolled. Enforcement action directed that a plan be submitted to reduce the dependence on Bakht accounts. Kabul Bank responded by explaining the justification for the Bakht scheme and providing a detailed plan of how to reduce the level of deposits. Additionally, Da Afghanistan Bank wrote to Kabul Bank in March 2007 in relation to reducing the Bank's reliance on Bakht accounts.

#### April 2007 – Enforcement Measures

Da Afghanistan Bank took enforcement measures against Kabul Bank directing the Bank to conduct meetings of board members, develop a strategic plan, prepare a budget plan, revise the credit policy, establish an extra reserve, decrease Bakht accounts, better identify

customers according to the counter money laundering policy, identify the customer's income source, and better recognize suspicious transactions. On April 23, 2007, Da Afghanistan Bank wrote to Kabul Bank indicating that they suspended the approval of additional Kabul Bank branches due to the lack of implementation of enforcement measures.

#### May 2007 – Special Examination

This special examination reviewed regulatory violations related to large loans, evaluated the administration of total loans, assessed counter money laundering efforts, and assessed the income sources for the bank.

In September 2007, Kabul Bank responded to Da Afghanistan Bank arguing in favour of keeping the Bakht accounts, due to the number of customers using them. The Bank highlighted that termination of Bakht accounts would result in the loss of customers, take people away from using banks, diminish public trust in public financial institutions, and remove money from the economy.

#### November 2007 – Record of Examination

**Governance:** The examination noted that corporate governance practices were weak, which created an environment that was relatively free of scrutiny and accountability. Five out of seven board members were not approved by Da Afghanistan Bank, and Kabul Bank delayed the interviewing of members by Da Afghanistan Bank indefinitely. The biographical information of board members was required and internal audit reports needed to include sufficient coverage of the lending functions as well as other audit areas. As a result, Kabul Bank sent biographical information in January 2008 and internal audit reports covering all areas of banking operations were prepared.

**Loan Files:** The examination noted inadequate credit policy, concerns over the credit review mechanism, omission and errors in the credit files, and a related party borrowers list that did not correspond to Da Afghanistan Bank's list. Enforcement action required a revision of the credit policy to include limits for principal and / or interest repayment, remove errors from credit files and develop improved loan review process; and to detail steps to improve all inclusive risk assessment measures. Da Afghanistan Bank noted that the lending policy was revised with better clarity and correction of files was partially complete. Of the five loan files reviewed, errors included sanctioned amounts crossed out, lack of collateral, appraisal signed by a single entity, and inventory valuation on the basis of bills.

**Bakht Accounts:** The examination noted that liquidity and asset liability management practices needed to be improved and that there was an over dependency on Bakht accounts. Enforcement action required that a plan be submitted to stop funding loan accounts with Bakht funds, resulting in a written plan to reduce dependency on Bakht accounts. Weekly and monthly draws stopped and the Kabul Bank claimed minor reduction in Bakht accounts with a plan to reduce further. However, in December 2007, Kabul Bank wrote to Da Afghanistan Bank quoting a December 2007 letter from the Financial Commission, Budget and General Accounting Bank Affairs of the lower house of Parliament asking that Da Afghanistan Bank reconsider its decision related to Bakht accounts. The letter from the lower house cited the use of Bakht accounts by people with security concerns and cautioned that terminating the use of Bakht accounts would result in the loss of customers and disappointed bank account holders.

### January 2008 – Corrective Actions

Subsequent to this intervention by the lower house, Da Afghanistan Bank's corrective measures resulting from the December examination did not include any reference to Bakht accounts. Instead, the letter focused on the elimination of legal violations related to the appointment of five individuals to the Management Board without Da Afghanistan Bank approval; a required increase in regulatory capital; an expanded capital and budget plan, problems in loan files; revision of the credit policy; assessing the record of internal audit and its effectiveness; stopping new branches; and bringing operating expenses under control. A targeted examination followed up on the implementation of these measures.

### May 2008 – Record of Examination

**Governance:** The examination noted that signatures of board members were missing from minutes and there were significant deficiencies in the management of Kabul Bank and that the board was not functioning properly with decisions being made in absence of all members. Enforcement action required Kabul Bank to ensure that all board members participated in meetings and signed the minutes. Monthly reports describing actions taken, including the proper implementation of policies and procedures were also required. This enforcement order was not sent until December 2008, and no targeted examination was undertaken as the next onsite examination was imminent.

**Loan Files:** The examination noted that the credit policy should be fully complied with for new loans; that credits have been sanctioned beyond approved limits; borrowers balances are not being reduced to zero prior to being extended; and some loans were paid out prior to approval. Enforcement action included a direction to improve the quality of internal loan review process; implementation of Kabul Bank's credit policy; and application of better credit analysis. As noted above, this order was not sent until December 2008, and no targeted examination was undertaken.

**Bakht Accounts:** The examination notes that there was an unwillingness to reduce dependability on Bakht accounts as a source of attracting deposits. Enforcement action directed the bank to reduce the dependency on Bakht accounts and to wind down Bakht account by the end of 2009. Kabul Bank responded by sending a request to maintain quarterly draws because restricting draws to bi-annual would send the wrong message to the public about the health of the banking sector.

### December 2008 – Corrective Action

Corrective action taken by Da Afghanistan Bank at this time included requirements to apply the credit policy, to prevent loans in specific sectors, enhance the quality and documentation of loan files, take note of loans to deposits which should be less than 75 percent, alter overdraft loans to fixed term loans, process loans according to loan standards, present specific information to Da Afghanistan Bank in regard to problematic loans, decrease the reliance on Bakht accounts and transfer Bakht rewards from quarterly to annually.

### December 2008 – Record of Examination

**Governance:** The examination noted Kabul Bank's failure to produce a comprehensive budget plan further indicating that the Board was not functioning. Enforcement action resulted in a requirement for a three-year strategic plan and the Board to evaluate the Bank's actual performance against the strategic plan on a quarterly basis. The targeted examination

did not address the governance deficiencies and two letters from the Bank claimed that the plan had been produced and sent to Da Afghanistan Bank. There is no evidence of further follow-up.

**Loan Files:** The examination noted that the total loans to total assets and total deposits ratios were above those stated in Kabul Bank's policy; that only 20 percent of loans had collateral; many companies failed to produce documentary evidence of stock; and that most overdrafts were converted to term loans due to weak repayment capacity of the borrower and without any change to the agreement of the borrower, all of which should have raised concerns about the quality of the loan-book and need for impairment of assets.

The enforcement action indicated that Kabul Bank was to implement a program to improve credit underwriting and administration process and deficiencies in all classified credit and reduce problem assets; and that Kabul Bank needed to require a percentage of principal to be repaid before renewing a loan. The targeted examination reported that the Bank had decided not to renew loans for a second time and had closed a number of classified loans; but the recycling of loans was now known to have continued.

**Bakht Accounts:** The examination notes no significant improvement on the dependency on Bakht accounts and directed the Bank to act on earlier recommendations, but the enforcement order did not include any directions on Bakht accounts. The result was that the final onsite examination report of March 2010, confirmed that there had been little change on the dependency of Bakht accounts as the primary means of raising deposits.

#### June 2009 – Corrective Actions

Corrective action from this time required Kabul Bank to expand its strategic plan to three-years, improve the method of administering loans, build staff capacity, and correct procedures for anti-money laundering activities.

#### August 2009 – Special Examination

The special examination from this period was focused on assessing loans and establishing effective mechanisms to strengthen administration of total loans and other sections related to counter money laundering.

#### January 2010 – General Examination

The last examination of Kabul Bank was carried out from January to March 2010, two-months after Da Afghanistan Bank was informed by the National Directorate of Security that Kabul Bank was engaged in inappropriate activities. The ex-Governor expressed concern about activities at Kabul Bank, but nothing was revealed aside from ongoing regulatory issues.

#### ***Other breaches discovered***

There were a number of other breaches that were noted by Da Afghanistan Bank, or that came to light after Kabul Bank collapsed, including:

- loans to a single individual or group of related borrowers exceeding 15 percent of unimpaired capital;
- direct investments in large businesses without the consent of Da Afghanistan Bank;
- providing loans to unidentified persons without adequate identification;

- maintaining accounts for anonymous individuals or individuals with false identities;
- transferring \$20,000 to or from the country without prior notice;
- loans to employees of more than 25 percent of their annual salary; and
- large financial transactions that lack a specific economic purpose were unrecorded and concealed.

#### **g.) The Financial Transactions and Reports Analysis Centre of Afghanistan**

##### ***Regulatory overview***

The Financial Transactions and Reports Analysis Centre of Afghanistan was established in 2006 to independently analyze suspicious activity and large transaction reports received from banks. The Centre provides intelligence to law enforcement for investigation, which may include authorization from the judiciary to obtain evidence through monitoring bank accounts; accessing computer systems, networks and servers; surveillance of electronic transmissions; and the seizure of records.

The Financial Transactions and Reports Analysis Centre of Afghanistan may exchange information with Da Afghanistan Bank, law enforcement agencies and foreign counterparts. In this last regard, the Centre has been an Egmont Group member since 2010, which is an informal group of 130 financial intelligence units from around the world who share financial information with each other to enhance the detection of financial crimes.

Whenever reasonable grounds to suspect that an offence of money laundering has been committed, the Financial Transactions and Reports Analysis Centre of Afghanistan must immediately forward a report to the Attorney General's Office which decides on further action. The Centre may issue an order to freeze funds and property for a period not exceeding seven-days in serious or urgent cases, in which time the matter can be referred to the prosecutor. The prosecutor must promptly determine whether it is appropriate to submit an application to a competent court for a freezing order, but may independently extend the temporary order for an additional period of seven-days.

The Financial Transactions and Reports Analysis Centre of Afghanistan is also responsible for overseeing financial businesses and professions, but this aspect has not been active because financial services are not currently regulated in Afghanistan.

##### ***Kabul Bank***

The Financial Transactions and Reports Analysis Centre of Afghanistan received approximately 500 suspicious activity reports from Kabul Bank over the course of the Bank's operations, but none of them related to insider loans. Kabul Bank was the biggest reporter of suspicious activities, but the volume was normal and what would be expected from a bank of that size. The ratio of reports deemed to be worth forwarding to the Attorney General for investigation is normally in the range of 30 to 40 percent for banks in Afghanistan. Kabul Bank however, was reporting at a rate of approximately six percent. The Centre attributed this ratio to over reporting, or defensive reporting since reporting was subjective and some banks report much more than they needed to.

The Centre has assisted the Financial Supervision Department of Da Afghanistan Bank in conducting the anti-money laundering aspects of their onsite investigations and have trained individuals. As a result of examinations, the Centre recommended a fine against Kabul Bank

of \$110,000 in 2008 for misreporting, but the fine was never pursued reportedly due to political influence.

The Financial Transactions and Reports Analysis Centre of Afghanistan was advised in late 2009 that Kabul Bank was moving money through food trays on Pamir Airway flights, which is supported by a Kabul Bank account that paid 10 Pamir Airways pilots for cash shipments. In response, the Centre worked with airport security, Da Afghanistan Bank, and customs officials to search airlines, but the launderers were apparently tipped-off and no evidence was found. After this, the Centre enhanced their visibility at airports with additional customs training.

After news emerged in February 2010 that Kabul Bank was misusing funds, the Centre required a criminal investigation so that they could cooperate with Europe, United States, and Russian Federation through the Egmont Group, but no investigation was started. After the Kabul Bank crisis, the President of Afghanistan was advised that the Centre required a letter from the Attorney General indicating that a criminal investigation was underway so that they could work with their international counterparts. However, the Attorney General's Office has been generally uncooperative in pursuing individuals suspected of financial crimes. The President even went so far as to direct the Attorney General to support the Centre, but instead of investigating financial crimes the Attorney General investigated the head of the Centre who was eventually charged with breach of duty and abuse of authority.

#### **h.) The role of external auditors and international financial firms**

##### ***Kabul Bank auditors***

Each bank in Afghanistan must appoint an independent external auditor; prepare an annual report with an audit opinion; inform Da Afghanistan Bank about any act that constitutes a material violation of the banking law or any deficiency expected to result in a material loss.

In early 2005, Kabul Bank sought Da Afghanistan Bank approval to use Dubai based Alliot Gulf Limited as their auditors for the year ending March 31, 2005. Da Afghanistan Bank rejected the firm as Kabul Bank's independent auditor in June due to the firm's lack of experience in auditing banks. In August 2005, Da Afghanistan Bank approved KPMG after conducting an interview with a firm representative. However, on December 26, 2005 Kabul Bank notified Da Afghanistan Bank that KPMG could not conduct the audit because they were "preoccupied", without further explanation. Kabul Bank resubmitted Alliot Gulf to conduct the audit and on January 3, 2006 Da Afghanistan Bank rejected the firm again in a tersely worded letter. Finally, in February 2006 Kabul Bank proposed Behl, Lad and Al Sayegh Chartered Accountants from Dubai. Da Afghanistan Bank sought additional information regarding their capacity to conduct the audit and approved them on February 21, 2006.

On April 22, 2006, Kabul Bank requested that the firm be allowed to audit the Bank for the year 2006, but this was denied by Da Afghanistan Bank with Kabul Bank being advised to find another firm with more extensive experience. Kabul Bank responded the same month with additional information and the firm was again approved. Behl, Lad and Al Sayegh was also used for the year ending March 31, 2008.

In all the audits performed, the auditors were responsible for issuing a statement based on financial statements approved by the Bank's management. The audits were to examine the

accounting principles used and evidence supporting the preparation of the financial statements and other disclosures, with reasonable assurances that the financial statements prepared by management were free from material misstatement and that the statements presented true and fair position of the Bank. While audits are not intended or designed to detect fraud, there are international standards related to the auditor's responsibilities in relation to fraud in an audit of financial statements. In this regard, auditors are expected to evaluate unusual or unexpected relationships, and are provided with guidance on methods to introduce unpredictability into their audits to counter efforts to mislead the auditors. The auditor's objective is also to conclude whether a material uncertainty exists related to conditions that may cast significant doubt on the entity's ability to continue as a going concern. Collateral has a substantial influence on a going concern assumption and the auditor's assignment and responsibility is to conclude whether collateral sufficiently supports the going concern assumption. Additionally, risks like liquidity and market risks are linked to a going concern assumption and therefore are something to be carefully assessed in the audit report. The audit reports for Kabul Bank give the impression that all risks and going concern assumptions have not been considered as substantial.

In the audit reports, the auditors concluded that the financial statements gave a true and fair view of the financial position of Kabul Bank and that to the best of their belief and knowledge no material violation of banking laws occurred. From December 31, 2008 on, Behl, Lad and Al Sayegh was replaced by AF Ferguson and Company - a Pakistan based member of PricewaterhouseCoopers as a result of Da Afghanistan Bank's directive that all Afghan banks use one of five major firms approved by the central bank. The December 31, 2009 audit was also conducted by AF Ferguson and on February 10, 2010, AF Ferguson issued a standard and clean audit opinion. The auditors of Kabul Bank believed that they obtained sufficient and appropriate information to provide a basis for such an opinion. AF Ferguson evaluated the Bank's controls and performed a series of audit tests, including the physical examination of loan collateral, to evaluate the Bank's valuation of its loan portfolio.

The auditors concluded that Kabul Bank's internal policies and procedures used in the preparation of financial statement and internal controls relevant to the preparation and fair presentation of the financial statements were consistently applied. However, this conclusion is questionable given that the Da Afghanistan Bank examiners consistently noted that the Bank was not complying with their own policies and procedures in other areas.

The audited financial statements disclosed that the Bank's loans and advances to customers included \$469 million in overdrafts, and \$235 million in term loans earning a reported \$88 million in interest. Based on classification of loans and taking into account standard provision rates, a \$16 million provision for doubtful loans and advances were higher than the calculated \$5.85 million. The loans and advances were primarily secured by using inventory as collateral, but also with mortgage of property, personal guarantees and / or assignment of receivables. The audit opinion contained no comment on the quality of the collateral.

In terms of deposits, the financial statements show that there were \$243 million in savings deposits and \$275 million in Bakht account deposits. The auditor did not raise concerns with the Bank's reliance on the volatile Bakht accounts like the Da Afghanistan Bank examiners did consistently. The auditors also did not question the Bank's liquidity risk management and the capacity of the Bank to replace volatile funds if they were withdrawn.

Audited financial statements also show that share capital equated to \$100 million, of which only \$28 million was paid; liabilities included “accruals and other payables” of \$2.1 million (or \$1.7 million more than the year before); and “others” at \$2.7 million, or \$2.5 million more than the year before, with no further detailed disclosures. Operational advances to employees were \$3.8 million (\$2.8 million more than the year before); personal advances were \$2.4 million compared to \$1.2 million the year before; and prepayments totalled \$4.7 million all without further disclosures.

Bonuses to employees went from \$200,000 in 2008 to \$1 million in 2009 representing bonuses of \$500,000 to the ex-Chairman and ex-Chief Executive Officer; security costs were \$4.4 million, which were paid to a related company; computers and software maintenance charges went from \$240,000 to \$1.8 million; and food items were \$3.2 million.

The audited financial statements also show that there were \$468,000 of loans made to related parties and \$11.5 million made to associated companies representing a loan given to Pamir Airways, and another \$856,000 was noted as advances against salaries of related parties.

The audit seemed to be satisfied with the risk management being exercised by the Bank, again in contradiction of the findings of the Da Afghanistan Bank examiners. It found that the Bank’s risk management policies were designed to identify and analyse risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits.

#### ***Financial advisors embedded in Da Afghanistan Bank***

The United States Agency for International Development’s Economic Growth and Governance Initiative was active from 2005 until April 2011 with the goal of increasing the capacity of Afghanistan’s central bank to regulate banking and to provide support to strengthen its ability to conduct oversight of commercial banks through onsite and offsite audits. The scope of work and mandate was to provide trainers and technical experts to build the supervision capacity and not to supervise private banks themselves. With the Program’s support, the Financial Supervision Department’s staff increased from 12 personnel, who had limited qualification, to 60 personnel trained in banking regulation methodologies.

The United States Agency for International Development’s capacity building activities were implemented by Bearing Point from September 2005 to September 2009. Bearing Point prepared a detailed and comprehensive enforcement manual, which was presented in June 2009. The manual contains several examples of unsafe or unsound practices that Da Afghanistan Bank observed at Kabul Bank, including asset quality problems. However, the manual was considered too onerous and not appropriate for Afghanistan’s banking system and was never finalized, though it has been used to provide guidance for enforcement. In January 2010, Deloitte advisors were described as providing theoretical advice instead of lending hands-on assistance, highlighted by a January memo to the ex-Governor with recommendations to enhance onsite supervision. Moreover, the opinion of Da Afghanistan Bank officials at the Financial Supervision Department was that the Bearing Point support was generally useful, especially for offsite examination. However, it was inadequate for onsite examinations.

Bearing Point was acquired by Deloitte during its engagement in Afghanistan and Deloitte came under contract from August 15, 2009 to provide Da Afghanistan Bank technical assistance. From October 2010 to March 2011, the program's performance targets for conducting onsite and offsite reviews of commercial banks were not always met. For instance, Deloitte planned to assist Da Afghanistan Bank's Financial Supervision Department in conducting 41 onsite examinations of commercial bank financial records, but only completed 22. Additionally, a target to issue 27 enforcement actions related to bank management was not met as Da Afghanistan Bank only issued 16.

The United States Agency for International Development managed the Deloitte contract through weekly face-to-face meetings between project leads and managers and weekly monthly, quarterly, and ad hoc written reports. A review of the United States Agency for International Development's engagement at Da Afghanistan Bank concluded that embedded Bearing Point and Deloitte advisers had several opportunities to learn about fraudulent activities at Kabul Bank and should have been more aggressive in following up on indications of serious problems, citing the following examples:

- Bearing Point's onsite examination adviser received death threats;
- In 2009 Bearing Point advisers were told of Kabul Bank's ability to interfere with financial supervision functions due to its political influence;
- In November 2009, the ex-Governor raised serious concerns about Kabul Bank's behaviour and the financial condition of bank shareholders; and
- In December 2009, Deloitte advisers heard that Kabul Bank owned Pamir Airways and that the shareholders had purchased properties in Dubai with Bank funds.

Deloitte's lead adviser reportedly indicated that his professional judgment and risk tolerance were probably clouded by the Afghanistan context of incessant rumour of fraud and corruption and that consequently he did not take the fraud indications seriously. The lead adviser acknowledged that Deloitte should have taken more aggressive actions in November 2009, such as resuming participation in onsite bank examinations, and moving previously planned fraud detection training forward. It has been suggested that if Deloitte's onsite assistance had restarted in November 2009, the fraud at Kabul Bank could have been detected earlier, and the magnitude of losses would have been smaller.

#### **i.) Other monitoring agencies**

##### ***National Directorate of Security***

The National Directorate of Security is Afghanistan's domestic intelligence service and conducts operations throughout Afghanistan using a variety of methods. Once information is received related to a crime or other legal infraction, the information is forwarded to the relevant regulatory or investigative body for follow-up. The Directorate does not conduct its own investigation, nor does it follow-up on information that it sends to regulatory or investigative agencies.

In late 2009, the National Directorate of Security received information that there were serious issues at Kabul Bank. In response, the National Directorate of Security wrote to Da Afghanistan Bank and the High Office of Oversight in late October 2009, advising them that they were informed of Kabul Bank funds being used to purchase property in Dubai, and that the Bank had insufficient capital and liquidity, and was conducting large transactions with

related persons, and offering impossibly high interest rates to high-valued customers. The Attorney General's Office was not informed at this time as the Directorate did not feel the information was sufficient enough for a criminal investigation. The High Office of Oversight forwarded the information to Da Afghanistan Bank several months later, but apparently did not carry out any activities of its own.

### ***High Office of Oversight***

The High Office of Oversight is the highest governmental institution in fighting against corruption in Afghanistan. The main responsibility of the High Office of Oversight is to oversee the implementation of the Strategy of Anti-Corruption and Administrative Reform. Based on a presidential decree the professional staff members of the High Office of Oversight are judicial officers, thereby allowing them to collect information and conduct primary investigations on corruption related cases.

The High Office of Oversight receives and collects information through different sources such as hotline centre, complaints boxes, face-to-face interviews, and other governmental organizations and whistleblowers. After an assessment, substantiated cases are forwarded to the Attorney General's Office for proper investigation and prosecution.

Although the High Office of Oversight received the same letter that Da Afghanistan Bank received from the National Directorate of Security in October 2009, it was not until January 2010 that they forwarded the content of the letter to Da Afghanistan Bank, asking them to look into the issue. The High Office of Oversight followed-up with Da Afghanistan Bank in April 2010, and Da Afghanistan Bank responded indicating that they had pursued the information received from the Directorate and evaluated the performance of the Kabul Bank. Da Afghanistan Bank sent the High Office of Oversight copies of reports from examinations of Kabul Bank.

In July 2011, the Independent Joint Anti-Corruption Monitoring and Evaluation Committee recommended that the High Office of Oversight analyze activities of public officials occupying important positions who are on the list of debtors and inform the proper authorities, but the High Office of Oversight appears not to have taken any action. The High Office of Oversight did not respond to the Committee's requests to participate in the public inquiry and so details regarding their involvement in responding to issues related to Kabul Bank were not provided.

### **j.) The Crisis and the Response**

#### ***The first signs of serious problems at Kabul Bank***

In 2008 members of Parliament warned the ex-Governor that the crash of the Dubai real estate market would hurt Kabul Bank's investments and in 2009 the ex-Governor of Da Afghanistan Bank had heard that the characters of Kabul Bank's managers were not appropriate to run a bank. Da Afghanistan Bank was generally concerned with the close relationship that bank managers had with senior elected officials and in advance of the 2009 elections, the ex-Governor sent a letter to the Chief Executive Officers of Afghan banks. The letter indicated that some management were incurring lavish expenses, had unnecessary security guards and bullet proof vehicles, and extended large donations and large scale monetary assistance to politicians and high profile officials. The letter reminded banks to remain politically neutral and refrain from campaigning, which was described as inappropriate in light of the fiduciary duty owed to depositors.

An October 19, 2009 cable from United States Embassy to the State Department in Washington, DC references money flowing from Kabul Airport through Pamir Airways, which is owned by Kabul Bank shareholders, and notes that the ex-Chairman has several properties in Dubai. However, there is no evidence that the Embassy informed any Afghan authorities of these issues. One day later, the National Directorate of Security raised similar more specific concerns with Da Afghanistan Bank, which were brought to the Deloitte advisors providing support to Da Afghanistan Bank in November. Regardless, a regularly scheduled onsite examination between January and March 2010 did not detect the fraud at Kabul Bank.

***The story breaks – responses to the Washington Post article leading up to the crisis***

On February 22, 2010, a Washington Post article cited insider lending abuse and the possible purchase of properties in Dubai with Kabul Bank funds. In response, the ex-Governor of Da Afghanistan Bank met the International Monetary Fund on February 24, 2010 to discuss concerns about Kabul Bank and other systemically important banks in Afghanistan. The ex-Governor indicated at this time that he had been trying to meet the President for months, but that the President was too busy to meet. The International Monetary Fund encouraged him to be more proactive and it was agreed that a technical assistance letter would be written to the United States Treasury Department to seek financial assistance for a forensic audit of Kabul Bank.

The letter requesting technical assistance was drafted that same day, but the ex-Governor at the insistence of the Treasury Department wanted to get the acquiescence of the President before sending it. That day the ex-Governor wrote an urgent letter to the President indicating that he was seeking to adopt serious decisions to bring key corrections to the leadership structure of Kabul Bank, the delay of which will result in the destruction of Afghanistan's banking system. The letter further states that the ex-Governor wanted to discuss sensitive banking issues concerning Kabul Bank's back-room deals, indicating that he had not met the President since June 2009, despite numerous requests over the past six-months.

It is also clear at this time that the United States Treasury Department was concerned with the reports of abuses at Kabul Bank. A March 4, 2010, letter from the United States Treasury Department Assistant Secretary to the ex-Chief Executive Officer of Kabul Bank referenced a meeting that they had in Kabul and highlighted the need for compliance with Afghan law and anti-money laundering best practices. A few days later, on March 7<sup>th</sup>, the United States Treasury Department agreed to take the lead in procuring a forensic audit firm for Da Afghanistan Bank, but United States officials wanted the Afghan President to endorse the audit before taking any action. However, the ex-Governor was out of favour with the President and was still unable to secure a meeting.

On March 29, 2010, after several unsuccessful attempts to meet the President, the ex-Governor sent the Treasury Department the letter seeking technical assistance for a forensic audit and comprehensive onsite examination of Kabul Bank. The letter states that despite best efforts, Da Afghanistan Bank has not been able to trace questionable transactions as they have limited capacity to detect and investigate sophisticated crime, or to conduct cross-border forensic audits.

The ex-Governor also committed in the letter to issue prudential guidelines on enhanced internal audits of transactions with related persons and monthly returns of transactions with

politically exposed people. He highlighted his intention to travel to the United Arab Emirates to meet his counterpart at the central bank. The ex-Governor's letter ends with a warning that failure to act would have grave implications for the safety and soundness of the financial sector. However, the United States Treasury did not immediately act on the letter because they too wanted the ex-Governor to obtain the President's acquiescence.

In May 2010, the Afghan President affirmed his support for the forensic audit to United States Treasury officials. In June 2010 Treasury issued a request for quotation to procure an audit contract with an expected initiation date of September 1, 2010. A memorandum of understanding was signed in July 2010 between Treasury and Da Afghanistan Bank agreeing to cooperate and share material information during the course of the audit. Due to concerns on the part of potential bidders about security in Afghanistan, the request for quotation process had to be revised and reissued on August 10, 2010, with a revised expected audit initiation date of September 15, 2010.

Following through on the commitments made in its request for technical assistance, Da Afghanistan Bank passed a resolution on June 6, 2010, noting the active involvement of shareholders in the affairs of banks that may threaten solvency and liquidity. The resolution prohibited shareholders from holding top management positions at banks, from constituting a majority of the Board of Supervisors, and from instructing members of the Supervision or Management boards to enter into specific commitments. Shareholders in management positions were given until March 20, 2011 to relinquish their positions, after-which they will be forced to divest their shares.

In July 2010, a division that had been emerging between two groups of shareholders of Kabul Bank had reached a point where one group had consolidated enough support from the other shareholders to force the ex-Chairman out of the Bank. This was reportedly facilitated by the ex-Chairman's preference to conduct all of his business activities in Dubai, while the ex-Chief Executive Officer secured political allegiances through the use of *ex-gratia* payments and other perks. Upon realizing that his control over Kabul Bank was threatened, the ex-Chairman of Kabul Bank visited the United States Embassy in Kabul and blew the whistle on Kabul Bank in the same month.

Subsequently, in early August the United States Embassy advised the ex-Governor that Kabul Bank ownership had split into two antagonistic groups, with the ex-Chief Executive Officer leading a group attempting to take control of the Bank. On August 29, the ex-Governor met with the ex-Chairman and the ex-Chief Executive Officer of Kabul Bank to seek their resignations, which they agreed to do at some unspecified date in the future. However, this did not satisfy the ex-Governor and within days he demanded their resignations under threat of imprisonment. The ex-Chairman and ex-Chief Executive Officer gave-in and the ex-Governor appointed Da Afghanistan Bank's Chief Executive Officer as the new Chief Executive Officer of Kabul Bank.

Almost immediately, the media reported on the change of control and it became public knowledge that Kabul Bank was insolvent. This led to depositors withdrawing their savings *en masse* and large scale civil disorder.

The first reaction of the Afghan government was to try and assure the public by downplaying the situation. The Minister of Finance is quoted stating confidently that "We know the money is there, they must not panic. We are sure, 100 percent, that the bank is safe." Likewise, the

ex-Governor brushed-off reports that the Afghan central bank had seized control of Kabul Bank as “baseless information and rumours” and the President stated that “This is nothing but a panic. People are under the impression that the bank is failing, and it’s not” and blamed the western media for “covering it in a negative and provocative way.”

These public assurances did not have the calming affect that they were intended to have and on September 5, 2010, Da Afghanistan Bank put Kabul Bank into conservatorship and suspended shareholder rights, while the government publicly guaranteed that Kabul Bank deposits would be honoured. These actions were sufficient with the closing of the Bank for the Islamic holiday Eid-ul-fiter to stop the run on Kabul Bank.

The money to meet the deposits of Kabul Bank customers came in the form of a lender-of-last-resort facility extended by Da Afghanistan Bank. The lender-of-last-resort could only be secured through the country’s reserves and a promissory note was subsequently signed between the Ministry of Finance and Da Afghanistan Bank providing for regular re-payment of the reserves from the government’s annual budget over eight-years. The promissory is correspondingly reduced by funds received by Kabul Bank receivership.

In October 2011, a bill was introduced in the Afghan Parliament to raise \$73 million in additional revenue to make a first payment on the lender-of-last-resort. The request for payment of the first year’s instalment was initially rejected, but after a period of engaging with parliament, a bill was resubmitted for a payment of \$51 million, with the remaining \$22 million having been transferred to the receiver out of asset recoveries. The bill was approved by parliament on October 15, 2011, and the government made the first payment on October 24, 2011.

### ***Conservatorship***

Under Afghan banking law, Da Afghanistan Bank must appoint a conservator for a bank when the bank’s assets are less than its liabilities or the bank has engaged in criminal activities. The appointment of a conservator transfers the powers of the General Meeting of Shareholders to Da Afghanistan Bank and the powers of the administrators to the conservator. Kabul Bank was placed into conservatorship because it was not repaying its obligations as they came due; the capital of the Bank was less than 75 percent of required capital; and the value of the assets of the bank were less than the value of liabilities. The conservator for Kabul Bank was the Chief Financial Officer of Da Afghanistan Bank at the time of his appointment.

In conformity with banking law, the conservator prepared a report detailing the financial condition and future prospects of the Bank and a proposed plan of action. The conservator’s special examination team conducted a forensic review of the loan portfolio and other aspects of the Bank and uncovered major fraudulent activities.

Of note here, is that the conservator’s team was composed of individuals from Da Afghanistan Bank, including several individuals from Da Afghanistan Bank’s supervision department. This calls into question the assertion that Da Afghanistan Bank did not have the ability to detect the illicit activities at Kabul Bank prior to conservatorship, particularly after information was received by Da Afghanistan Bank from the National Directorate of Security and the opportunity provided by an onsite examination carried out at the beginning of 2010.

The explanation provided for this apparent discrepancy is that the conservator's examination benefited from information provided by the ex-Chairman and others and therefore focused on obtaining details about to verify the information provided. Another reason provided is that conservatorship benefited from the removal of individuals at Kabul Bank who were obstructing Da Afghanistan Bank's examinations by providing false information. Previously, Da Afghanistan Bank's examination teams visited as examiners, without the powers of conservatorship, and operated from a room where they were provided with requested documents. With conservatorship came the powers to access and control all books and records and information technology systems. Regardless, the fraud would have been detected earlier if investigative or forensic techniques were used to review Kabul Bank sooner. However, this would have required stronger action from Da Afghanistan Bank in the form of a forensic audit, or the appointment of conservatorship, both of which faced obstacles.

The results of the conservator's examination was supported by details provided by the ex-Head of the Audit Committee days after the appointment of the conservator. As a result, the conservatorship report of October 30, 2010 noted numerous violations of banking and anti-money laundering law, including inappropriate expenditures on fuel and cars for family and friends; and unnecessary travel, with average monthly expenses of \$7.5 million. The report notes that Kabul Bank was an overly large organization with nearly 3,400 employees on paper, although many never worked for the Bank, were employed in related companies, were related to shareholders and or management, or had salaries well beyond their education and experience. The conservator's report notes the following actions taken by conservatorship:

Establish Control and Oversight of the Bank's Operations

- a moratorium on lending;
- review of activities of the information technology back office in Dubai;
- cases prepared to recommend individuals for criminal prosecution;
- deposits of shareholders and related parties have been frozen; and
- cost reduction efforts including restricting the use of expense accounts, and payment of ghost employees.

Evaluate the Bank's Condition and Further Evaluate all Assumed Asset Losses

- begun to determine actual recipients of loans;
- shareholders have been required to acknowledge their loans in writing;
- negotiations to collect outstanding loans and recover assets from shareholders; and
- investigation and recovery of assets in Dubai.

Conservatorship Plan

- receivership was considered the most viable alternative and least costly of options.

***After conservatorship – dealing with the fallout of bank failure***

On September 5, 2010, the ex-Governor wrote to the Ministry of the Interior to seek a travel ban for Kabul Bank's Internal Audit Manager and Credit Manager who are citizens of India.

A letter was also sent that day to Kabul Airport headquarters informing the airport authority that the two were attempting to flee. They were later arrested.

On September 7, 2010, the Kabul Bank ex-Chairman informed Da Afghanistan Bank of his holdings acquired through loans from Kabul Bank, including Gas Group, Gulbahar Centre, and Zahid Walid Jewellery Market, and guaranteed that ownership deeds would be transferred to Kabul Bank. Other key shareholders, including the ex-Chairman, a former Chief Executive Officer, and the brothers of the President and the First Vice-President, signed a letter on September 15, 2010, committing to work with Da Afghanistan Bank to immediately prepare a payment schedule for all amounts owing.

On September 8, 2010, the ex-Governor wrote to the President highlighting that the ex-Chairman and ex-Chief Executive Officer were a flight risk and needed to be in custody. He asked the President to issue an order, which resulted in the President allowing the ex-Governor to write to Council of Ministers security who took the ex-Chairman and ex-Chief Executive Officer into custody.

On September 19, 2010, Da Afghanistan Bank sent two letters in an attempt to freeze assets of shareholders. The first was issued to the Independent Directorate for Local Governance requesting the Directorate to order Municipality Directorates of Mazar-e-Sharif, Hairatan and Herat to prevent the trade of assets belonging to specific individuals. The second was directed to the heads of commercial banks in Afghanistan directing them to immediately freeze the accounts of the same individuals and companies.

On October 10, 2010, Da Afghanistan Bank passed a resolution setting out qualifications for the Chairs of Boards of Supervisors, providing clarification on the definition of fit and proper, and additional requirements for loans to related people. Da Afghanistan Bank stated that they were not satisfied with performance of many banks in exercising oversight and ensuring adequate internal controls, noting that shareholders continue to exercise undue influence. The resolution introduced a requirement that banks provide monthly reports on loans to related persons and that any such loan have the signature of a majority of the Board of Supervisors and the stamp of the Chief Internal Auditor.

In December 2010, Da Afghanistan Bank requested a broad travel ban from the Attorney General's Office which included some of Kabul Bank's administrators and shareholders, raising concerns in February 2011 when the ex-Chief Executive Officer was allowed to travel abroad.

On April 20, 2011, the ex-Governor appeared before Parliament and testified that Da Afghanistan Bank had referred 19 cases of fraud and questionable lending to the Attorney General's Office and two corruption cases to the High Office of Oversight, none of which appear to have been acted upon. In a subsequent appearance on April 27<sup>th</sup>, the ex-Governor read a list of people and recommended that they be pursued, noting that most shareholders had confessed to owing money. The list consisted of eight shareholders and two leading businessmen, including the brothers of the President and the First Vice-President. The ex-Governor also testified that Members of Parliament and Cabinet ministers received money from Kabul Bank.

After his appearance in Parliament, the ex-Governor faced inquiries by the High Office of Oversight and the Attorney General's Office due to complaints about the naming of certain

individuals. In early May 2011, the ex-Governor wrote to all major central banks around the world asking them to freeze accounts in the name of Kabul Bank shareholders on the basis of suspected embezzlement and the need to prevent dissipation of the proceeds of loans.<sup>4</sup> In May 2011, shareholders became aware that the ex-Governor was seeking to have their assets frozen and some confronted him on the issue.

The ex-Governor made one last appearance before Parliament in June, shortly after which he fled to the United States and resigned from Da Afghanistan Bank, setting out his reasons in a June 27, 2011 press release. The press release cited the undermining of Da Afghanistan Bank's independence by high-level political authorities; the politicisation of the forensic audit; the rejection of legislative reform that would have required owners and shareholders of banks not to interfere in management and to resign from their positions as chairman and deputy chairman of supervisory boards; the lack of a plan to establish a special prosecution and a special tribunal to try those implicated in fraud; and the failure of law enforcement agencies to bring pressure on borrowers and insiders who took loans, instead focusing their efforts against staff of the central bank.

### ***The international community sets expectations for government action***

At the beginning of October 2010, the United States Agency for International Development and United States Treasury created the Financial Sector Working Group to coordinate the response to the Kabul Bank crisis with representation from the International Monetary Fund, the World Bank, and Deloitte. The group met weekly from October 2010 through March 2011 and then bi-weekly and monthly through December 2011. The group quickly determined that receivership was the best option for Kabul Bank and that the bad assets of the Bank should be split from the good assets, with the good assets being included in a newly privatized bank. However, the Afghan government initially believed that Kabul Bank could be rehabilitated and was concerned about initiating another run of depositors. Under the banking law, rehabilitation can be required if the President decides, upon the recommendation of Da Afghanistan Bank and with the concurrence of the Minister of Finance, that it is required for the stability of the banking system.

Coincidentally, the International Monetary Fund's Extended Credit Facility Program for Afghanistan expired in September 2010. Extended Credit Facility Programs are detailed financial plans and benchmarks that are agreed on by the International Monetary Fund and a receiving country to ensure that the financial sector of the developing country is operating in an accountable and sustainable manner. Many donor countries use the existence of a program as a benchmark of sound economic and financial management to assure themselves that the recipient country has taken sufficient steps to safeguard public funds.

The expiry of Afghanistan's Extended Credit Facility Program in September, provided the International Monetary Fund an opportunity to use the renewal of the program as leverage to convince the Afghan government to take action on essential components related to Kabul Bank, namely, conducting a forensic audit, putting Kabul Bank into receivership, and initiating an independent review of the Kabul Bank crisis.

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<sup>4</sup> Although central banks were contacted by the ex-Governor of Da Afghanistan Bank, they did not have the authority to comply with the request as they did not exercise control over individual accounts held at commercial banks.

### ***Forensic audit – the government fulfils the first expectation***

During the initial crisis period, the Minister of Finance and ex-Governor of Da Afghanistan Bank were now meeting the President regularly and were pushing for a forensic audit. The United States Treasury Department had completed their procurement process and identified an auditor in September 2010. However, although approval was within the authority of Da Afghanistan Bank, the President of Afghanistan was reluctant to consent to the audit, citing the concerns that the Treasury Department would have been the client of the auditors, and that the findings may lead to greater loss of confidence in the Bank and outflows of funds. The United States Treasury was informed that the Afghan government would only support an audit if the contract would be between the auditor and the Afghan government; the contract would include International Monetary Fund and World Bank participation; and the audit would encompass all 17 of Afghanistan's banks.

In October, the Afghan government was informed that United States contracting laws required that the United States government itself had to be the recipient of any resulting report. As a result of this impasse, the Ministry of Finance negotiated terms of reference with the International Monetary Fund and then initiated a tender for a forensic audit of Kabul Bank in November 2010, with funds ultimately secured from the United Kingdom Department for International Development and the Canadian International Development Agency.

A well-respected international forensic audit firm won the tender in early 2011, but there were delays in receiving the President's direction allowing Da Afghanistan Bank to sign the contract, despite the central bank's independence. The President was reportedly unhappy that a western firm was selected, and preferred to have a company from Asia. The ex-Governor and the Minister of Finance were encouraging the President to approve the contract given the importance of the forensic audit in re-establishing the Extended Credit Facility Program. In the end, the ex-Governor was indirectly advised that the President had approved the execution of the forensic audit contract and so he signed. It later came to light that the President had not actually given his approval, and was reportedly displeased that it was signed. However, the authority to sign the contract was within the independent authority of Da Afghanistan Bank and so it was carried out.

### ***Receivership – the government finally meets the second expectation***

The conservatorship of Kabul Bank continued to drag on from September 2010 until early 2011 due to the lack of agreement amongst national and international financial institutions and the Afghan government. Receivership requires a petition to be filed to the Financial Disputes Resolution Commission, which places the receiver as the sole legal representative of the bank with all rights and powers of the shareholders, the Board of Supervisors, and the Board of Management, upon approval. The lack of agreement from elements in the Afghan government appear to relate to different factors, including a desire on the part of some to retain shareholders' interest and concern that the translation into Dari of the word receiver had negative connotations that would spark another run on the Bank.

The International Monetary Fund was insistent that receivership was required, and after a mission to Afghanistan issued a press release in February 2011 calling for receivership and the prosecution of involved individuals. By March 2011 these demands were still not met and the effects of not having an Extended Credit Facility Program in place mounted as the Afghanistan Reconstruction Trust Fund – a central source of donor funding – faced financial

pressure. These pressures were created because certain programs under the Trust Fund were tied to an Extended Credit Facility Program, and because some donors were withholding contributions, including a substantial contribution from the United Kingdom.

Finally, the President of Afghanistan announced on April 11, 2011 that Kabul Bank would be placed under receivership and that Kabul Bank management would face prosecution. On April 20, 2011, Da Afghanistan bank initiated formal receivership proceedings.

***Investigative Commission Evaluation of Kabul Bank Crisis – the government tries to meet the third expectation***

The third condition before an Extended Credit Facility Program would be approved by the International Monetary Fund related to an independent review of the Kabul Bank crisis, which proved to be a contentious issue based on the composition of the commission. In early 2011, the idea of a commission with international and national representation was being considered. However, on April 2, 2011 the President of Afghanistan appointed the head of the High Office of Oversight to report in a short period on the factors of the crisis and the government officials and foreign entities involved in Kabul Bank recklessness. The Investigative Commission was comprised of representatives from the High Office of Oversight, the Ministry of Justice, the Attorney General's Office, and the Ministry of Finance, but did not include any international representation.

On May 16, 2011 – only six-weeks after its establishment - the Investigative Commission delivered its report to the President, concluding that the Kabul Bank crisis resulted from shareholders' failure and neglect of laws, violations by Kabul Bank's governance boards, and the concealment of facts by Da Afghanistan Bank. The Commission blamed the ex-Governor and Da Afghanistan Bank for weak oversight in disregard of their duties despite warnings that Da Afghanistan Bank had received from the National Directorate of Security and the High Office of Oversight. The Commission also listed 200 people, including ministers who were allegedly paid to register salary accounts with Kabul Bank.

The Commission recommended that shareholders who repaid their loans from Kabul Bank should not be held criminally responsible. However, they stated that crimes were committed by officials from Kabul Bank and Da Afghanistan Bank, and international auditors and that they should be punished. The Commission's report contains an unsubstantiated suggestion that managers of Da Afghanistan Bank and Kabul Bank committed theft and may have taken bribes to present incorrect information to the government. The Commission recommended that the Directors of the Da Afghanistan Bank, Kabul Bank, and of foreign audit companies be investigated by the Attorney General's Office; and that borrowers who neglected receivership should have their property and assets seized.

After the Commission issued its report, it publicly announced that the President would decide who to prosecute based on their recommendations. When reportedly asked why the independent Attorney General's Office could not make such a decision, a Commission member and the head of the Attorney General Office's Monitoring of the Law Implementation Department replied that they would defer to the President.

## **k.) Efforts to recover missing money and assets**

### ***Who owes what?***

After Kabul Bank was put into conservatorship it was discovered that over 92 percent of the Bank's loan-book, or \$861 million, was extended to 19 related individuals and businesses ultimately benefiting 12 individuals, with the remaining \$74 million being extended to legitimate customers.

Of the related borrowings, the ex-Chairman was accorded a total liability of \$270.3 million, and \$94.3 million was assigned to the ex-Chief Executive Officer. Another 10 related individuals were assigned liabilities between \$43.6 million and \$1.7 million, totalling \$210 million.

Related party borrowings to companies with shared ownership include \$121.2 million for Gas Group, \$88.9 million for Pamir Airways, \$22.9 million for Zakhira, \$21.5 million for Kabul Neft, \$15.5 million for Corporative Hewadwal, \$16.8 million for Gulbahar Towers, and \$1.5 million for Ariana Steel.

### ***What is being done to get the money back?***

As detailed above, the Kabul Bank receivership is responsible for recovering assets owed to the bank by various beneficiaries. As of August 31, 2012,<sup>5</sup> \$128.3 million has been recovered in cash from repayment or the proceeds of selling assets. Receivership has recovered assets with a book value of \$190.6 million, though the actual amount of cash recovery from these assets is likely to be much less due to depreciation and the inflated price listed on Kabul Bank's books to allow beneficiaries to embezzle funds. Approximately \$62.8 million in discounts have been approved under legally binding agreements or decree.

#### Recoveries from Beneficiaries of Loans

Kabul Bank receivership has legally binding agreements with most debtors representing \$359.5 million, but the actual recovery of cash from these agreements has been extremely low amounting to only \$77.8 million being recovered from related parties. Normal customers have paid \$48 million, or nearly 40 percent of all cash recoveries, despite representing only eight percent of the loan balance of Kabul Bank at the time of receivership. Some individual debtors of Kabul Bank have repaid their principal amounts in full, but still dispute their liability for loans to buy shares or provide capital injections; other debtors are paying more or less according to the legally binding agreement, while some have rejected any liability for their debts, or have absconded.

Although some companies have repaid their loans, the recovery of other group loans has proceeded slowly, including Gas Group who has failed to pay according to its legally binding agreement and has paid only \$190,000 of \$121 million. The unresponsiveness of companies in repaying their loans often involves underlying disputes between shareholders about the true beneficial ownership – and therefore liability – of the company. The receiver intends to liquidate companies that do not repay their loans and may hold controllers of these companies liable where they allowed the company to receive funds from Kabul Bank without the intention of repayment.

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<sup>5</sup> The receiver is expected to issue an updated report at the end of November 2012.

The government has indicated that the option of legally binding agreements has been discontinued because of their poor performance. Instead, the President issued a decree in April 2012 providing debtors with amnesty from prosecution and forgiveness of interest payments if the principal loan amount was paid within two-months. This decree reportedly resulted in an additional \$30 million being paid in cash. However, there are legal concerns related to this decree, as the constitution and the laws of Afghanistan make it clear that the decision to pursue criminal charges is within the independent jurisdiction of the Attorney General and the authority to pursue financial recoveries is within the independent legal authority of the Kabul Bank receivership. The existence of specific laws in this regard means that the President likely does not have the legal jurisdiction to issue such an order, as it interferes with the independent discretion of legally competent institutions. Of additional interest, the main beneficiary of the Presidential decree is one politically exposed person who received interest forgiveness of \$18 million.

### Asset Recoveries

The Kabul Bank receiver has full authority to determine the manner and price at which assets of receivership are sold. However, the receiver has established an advisory committee composed of the High Office of Oversight, the Attorney General's Office, Da Afghanistan Bank, and the Ministry of Finance to provide advice and assessments of offers.

Assets with a book value of \$321 million have been identified as belonging to receivership, with \$190.6 million book value of assets under the control of the receiver. However, the expected recovery from these assets is only \$104 million due to depreciation and inflated purchase prices that allowed some beneficiaries to embezzle the difference between the loan amount and the actual cost of the asset. The \$128 million cash recovered by receivership as of August 2012 includes the sale of some assets.

Other assets are in the process of being sold, including 11 properties in Dubai valued between \$41.7 million to \$46.9 million, which have been transferred to receivership. These properties are being sold in batches to avoid flooding the real estate market. The first four have been listed, and two have received offers, exceeding the average valuation provided by five real estate agents. The receiver's advisory committee rejected one of the offers because the target price of the committee was not met. However, the advisory committee's target is at the top end of evaluations and is viewed by some as unrealistic. The deference to the advisory committee in this regard is an impediment to recovery and effectively transfers decision making responsibility from the legally competent receiver to a committee with no legal standing.

There are also several assets in receivership that have proven difficult to sell, including apartment buildings in Kabul and an oil storage facility that have been auctioned without any firm offers. The lack of offers is attributed to the reluctance of potential buyers to purchase assets tainted by the Kabul Bank crisis and reports that the former owner has directly interfered by contacting potential buyers to dissuade them from making offers. The sale of other properties has reportedly met with political interference.

Other assets are tied up in litigation, including land in Shar-e-Naw which is being disputed in court and Gulbahar Centre and Gulbahar towers which the receiver, through the Attorney General, has applied to the Supreme Court for an order directing monthly revenues to be assigned to receivership.

### ***The sale of New Kabul Bank can contribute to recoveries***

New Kabul Bank was created upon receivership with the Ministry of Finance as the sole shareholder and the former conservator of Kabul Bank as the Chief Executive Officer. The creation of New Kabul Bank will allow good assets to move from Kabul Bank to a clean bank, while the bad assets will remain with Kabul Bank receivership. Up until August 2012, the split between the good bank and the bad bank has been conceptual, as the division of assets is a lengthy process that requires detailed identification and assessment of assets. This process was substantially completed as of August 2012 paving the way for the sale of New Kabul Bank. Although many areas of Kabul Bank and New Kabul Bank have been split, some will only be separated at the time that the Bank is handed over to the successful bidder. The assets of New Kabul Bank will equal its liabilities, providing the buyer with a clean balance sheet. At this time, New Kabul Bank is restricted from conducting any lending activities that are not 100 percent secured through collateral, effectively eliminating its main stream for potential revenues.

The Afghan government approved the privatization of New Kabul Bank on June 11, 2012 and approved the action plan for the sale of New Kabul Bank on August 27, 2012. The Bank was offered to the market in the early fall of 2012, with a deadline of November 27, 2012 for expressions of interest and January 7, 2013 for formal bids. Evaluation of bids and Cabinet approval are targeted for March 7, 2013 and April 7, 2013 respectively. The Ministry of Finance has established a New Kabul Bank Privatization Steering Committee to oversee and implement the sale of the Bank. The Committee is responsible for the overall organization of the sale process and evaluation of applicants and bidders and the selection of the winning bid.

Despite rumours that old shareholders of Kabul Bank were organizing a bid for New Kabul Bank, the government has developed eligibility criteria for fit and proper bidders and shareholders in Kabul Bank (in receivership), their associates or proxies, senior management, persons in unresolved litigation with either Kabul or New Kabul Bank and persons still a borrower from Kabul Bank will be excluded from bidding.

To date there have been expressions of interest registered by one international and one national institution. Others have indicated their interest, but have not formally registered. Failing the identification of a suitable buyer, New Kabul Bank will be liquidated by the end of 2013.

#### **I.) Challenges to recovering money owed to Kabul Bank receivership**

##### ***Capacity***

Bank receivership is a novel concept and institution in Afghanistan, and like other new institutions, capacity is an ongoing issue. Receivership has been noted to be highly dependent on a few senior department heads and suffers from the inability to recruit sufficient numbers of skilled individuals due in part to uncompetitive salaries. There has also been a lack of an information technology system, which is being deployed with staff training.

Kabul Bank receivership has benefited from the assistance of asset recovery specialists from Kroll - the international audit firm that conducted the forensic audit of Kabul Bank. The team provided receivership with an asset recovery strategy in March 2012 and is currently

assisting with a liquidation plan, which the receivership unexplainably wants to present to the President for approval.

### ***Absence of requests for international assistance***

Hundreds of millions of dollars derived from Kabul Bank has been transferred out of the country electronically through transfers to the Shaheen Exchange and other international bank accounts; and cash smuggling facilitated by the use of Pamir Airways. The final destinations of these funds reportedly include the United Arab Emirates, the United States, Switzerland, and other unknown places.

There are multiple mechanisms to trace these funds to their final destination, and the ultimate beneficiaries, and to freeze associated accounts, which would be of great benefit to the civil recovery of funds and the criminal prosecution. However, international cooperation requires an active criminal investigation by the Attorney General's Office and a formal request under mutual legal assistance agreements, the United Nations Convention Against Corruption, or the United Nations Convention Against Transnational Organized Crime, both of which have been ratified by Afghanistan. The Financial Transactions and Reports Analysis Centre of Afghanistan has also faced difficulty in receiving responses to requests for intelligence sent through the Egmont Group because there was no criminal investigation.

Until very recently, the Attorney General did not take the necessary steps to secure international assistance. Letters were only recently sent to some countries, but these were deficient in that they only relate to the ex-Chairman and ex-Chief Executive Officer and do not include other debtors or beneficiaries.

### ***Disputes before the Financial Disputes Resolution Commission***

Further challenges in recovery relate to unsigned loan agreements and the refusal to accept responsibility for group loans or loans to companies with many stakeholders. There are also a large number of funds tied up with the dispute over shareholders loans, which are being contested because beneficial ownership of Kabul Bank has been transferred to the Ministry of Finance; or because the recipients argue that shareholder loans were components of other loans received by Kabul Bank.

Ownership and shareholder disputes of this nature often end up in the Financial Disputes Resolution Commission. The Commission is an independent administrative tribunal with exclusive jurisdiction under Afghan banking law to mediate disputed financial cases prior to judicial proceedings in the Supreme Court. The Commission is composed of three lawyers, and three professional accountants, with the Chair selected from one of the lawyers. The Commission only deals in civil remedies with issues of criminality being referred to the Attorney General's Office.

The Commission has resolved dozens of smaller cases related to Kabul Bank and has referred one or two to the Attorney General's Office. The biggest cases to date have involved a determination of the beneficial ownership of Gas Group and the soon to be determined shareholder liability. Gas Group loans amount to \$121 million and the shareholder disputes represent approximately \$150 million. The audit firm assisting receivership has provided significant support to assist the receivership in submitting disputes to the Financial Disputes Resolution Commission, along with the Attorney General's office and other law enforcement bodies.

### ***Political intervention***

The receivership of Kabul Bank has the legal authority to determine the manner and method of recovering money and assets, subject to the oversight of the independent Financial Disputes Resolution Commission. However, receivership's work has been directly and indirectly interfered with in at least two important ways. First, there has been direct political intervention caused by the Presidential decree of April 2012 that forgave interest and absolved some debtors of civil and criminal liability if they paid the principal of their loans during the redemption period. This decree is likely illegal as it purports to override the independent authority properly granted to receivership and the Financial Disputes Resolution Commission through legislation. This interference with the independent functions of receivership and the Commission introduced confusion about the roles of the two institutions, led to forgiveness of millions of dollars that were due to the receiver, and delayed other recovery efforts during the redemption period.

The second level of interference is of receivership's own doing and comes in the form of the advisory committee that it established. Again, the receiver has legal independence to pursue recoveries in the manner that he deems most appropriate. However, this authority has been effectively delegated to an advisory committee that has provided advice that the receiver acknowledges is not in the best interest of recoveries. Despite this, the receiver is reportedly reluctant to act because of an omnipresent and justified fear that acting outside of the advice of the advisory committee will open receivership to criticism within the Afghanistan government and potential investigation by law enforcement authorities.

More directly, the Attorney General's Office had begun to issue directions to receivership on the disposal of assets after an earlier Presidential decree issued on April 2, 2011, which instructed the Attorney General to oversee all Kabul Bank issues. This was rightly or wrongly, but certainly unlawfully, interpreted as authority to direct receivership in matters despite its legal independence which represents another major source of political interference. In July 2011, the Attorney General directed New Kabul Bank to provide the ex-Chairman and the ex-Chief Executive Officer with immediate access to Kabul Bank's system and documents so that they could assist the National Directorate of Security.

#### **m.) The criminal justice response to the Kabul Bank crisis**

##### ***Investigation***

Afghanistan criminal procedure makes the police responsible for the detection of crime and for the arrest of suspects. A criminal case report is then sent to the prosecutor who performs the investigation, with assistance from the police. An investigating prosecutor also has the authority to initiate their own investigation. If the Attorney General's Office initiates a complaint – or if a case is received from the police – an investigating prosecutor will conduct further investigation and perfect the file for submission to the Court.

Under the Afghan constitution, the filing of a case is the responsibility of the Attorney General's Office, who is independent in the performance of all functions. The prosecutor is bound to introduce criminal proceedings for all crimes known to him, unless otherwise expressly provided by law and cannot dismiss a case except in accordance with the law. The decision to investigate – and to lay an indictment – is a function that is to be completed independently of any outside influences and at the sole discretion of the investigating prosecutor.

It does not appear as though the police conducted any investigation into the events related to Kabul Bank and there are conflicting reports as to when the Attorney General's Office initiated a criminal investigation. There were some indications that the Attorney General's Office initiated an informal investigation in the fall of 2010. However, this investigation was not allowed to proceed and it was not until April 2011 when officials from the Attorney General's Office joined the Investigative Commission Evaluation of the Kabul Bank Crisis that any formal investigation was pursued. A criminal indictment was signed by senior officials at the Attorney General's Office in May 2011, but was not filed with the Supreme Court until June 2012, reportedly because of influence being exerted from high-levels. The filing of the criminal indictment followed only days after the expiration of the redemption period contained in the Presidential decree. The timing of the indictment fell within the lead up to the 2012 Tokyo conference meetings during a period when the Afghan government made several public announcements asserting their commitment to fighting corruption.

The Attorney General's delay in the investigating potential criminal activity at Kabul Bank and the manner that the investigation was ultimately conducted is of great concern. Reasonable grounds for an investigation may have existed after the Washington Post article in February 2010, but certainly existed after the fraud at Kabul Bank became clear in September 2010 and after the ex-Governor of Da Afghanistan Bank asked the Attorney General's Office to investigate in November 2010. Additionally, the Attorney General's investigation conducted in conjunction with the Investigative Commission Evaluation (appointed by the President in April 2011 to review the crisis) also seemed to be focused on Da Afghanistan Bank as opposed to some of the obvious beneficiaries of the Kabul Bank fraud. During this investigation, officials from the Attorney General's Office had approximately 30 individuals from Da Afghanistan Bank questionably arrested and detained.

### ***Serious Organized Crime Agency (United Kingdom)***

The Afghan government has sought to add credibility to its investigative and recovery efforts by touting the involvement of the United Kingdom's highly-reputable Serious Organized Crime Agency. However, a fuller understanding of their involvement is required to assess how much credence should be given to these attempts to project legitimacy into their investigations.

In May 2011, the ex-Governor of Da Afghanistan Bank requested the assistance of dozens of his central bank counterparts in detecting and freezing assets of the perpetrators and participants of the Kabul Bank fraud. It was reportedly clear to United Kingdom officials that Da Afghanistan Bank did not have a comprehensive understanding about international recovery and financial crime detection and investigation. The Serious Organized Crime Agency was solicited by the United Kingdom Ambassador to offer assistance to the Afghan government. Between July and December 2011 the Serious Organized Crime Agency repeatedly offered assistance to the Attorney General's Office, but this offer was not accepted until December 2011 and was limited to tracing of assets relating to the ex-Chairman and ex-Chief Executive Officer. The intention of the assistance was also to help law enforcement in Afghanistan to establish an international network to ensure that admissible evidence is collected for future prosecutions. Despite this engagement, the Serious Organized Crime Agency was not given permission by Da Afghanistan Bank to access and use the foundational forensic audit of Kabul Bank until February 2012. The

forensic audit firm now continues to provide assistance to the Serious Organized Crime Agency and has completed in depth analysis and tracing of funds sent aboard.

A major element of asset recovery is the identification of international assets through criminal law channels. This requires the issuance of mutual legal assistance request to jurisdictions in which assets are likely to be held or through which funds are laundered. Requests for mutual legal assistance are an essential requirement for the Serious Organized Crime Agency to fully assist the Attorney General's Office. The Attorney General is the only competent body to issue these letters, but as noted earlier in this report has been extremely slow to process these requests. Letters were only recently sent out in September 2012 to Switzerland, France, the United Kingdom and India requesting assistance pursuant to the United Nations Convention Against Transnational Organized Crime and the United Nations Convention Against Corruption. This is despite recommendations and benchmarks issued by the Independent Joint Anti-Corruption Monitoring and Evaluation Committee in July 2011, directing the Attorney General to freeze assets of major debtors in cooperation with foreign authorities.

The Serious Organized Crime Agency provided assistance in the initial development of assistance letters that were much broader, but the ultimate decision on content was made by the Attorney General's Office. Although the letters for international assistance will certainly assist in the criminal investigation, they were ultimately narrow in scope as they focus exclusively on the ex-Chairman and ex-Chief Executive Officer and their potential assets outside of Afghanistan.

### ***The criminal indictment***

As mentioned above, the President of Afghanistan issued a decree directing the Attorney General's Office to cooperate with the Kabul Bank receivership to adopt effective measures in order to retrieve outstanding loans from debtors in April 2012. The decree states that those who repay the principal of their loans would be free from interest payments and from criminal prosecution and warns that the cases of debtors who do not pay the principal of their loans must be referred to the Special Tribunal of the Supreme Court. This decree is a clear interference with the independent function of the Attorney General's Office to determine the suitability of criminal charges. Even worse, several sources have indicated that it was a high-level political committee that decided on who would be charged and what charges they would face and prosecutors from the Attorney General's Office were called in to construct the indictment to conform to the decisions taken by this committee. In June 2012, days after the two-month redemption period of the President's decree expired, the Attorney General indicted 21 individuals and named several others as persons of interest.

Despite explicitly stating that the indictment was developed on the basis of the Kabul Bank forensic audit, the indictment refers more extensively to the Investigative Commission on the Kabul Bank Crisis and aligns with its assessment of criminal responsibility. Of particular note is the inclusion of many Da Afghanistan Bank employees for concealment of crimes, without the indictment of the principal perpetrators. The indictment's focus on regulators as opposed to approvers and beneficiaries of Kabul Bank loans occurs despite the fact that the indictment clearly states that responsibility for the Kabul Bank crisis lies with individuals who sanctioned illegal loans; and those who received and used the money.

### Charges Against Kabul Bank Officials

The ex-Chairman and ex-Chief Executive Officer of Kabul Bank have been charged under the *Penal Code* for the misuse of authority, forgery, the use of counterfeit documents and opening accounts using pseudonyms. They are also charged under the *Anti-Money Laundering and Proceeds of Crime Law* with money laundering for alleged activities that include transferring funds to foreign countries. The ex-Chief Executive Officer has also been charged under the banking law for alleged investments in non-permissible areas.

The ex-Manager of the Loan Department, the Audit Manager, and another ex-employee of Kabul Bank were charged for the misuse of authority, the concealment of crimes, and embezzlement. The ex-Head of the Loan Department and member of the Management Board was charged for allegedly signing loans and the ex-Head of the Audit Department is being charged in relation to the alleged failure to detect illicit loans and to inform the relevant authorities. The ex-Head of the Information Technology Department, the ex-Head of External Relations, and two ex-employees of Kabul Bank are being indicted for the alleged misuse of authority.

Members of the Board of Supervisors, including the ex-Director of Pamir Airways, are charged with the abuse of authority, forgery, and failure to notify authorities. Another member of the Board of Supervisors is charged for allegedly failing to monitor internal operations and report breaches to Da Afghanistan Bank. The ex-Director of Pamir Airways is accused of signing counterfeit loan documents for unlicensed companies. He also allegedly processed and signed approximately \$12 million worth of loans to Pamir Airways. The ex-Operations Manager is also charged for allegedly signing loans to Pamir Airways and for opening, signing and processing loans to related persons, and loans against pseudonyms in violation of banking laws and the anti-money laundering law.

### Charges Against Officials from Da Afghanistan Bank

The former conservator of Kabul Bank and current Chief Executive Officer of New Kabul Bank was charged with the misuse of authority, embezzlement, and concealment, for allegedly allowing \$5 million to be transferred from the ex-Chairman's bank account during his oversight of Kabul Bank and not reporting it. The indictment accuses him of concealing facts, illegally transferring funds and being an accomplice.

The ex-Governor of Da Afghanistan Bank and the ex-First Deputy Governor are accused of facilitating, concealing and deliberately refraining from preventing the crimes of embezzlement, forgery, and money laundering despite frequent violations exposed by the Da Afghanistan Bank supervisory team. They are further accused of barring the High Office of Oversight from carrying out an investigation by presenting misleading reports; and by misrepresenting facts in order to mislead high ranking officials. They are also accused of neglecting to investigate the educational, social and work history of the ex-Chief Executive Officer and supervisory departments in accordance with the banking law.

The Director of the Financial Transaction Reporting Centre of Afghanistan, the Da Afghanistan Bank Heads of Monitoring, and the General Manager of Supervision are charged with the misuse of authority and concealment of crimes. The Director of the Centre is accused of refraining from sending reports of suspicious transactions to the Attorney General's Office. The heads of monitoring were accused of misuse of authority for not

sufficiently monitoring Kabul Bank's management and giving high grades to the liquidity ratio of Kabul Bank, which resulted in a grade increase.

#### A note on absconders

The indictment indicates that a variety of people are suspects, but were absent or missing during the investigation period. This includes Kabul Bank's ex-Deputy Chief Executive Officer, Kabul Bank's ex-Heads of Finance, Credit, Financial Risk, and Review; ex-members of Kabul Bank's Board of Supervisors and Management Board; the brother of Kabul Bank's ex-Chief Executive Officer; the ex-Head of Financial Supervision at the Da Afghanistan Bank; and one employee from Kabul Bank and one from Sherkhan Farnood General Trading. These individuals are the subject of investigation and potential charges.

#### ***Arrest and detention – where are they now?***

According to the information received there are five individuals in custody. This includes the ex-Chairman and ex-Chief Executive Officer who are in custody of the National Directorate of Security. Although the two detainees are permitted to attend to matters outside of detention, they have been in detention since July 6, 2011, which is contrary to legal requirements that cases be settled within 10-months. According to the law, the administration of the jail must notify the Attorney General or the Court of any detention that goes beyond nine-months and if there is no response the person is to be released. In June 2012, the National Directorate of Security sought direction from the Special Tribunal regarding the detention of the ex-Chairman and ex-Chief Executive Officer, but were simply advised by the Tribunal that the case was in process. The other three individuals in custody have been detained since June 2012, therefore, the statutory time limits have not expired.

As indicated above, many individuals who have been indicted or are of interest have fled Afghanistan. However, the Attorney General's Office seems to be predominantly fixated on the ex-Governor to the exclusion of others. The Attorney General's Office has sent numerous letters to Interpol in Afghanistan seeking the arrest of the ex-Governor through United States Interpol, but the Attorney General's Office has not submitted sufficient supporting documents. Furthermore, Afghan authorities were informed by United States Interpol that the ex-Governor was legally residing in the United States and could not legally be pursued or prosecuted. Afghan authorities were directed to use diplomatic channels to contact the United States Department of Justice if they wished to receive further legal assistance.

Interpol has also received other requests related to absconders, but there has been insufficient detail provided to Interpol to allow for identification and the Attorney General's Office has not aggressively pursued them. The situation of the ex-Chairman is of particular interest, since he is wanted in the Russian Federation on charges related to illegal banking activities. Russian authorities issued a notice about the ex-Chairman in July 2007, a copy of which was provided to Afghanistan Interpol. Interpol then forwarded the arrest warrant along with evidence to the Attorney General's Office, which was supplemented in July 2011 with more information from Interpol headquarters, yet no arrest has been made on these charges by Afghan authorities.

## **n.) Special Tribunal of the Supreme Court**

### ***Mandate***

The creation of the Special Tribunal of the Supreme Court was announced on April 4, 2012, to expedite Kabul Bank cases, and the recovery of outstanding loans from debtors. This was done under the authority of the *Law on the Structure and Jurisdiction of Courts*. On April 17, 2012, the Afghan President signed an order approving the Special Tribunal with the approval of the High Council of the Supreme Court. The Special Tribunal is composed of three sitting judges from the Supreme Court's National and International Security Tribunal; the Commercial Affairs Tribunal; and the Public Security Tribunal.

The Special Tribunal provides a specialized forum for the resolution of criminal and civil issues emanating from the Kabul Bank collapse and has all of the regular powers of the Supreme Court, including the power to order the confiscation of funds and property constituting the proceeds of an offence. The Tribunal provides an appeal function for Financial Disputes Resolution Commission decisions, and serves as the primary court for criminal cases brought by the Attorney General's Office.

As a branch of the judiciary, the Special Tribunal is independent in all of its functions and trials are to be held openly. Under Afghan law, the Special Tribunal is required to immediately order the commencement of a trial after receiving an indictment.

### ***Current activities***

To date, the Special Tribunal has not received any cases on appeal from the Financial Dispute Resolution Commission, but received the criminal indictment from the Attorney General's Office on June 2, 2012. The indictment has not proceeded substantially before the Special Tribunal, as the Tribunal initially elected to deal with the criminal case after all civil matters related to Kabul Bank were settled, which will take many months. However, in a complete turn-around, the Tribunal advised that it would deal with the criminal case without delay and held its first November 2012.

Regardless, the past activities of the Tribunal - including attempts to sort out issues of recovery by issuing *ad hoc* instructions to the receivership and New Kabul Bank; conducting extra-judicial inquiries into issues other than the case before it; conducting off-the-record meetings with shareholders and accused to encourage them to repay amounts owed - does not inspire confidence in the process.

The Tribunal has received petitions from Kabul Bank's former management and shareholders relating to issues that fall under the mandate of receivership. In response the Tribunal seems to have conducted its own extra-judicial investigation into the recovery of Kabul Bank funds. The Tribunal has sent multiple letters asking about the allocation of lender-of-last-resort funds and Kabul Bank assets; and conducting inquiries based on petitions from the ex-Chairman and ex-Chief Executive Officer, but not in relation to any case before it. It has also reportedly issued an order declaring that the Ministry of Finance, the Attorney General's Office, and other government ministries should auction all Kabul and Dubai based properties and give the proceeds to the receivership. This further demonstrates confusion about the appropriate roles of various institutions and the Court itself, as these activities fall under the purview of receivership and are already being undertaken.

In June 2012, the Special Tribunal indicated in a letter to New Kabul Bank that the Kabul Bank financial crisis was being investigated by the Court. The Special Tribunal was seeking information related to the dispensation of the lender-of-last-resort funds and the valuation of former Kabul Bank assets now in possession of New Kabul Bank. However, the Tribunal was not satisfied with the response from New Kabul Bank and took exception to the suggestion that the Tribunal did not have the mandate to retrieve debts, which fell within the purview of receivership. The Tribunal stated that the civil part of the case - the retrieval of loans – is also a part of their jurisdiction therefore the assertion that they did not have the mandate to deal with these issues was meaningless.

While it is true that the Tribunal has the final authority to decide on civil cases, these issues must be properly brought to the Tribunal according to legal procedures before they can be considered. In this case issues would come to the Tribunal on appeal from the Financial Disputes Resolution Commission, which in turn decided disputes from receivership. At the end of July 2012, the Tribunal was still seeking clarification from New Kabul Bank and had forwarded a petition from the Ex-Chief Executive Officer to the receiver. New Kabul Bank expressed their frustration with shareholder petitions being made directly to the Tribunal and the misplaced requests for information from New Kabul Bank on receivership related issues. In a September 2012 response to the Tribunal, New Kabul Bank informed the Tribunal that many of the issues they raised were within the mandate of receivership.

In terms of process, the Tribunal will try all individuals together despite the clear differences in their cases, which could prejudice some accused and interfere with their ability to present a proper defence. Concerns over the impartiality of the Special Tribunal have also been raised after the head of the Tribunal was quoted in a June 2012 interview commenting that the President and Vice-President's brothers had cleared all of their debts and interest and that the loans for shares was to be recovered. The repayment status and shareholder loans are issues that may come before the Tribunal at a future date.

#### **o.) Reforms being pursued since the collapse of Kabul Bank**

##### ***Capacity at Da Afghanistan Bank***

Da Afghanistan Bank conducted a lessons learned exercise in December 2010, shortly after the Kabul Bank crisis. The exercise highlighted weaknesses in the examination procedures and identified recommendations to be incorporated into an action plan. It found that different teams of the Financial Supervision Department were being shown the same inventory for different companies to verify collateral, calling for better coordination and information sharing.

Da Afghanistan Bank has developed a new organizational structure for the Financial Supervision Department and recently hired 14 additional staff with current vacancies to be filled by December 2012. However, they have had difficulty attracting qualified candidates.

In addition, the International Monetary Fund has provided training sessions covering licensing, reporting and auditing, capital, asset quality, management, profitability ratings, liquidity, fraud detection, early warning systems, anti-money laundering, credit ratings and risk management, and asset management liquidity risk management.

##### ***Enhanced supervision***

Da Afghanistan Bank's December 2010 lessons learned report recommended enhanced examination techniques to verify documents and business licenses and a stricter application

of the fit and proper test, and eligibility criteria for the chairman and management, which have been implemented by Da Afghanistan Bank. It also suggested that the enhanced examination also include discussions with the heads of all departments to avoid being manipulated by one individual as was the case with Kabul Bank, and deeper analysis of banking and accounting systems.

Da Afghanistan Bank has developed a work plan to strengthen enforcement regulations, has reviewed and amended the enforcement manual, is working to streamline examination and special supervision. Da Afghanistan Bank is also attempting to implement more timely and forceful enforcement actions, conduct regular reviews of compliance with recommendations, and issue time-bound enforcement letters. Da Afghanistan Bank will sign a memorandum of understanding with the Financial Transactions and Reports Analysis Centre of Afghanistan, and law enforcement authorities to better coordinate efforts in detecting and responding to unlawful banking activity.

Da Afghanistan Bank has completed prudential audits of 10 smaller banks with the technical assistance of the World Bank, which largely confirmed onsite examination findings that the sector is vulnerable to inadequate capital, deficiencies in governance, and excessive exposures. The World Bank is also supporting the automation of offsite supervision to enhance supervision capacity.

The banking law amendments being proposed by the government address corporate governance, capital, large exposures, related parties, consolidated supervision, early intervention, enforcement, bank resolution, and Islamic banking. It is expected that the revised banking law will be sent to Parliament by March 31, 2013, supported by amended regulations and informational circulars and trainings. Da Afghanistan Bank has published a circular clarifying the criteria that banks' shareholders and managers must meet in order to be fit and proper.

#### ***Strategy for combating economic crimes***

The Afghan government has indicated that it is developing an economic crimes strategy to be integrated into the Governance National Priority Program Five – *The National Law and Justice for All Program*. The strategy includes new legislation where necessary, specialized training, and better coordination among agencies responsible for financial supervision. The government committed to establish an interagency economic crimes task force to operate as a steering committee and to oversee the passage and implementation of new law.

## **IV. Conclusion**

The primary reason behind the Kabul Bank crisis is simple to identify. A group of shareholders and related parties capitalized on the regulatory vacuum in Afghanistan by using a scheme to recklessly divert Afghans' savings to their own personal and business ventures. Everything else that has happened since are simply compounding factors that allowed the fraud to continue and for the perpetrators and participants to escape any form of accountability or justice.

Some of the factors that contributed to this circumstance are specific to the financial sector and Kabul Bank, while others are much broader and are symptomatic of graver issues facing

Afghanistan. Specific factors relate to banking governance in Afghanistan, the capacity of Da Afghanistan Bank, and coordination amongst regulatory bodies and law enforcement. Systemic issues facing Afghanistan relate to the inability of national and international governments to deliver and develop capacity in regulatory environments, the inability of institutions to understand and implement their mandates, political interference in the independent function of public bodies created to safeguard the public interest, impunity for powerful Afghans, and scapegoating of the less powerful through abuse of process and abuse of office.

Resolving the specific issues is important, because there are indications that other banks in Afghanistan also suffer from weak governance and management; conflicts of interest; excessive loans to related individuals and companies; and improper reporting. However, resolving the broader concerns is of the greatest importance to Afghanistan, as one has to be concerned about how the issues related to Kabul Bank transpire in other regulatory or justice related contexts.

***Specific issues – good governance, regulatory capacity and oversight***

Corporate governance refers to the structures and processes for the direction and control of companies and covers the relations among the management, board of directors, controlling shareholders, minority shareholders, and other stakeholders. Good corporate governance practices were insufficiently embedded into the core of Kabul Bank management and financial supervision, allowing for fraudulent activities. In the case of commercial banks, management and supervision should be strictly separated to minimize the probability of fraud, and significantly increase the probability of its detection.

The institutional framework supported with legislative framework was developed with international assistance applying benchmarks from developed countries. Da Afghanistan Bank operated in a legal framework consistent with standards of developed countries and there are no significant loopholes in the legislation that could be considered instrumental for regulatory failure. Newly established institutions, however, lacked necessary capacity to effectively implement the institutional and legal requirements and did not receive adequate support from the international community.

Da Afghanistan Bank clearly had insufficient supervisory capacity both in terms of manpower and necessary expertise in areas of financial analysis, audit procedures and information technology. The lack of capacity was most pronounced in the area of fraud detection and the support of international advisors was still insufficient to address the functional gaps that existed. Problems with lack of capacity were exacerbated with distress in the banking system that preceded the collapse of Kabul Bank. The collapse of the Development Bank of Afghanistan in November 2008 apparently shifted the regulatory priorities away from Kabul Bank.

Although Da Afghanistan Bank was unable to discover the full extent of fraudulent activities, it was consistently revealing regulatory breaches, which were a consequence of illicit banking activities, including corporate governance, liquidity risks, and loan administration. This means that Da Afghanistan Bank was aware that Kabul Bank operated in violation of sound banking practices and that – considering that the Bank's assets expanded at a very fast pace – the magnitude of financial risk kept growing.

Da Afghanistan Bank did attempt to use regulatory levers to make Kabul Bank comply, but never used the full extent of their powers until Kabul Bank was made to go into conservatorship and the ex-Chairman and ex-Chief Executive Officer were made to resign. However, Da Afghanistan Bank had sufficient knowledge and grounds to take stronger regulatory action against Kabul Bank much earlier. Given recurrent deficiencies detected in the areas of corporate governance, liquidity risks, and loan administration, and the fact that rapid expansion of Kabul Bank's loan-book led to continuous requests for recapitalisation of the Bank, it was evident that risks were accumulating to unsustainable levels. Moreover, the level of diversification of Kabul Bank's loan-book was very low. This feature of the Bank's assets could have been observed regardless of the fact that the true recipients of funds were skilfully concealed. One effective measure – if it were allowed to proceed without political interference – would have been for Da Afghanistan Bank to consider imposing a moratorium on lending until corrective measures were fully implemented. Such a measure would not prevent well-concealed fraudulent activities in general, but would clearly prevent risk from cumulating within fast-growing balance sheet and contain the extent of the problem. Regulators around the world – especially in emerging financial systems - are generally reluctant to enforce severe corrective measures due to potential disruptions that public revelations of such measures could trigger in financial markets with low levels of confidence and severe problems with the asymmetry of information. In such circumstances some degree of automaticity in the application of simple and preventive enforcement measures can compensate for lack of regulatory experience.

Some government officials have been eager to blame international advisors and audit firms for the crisis, even suggesting that they be pursued in civil and criminal courts. Without offering an opinion about whether such action is justified, it appears in hindsight that there were opportunities for the advisors and auditors to have taken further action on fraud indicators, or to pursue their work with more diligence and depth. That being said, it is not clear that stronger action would have resulted in identification of the fraud because the central bank was already aware of the allegations and was attempting to find it, but could not. The audit reports produced in the last two-years of Kabul Bank's operations were very standard and a reflection of the industry practice, which admittedly would benefit from being more extensive and detailed. Even though standards require audit firms to consider fraud, without deeper investigation than is the norm in regular audits, it is improbable that fraud would have been detected. A bank that knows the audit industry, standards, procedures, and depth of investigation could easily mislead auditors, making the probability of detection very low. The Kabul Bank auditors met minimal standard procedures and the results were minimal.

### ***Systemic issues – political interference and impunity***

Institutions are established with independence to ensure that they have room to operate outside of politics and can protect the public interest, but institutions have simply not progressed that far in Afghanistan and are beholden to politicians and vested interests. This problem goes both ways. There are independent institutions that delegate their authority upwards by unnecessarily deferring to high officials; and there are institutions that are directly interfered with by political interests. For example, the Kabul bank receivership has delegated its authority in some areas to an *ad-hoc* committee to the detriment of recoveries. On the other side, there has been clear and direct interference with the criminal process by

high-ranking officials that goes so far as to identify who should, and who should not, be indicted for criminal conduct.

It is important to note that the intention behind actions that lead to political interference is not clear. For example, the Presidential decrees that appear to be illegal, and interfere with the mandates of several independent institutions, were done in such a public manner that they are either misguided or callous. The Independent Joint Anti-Corruption Monitoring and Evaluation Committee cannot offer an opinion, but it makes no difference, because the fact that it has happened and its effect is enough to call for intervention. Interference with the work of public bodies is an issue that this Committee identified as areas of concern in its recommendations and benchmarks in November 2011.

Of great concern is the level of impunity that has been facilitated by the Afghan justice system. The lack of action from the Attorney General's Office also because of political influence has resulted in a lack of investigation, procedural delays that have allowed perpetrators to escape and likely for money derived from Kabul Bank to be lost forever. The narrow focus of the Attorney General's Office has allowed participants to escape criminal scrutiny, while many of the primary actors carry-on their business in Afghanistan without fear of ever being held accountable, not to mention prosecuted. On the other-hand, the Attorney General's Office appears to be focused on individuals from regulatory institutions that do not seem to have played any role in perpetrating the Kabul Bank fraud. Conversely, most appear to have been attempting to fulfil their functions in good faith under difficult circumstances. This focus to the exclusion of others is difficult to reconcile with what is known about the events related to Kabul Bank today.

The criminal indictment – with its shortcomings – was a major achievement in the pursuit of justice in the Kabul Bank fraud. However, this achievement is threatened to be squandered by the unexplainable functioning of the Special Tribunal designated to hear the case. The Tribunal appears to have been engaged in everything else except the processing of the one case they have before it, contrary to the most basic principles and laws related to fundamental justice. Even the recent criminal proceedings at the Tribunal do not wholly satisfy concerns about whether justice will prevail in the Kabul Bank case.

Although the specific issues related to Kabul Bank are of fundamental importance to the financial sector and the country and must be resolved, the systemic issues are of existential importance to the future of Afghanistan and touch on all aspects of the development effort. If the systemic issues raised by Kabul Bank are not resolved, the viability of Afghanistan as a fully functioning democracy is lost.

## V. Recommendations

### **Governance**

1. The Government of the Islamic Republic of Afghanistan should ensure the adoption of legislation establishing the institution of an Ombudsman who will ensure protection of human rights and liberties, initiate procedures to ensure that laws and administrative decisions, including presidential decrees, comply with the constitution of Afghanistan; review the independence of quasi-governmental institutions, including their exercise of discretionary powers, and the avoidance of undue political influence; and who will report directly to Parliament. The Ombudsman should have statutory investigative powers sufficient to compel oral and documentary evidence.
2. The heads of independent quasi-governmental organizations should undertake training at the beginning of their appointment regarding administrative independence, the appropriate use of discretion, and inappropriate government interference or influence.
3. The Government of the Islamic Republic of Afghanistan should ensure adoption of a law regulating financing of political parties and electoral campaigns to ensure that all political contributions are transparent and reported to the public.
4. The Government of the Islamic Republic of Afghanistan should ensure adoption of legislation that will enhance whistleblowing, protect whistleblowers from adverse consequences of their disclosures, establish whistleblower and witness protection programs, and protect public officials from criminal and civil liability or adverse employment action when conducting official duties in good faith.
5. The Government of the Islamic Republic of Afghanistan should ensure the establishment of an institute of directors of companies to develop and monitor standards for corporate governance in order to ensure that all corporations are governed professionally.

### **Regulatory environment**

6. The Government of the Islamic Republic of Afghanistan should establish a self-governing professional accounting and auditing body wherein all the accountants and auditors get their licenses and which can take disciplinary action. This body should establish requirements for education and should establish accounting and auditing principles that will govern every industry. This body should regularly monitor adherence to these principles and should create a public registry of all audit and accounting companies that are licensed and in good standing.
7. The Government of the Islamic Republic of Afghanistan should establish requirements for economically important companies and institutions to develop and publish annual reports, including audited financial statements prepared according to the standards set by the professional oversight body, three-months after the end of their fiscal year.
8. The Afghanistan Investment Support Agency should make additional data related to registered companies available to the public online, including complete information related to the companies owners and management teams.

## ***Supervision and enforcement***

### *Capacity*

9. The Financial Tracking and Reports Analysis Centre – with the assistance from the international community – should develop mechanisms, including information technology, that would allow it to proactively monitor all banking transactions and to be automatically and immediately notified of suspicious transactions and large cash transfers. The appropriate legal requirements for this new function should be clearly set-out in Financial Tracking and Reports Analysis Centre’s constituting legislation.
10. Da Afghanistan Bank – with the assistance from the international community – should implement a program for supervisory capacity building particularly focused on fraud detection, financial analysis, and monitoring of bank information systems tailored to the level of development of the financial system in Afghanistan. Furthermore, special attention should be devoted to monitoring of the effectiveness of the supervisory process and prompt planning of changes to the system, if required.

### *Cooperation*

11. The Financial Tracking and Reports Analysis Centre and the Financial Supervision Department of Da Afghanistan Bank should vigorously implement their memorandum of understanding to share information more effectively, particularly in relation to the results of bank examinations and suspicious transactions or large money transfers.
12. Da Afghanistan Bank should establish a financial irregularities working group to share information and coordinate detection and enforcement efforts. This group should consist of the Financial Supervision Department, the Financial Tracking and Reports Analysis Centre, National Directorate for Security, the High Office of Oversight, the Attorney General’s Office, and police.
13. The Government of the Islamic Republic of Afghanistan should develop formal procedures for cooperation between Da Afghanistan Bank, the Ministry of Finance and the government in case of financial crisis. The procedures should outline the divisions of responsibilities and cost sharing between the central bank and the Ministry of Finance when the severity of the crisis requires government intervention.

### *Governance*

14. The Government of the Islamic Republic of Afghanistan should ensure adoption of bankruptcy legislation that details procedures and terms of financing bank collapses, including the activation of lender-of-last-resort facilities. The legislation should clearly delineate responsibilities of all institutions, including potential financial liabilities, and provide a certain degree of automation to increase the expediency and transparency of the process.
15. Da Afghanistan Bank should review caps on the amount of money that it approves for disbursement through borders to ensure that proper banking channels are used.
16. Da Afghanistan Bank should set industry and sector wide exposure limits for banks.
17. Da Afghanistan Bank should strictly adhere to all legislative requirements for licensing and approving shareholders, management and supervisors of banks.

18. Da Afghanistan Bank should limit shareholdings of banks to 10 percent holdings per person or group of related persons.

#### *Reporting*

19. Da Afghanistan Bank should develop standards – in terms of format and content - and procedures for financial reporting in banks in order to increase the efficiency of information collection in the supervision process.
20. Da Afghanistan Bank should prepare guidelines for commercial banks in the areas of internal audit and risk management, focusing on efficient communication between the internal audit departments, risk management departments and supervisory boards with the aim to promptly identify all risks.
21. Da Afghanistan Bank should develop standards of reporting on international financial transactions that would enable prompt monitoring of international financial flows on monthly basis.

#### *Lending and credit files*

22. Da Afghanistan Bank should make it mandatory that proceeds of a loan account can only be transferred to a seller by way of check or wire transfer.
23. Da Afghanistan Bank should ensure that all deposits held at commercial banks are insured.
24. Da Afghanistan Bank should require all corporate borrowers to furnish tax returns and audited balance sheets to the lending bank, which should be retained and available for review by Da Afghanistan Bank examiners.
25. Da Afghanistan Bank should establish guidelines restricting bank shareholders from directly approving loans and prohibiting related persons from approving loans to themselves.

#### *Enforcement*

26. The Government of the Islamic Republic of Afghanistan should ensure amendments of the banking laws of Afghanistan to incorporate a degree of automation in the implementation of enforcement action to remove the inherent reluctance of regulators to implement severe corrective measures.

#### ***Investigation and law enforcement***

27. The Attorney General's Office should send expanded mutual legal assistance requests to include all current debtors and beneficiaries of Kabul Bank funds.
28. The Attorney General's Office should consider initiating a criminal investigation to determine if criminal charges are warranted against other shareholders of Kabul Bank, employees of Pamir Airways, accounting firms used by companies receiving loans from Kabul Bank, government staff who may have fraudulently registered companies, and anyone else, if appropriate.
29. The Attorney General's Office should document the outcome of all criminal investigations in writing, particularly those recommended above, providing clear and transparent rationale for decisions to lay charges or not.

30. The Attorney General's Office – with support from the international community – should establish a capacity building program for prosecutors to enhance its ability to conduct special investigations and incorporate intelligence led criminal investigations.
31. The international community should support a capacity building program to provide training for prosecutors in criminal procedure, the United Nations Guidelines on the Role of Prosecutors (1990) and Handbook on Practical Anti-Corruption Measures for Prosecutors and Investigators (2004).
32. The Attorney General's Office should enhance standards for writing indictments and the laying of criminal charges to ensure that unified standards on prosecutions, especially in highly demanding cases of economic criminality, will be applied throughout the country.
33. The Attorney General's Office should immediately review the status of people currently in detention in relation to Kabul Bank to ensure that their detention is lawful.
34. The Attorney General's Office should create and maintain a central repository for the registration of all criminal investigations, charges, and outcomes in the country that can be accessed for legally authorized criminal background checks.
35. The Attorney General's Office should better coordinate the exchange of information with Interpol through a memorandum of understanding.
36. The Attorney General's Office should consider using the police more fully and effectively for the collection of evidence, including the full participation of the Major Crimes Task Force.
37. The Government of Islamic Republic of Afghanistan should develop legislation to extend the application of special investigative techniques to cover a wide range of serious offences and to provide competent agencies with appropriate means and training in order to make the system of special investigative techniques work efficiently in practice.
38. The Government of Islamic Republic of Afghanistan should ensure adoption of legislative measures to ensure that legal entities can be held liable for criminal offences committed for their benefit by any person who has a leading position within that entity. Liability should not exclude criminal proceedings against the people who perpetrate, participate, or act as accessories to the criminal offences.

### ***Judicial proceedings***

39. The Special Tribunal should focus on processing the criminal charges in the Kabul Bank indictment and should cease all extra-judicial activities, including those related to the recovery, until such time as those issues are brought properly before the Tribunal. All proceedings of the Tribunal should be on the record, except where the laws of Afghanistan provide otherwise.
40. The Special Tribunal should ensure that it has financial expertise available to assist it in analysing financial data, or other technical issues.
41. The Special Tribunal should appropriately scrutinize charges brought by the Attorney General's Office related to Kabul Bank, particularly charges against regulators; and should ensure that the rights of the accused are sufficiently safeguarded.

42. The international community should support a judicial capacity program to provide training for judges in criminal procedure and the principles of fundamental justice, and the United Nations Universal Declaration of Human Rights, International Covenant on Civil and Political Right, and the Bangalore Principles of Judicial Conduct.
43. All courts and administrative tribunals should conduct their proceedings publicly and should publish their judgments, including the Financial Dispute Resolution Committee.
44. The Government of the Islamic Republic of Afghanistan should ensure adoption of a law that provides for administrative decisions, including presidential decrees, to be exposed to judicial review by individuals having a direct and substantial interest, or who can satisfy a court that it is in the public interest to do so.

### ***Recoveries***

45. Kabul Bank receivership should make decisions based on economic considerations and should more fully exercise its discretion in selling property where recoveries would be strengthened, despite any external advice, and should be protected from investigation or prosecution for decisions made in good faith.

### ***Sale of New Kabul Bank***

46. New Kabul Bank should be sold in strict adherence with the action plan approved by the Council of Ministers to ensure that parties associated with Kabul Bank do not exercise ownership or management in the new bank.

### ***Monitoring and reporting***

47. Within 60-days of the issuance of this report, the Government of the Islamic Republic of Afghanistan, Da Afghanistan Bank, and other affected institutions should provide a written response to the Independent Joint Anti-Corruption Monitoring and Evaluation Committee indicating their intention to implement the recommendations of this report, and timelines for doing so.
48. The Government of the Islamic Republic of Afghanistan, Da Afghanistan Bank, and other affected institutions should respond to the Independent Joint Anti-Corruption Monitoring and Evaluation Committee's requests for progress reports in a timely manner.

## Annex I: Letter Requesting that the Committee Conduct a Public Inquiry

جمهوری اسلامی افغانستان  
وزارت مالیه



د افغانستان اسلامي جمهوریت  
د مالیې وزارت

2012/6/2

Seema Ghani  
Executive Director  
Independent Joint Anti-Corruption Monitoring and Evaluation Committee (IMEC)  
House #30, Park Street, Shahre Naw, Kabul, Afghanistan

Dear Ms. Ghani:

As you are aware, Afghanistan signed an agreement with the International Monetary Fund (IMF) in November 2011 re-establishing the IMF program that had been suspended in September 2010. It had been suspended due to the emergence of the Kabul Bank Crisis as a challenge to the macro-fiscal stability of the country. The November 2011 agreement contains a number of benchmarks aimed at addressing the institutional weaknesses uncovered by the Kabul Bank Crisis.

One very important benchmark calls upon IMEC to produce a report for public release, examining the circumstances of the bank failure, and assessing the government's response to it. Specifically, the IMF benchmark requires the following:

The independent Monitoring and Evaluation Commission will conduct an in-depth public inquiry to examine the events leading to the Kabul Bank crisis, starting with the inception of the bank, and look into the operations of the bank, activities of its shareholders, the role of supervisory and auditing bodies, and the subsequent effectiveness of the government and the criminal justice system in dealing with any crimes committed.

As the designated representative of the Government of Afghanistan with respect to implementation of the commitments made by Afghanistan to the IMF, I request that IMEC commence this very important work on behalf of the country as soon as possible. The deadline agreed with the IMF for release of this report is 30 September 2012. Consistent with its mandate, IMEC should conduct this inquiry independent of government interference or opposition, and reach its own conclusions. We will do everything possible to facilitate IMEC's access to information regarding the matter.

Sincerely,

Dr. Omar Zakhilwal  
Minister of Finance  
Islamic Republic of Afghanistan

## Annex II: Terms of Reference for the Kabul Bank Inquiry

WHEREAS, in August 2010 significant public concerns were raised that the Kabul Bank did not have assets to meet its liabilities;

WHEREAS, the Government of the Islamic Republic of Afghanistan (the Government) provided Kabul Bank with significant budgetary support to meet Kabul Bank's financial obligations;

WHEREAS, there have been allegations that the collapse of Kabul Bank was caused by a variety of factors including fraud; inadequate oversight and accountability; and a weak regulatory environment;

WHEREAS, despite multiple investigations and audits conducted by a variety of institutions there has never been a full public assessment of the facts related to the establishment of the Kabul Bank, the activities that led to its collapse, and the adequacy of the response to the crisis;

WHEREAS, the Independent Joint Anti-Corruption Monitoring and Evaluation Committee (the Committee) was established by the international community and the Government as an independent body mandated to monitor and evaluate the Government and the international community's efforts to combat corruption;

WHEREAS, the Government and the International Monetary Fund agreed in the *2011 Article IV Consultation and Request for a Three-Year Arrangement Under the Extended Credit Facility Country Report* that it is desirable for the Committee to conduct a public inquiry into the Kabul Bank collapse aimed at making recommendations to address the failings that may have occurred;

AND WHEREAS in a letter dated June 2, 2012 the Minister of Finance for the Government asked the Committee to undertake such an inquiry, which was accepted by the Committee;

THEREFORE, pursuant to the authority contained in the Committee's terms of reference:

### Establishment of the Public Inquiry

1. The Committee will conduct an in-depth public inquiry commencing on July 12, 2012 in an expeditious manner and will deliver its final report and recommendations to the Government, the International Monetary Fund, and the public.

### Mandate

2. The Committee will inquire into:
  - a. the events leading to the Kabul Bank crisis starting from the inception of the Kabul Bank to the present, including the operations of the bank, activities of its shareholders, the role of supervisory, auditing, and advisory bodies; and
  - b. the subsequent appropriateness, effectiveness, and timeliness of the response of the government, the central bank, and the justice system for the purposes of safeguarding the financial sector, to deal with governance issues, and to uphold Afghan lawin order to increase public awareness, transparency, and confidence; and to make recommendations to protect the financial sector and prevent similar events in the future.

3. In its report the Committee will not assign any form or level of guilt on any individual.

### Powers and Procedures

4. The Committee will:
  - a. conduct research and collect information, including conducting interviews;
  - b. consult, in private or in public, with persons or groups; and

- c. receive oral and written submissions.
5. The Committee will first review and consider any relevant records or reports; and will rely wherever possible on existing reports and written statements submitted to the Committee. The Committee may consider such reports and records instead of calling witnesses.
6. The Committee will determine whether a person or institution can participate in the public inquiry and the manner and scope of the participation.
7. The Committee will rely wherever possible on representative witnesses on behalf of institutions and will rely on representative organizations to represent the public interest, or the perspective of civil society.
8. The Committee may give directions necessary for an in-depth inquiry and may invite a person or a representative of an institution to,
  - a. attend the public inquiry to provide testimony; and
  - b. produce any information, document or object under the person or institution's power or control.
9. The Committee will ensure that the report is available in Dari, Pashto, and English.

### **Resources**

10. The Committee may retain such experts or staff it considers necessary to perform its duties.
11. The Committee will use all legal means to promote accessibility to and transparency of the report of the inquiry to the public.
12. Afghan ministries, agencies, boards, commissions and independent institutions and the international community are invited to assist the Committee to the fullest extent so that the Committee may carry out this public inquiry.

## Annex III: Summary of Events

Date	Event
June 2004	Kabul Bank is licensed by Da Afghanistan Bank.
June 2005	Da Afghanistan Bank rejects Alliot Gulf Limited as independent auditors for Kabul Bank for the year ending March 31, 2005.
August 2005	Da Afghanistan Bank approves KPMG as independent auditors for Kabul Bank.
September 2005	Bearing Point is contracted by the United States Agency for International Development to build supervisory capacity at Da Afghanistan Bank.
December 2005	Kabul Bank advises Da Afghanistan Bank that KPMG is too preoccupied to conduct the independent audit and resubmits Alliot Gulf, which is rejected by Da Afghanistan Bank.
2006	Financial Transactions and Reports Analysis Centre of Afghanistan is established.
February 2006	Behl, Lad, and Al Sayegh Chartered Accountants are approved as independent auditors for Kabul Bank after satisfying Da Afghanistan Bank inquiries.
March 2006	Da Afghanistan Bank issues a plan to take corrective action for Kabul Bank.
April 2006	Four new shareholders buy in to Kabul Bank, including the ex-Chief Executive Officer.
	Behl, Lad, and Al Sayegh are rejected for the 2005-2006 Kabul Bank audit despite doing the one for the year before. They are eventually approved after receiving additional assurances. They are used until the year ending December 31, 2008.
August 2006	Da Afghanistan Bank defers decision to approve the Kabul Bank Chief Executive Officer until Kabul Bank complies with several central bank directions.
2007	Nine new shareholders join Kabul Bank, including politically exposed persons.
February 2007	The first onsite examination of Kabul Bank is conducted with assistance of Bearing Point.
April 2007	Da Afghanistan Bank raises concern that Kabul Bank's Chief Security Officer was acting as the Deputy Chief Executive Officer without approval and directs him to stop.
	Da Afghanistan Bank issues a warning letter.
May 2007	Da Afghanistan Bank changes their opinion about the Deputy Chief Executive Officer, advising that Kabul Bank's Chairman is entitled to appoint employees of the Bank without Da Afghanistan approval.
	Da Afghanistan Bank conducts a special examination.

Date	Event
<b>September 2007</b>	Kabul Bank makes its first payment to a Kabul accounting firm that provided false statements to the Bank.
<b>November 2007</b>	Record of examination notes several issues in governance, loan file, and Bakht accounts.
<b>January 2008</b>	The ex-Governor of Kabul Bank is appointed.
	Da Afghanistan Bank requests biographical and financial information for most of Kabul Bank's shareholders.
	Da Afghanistan Bank issues corrective action against Kabul Bank.
<b>March 2008</b>	Kabul Bank independent auditors Behl, Lad and Al Sayegh are replaced by AF Ferguson and Company due to a Da Afghanistan Bank requirement that independent auditors be form one of five approved firms.
<b>May 2008</b>	Record of examination notes several issues in governance, loan file, and Bakht accounts.
<b>July 10, 2008</b>	The ex-Chief Executive Officer assumes his role as Chief Executive Officer without a Da Afghanistan Bank interview.
<b>November 2008</b>	Bearing Point discontinues participation in onsite bank examinations.
<b>December 2008</b>	Record of examination notes issues in governance, loan file, and Bakht accounts.
	Da Afghanistan Bank orders corrective action.
	AF Ferguson conducts the independent audit of Kabul Bank for year ending December 31, 2008 and provides a clean opinion.
<b>2009</b>	Ex-Chief Executive Officer becomes a qualified shareholder and submits personal and financial data for Da Afghanistan Bank review, but there is no evidence that any review was undertaken.
<b>January 2009</b>	The ex-Governor sends a letter to Chief Executive Officers of all commercial banks advising them to refrain from participating in elections and to reign in expenditures.
<b>June 2009</b>	Da Afghanistan Bank issues a plan to take corrective action.
<b>August 2009</b>	Deloitte acquires Bearing Point and comes under contract with United States Agency for International Development to provide supervision capacity building at Da Afghanistan Bank.
	Special examination of Kabul Bank.

Date	Event
<b>October 19, 2009</b>	The United States Embassy in Kabul notifies the State Department in Washington, DC that Pamir Airlines is being used to move money from Afghanistan and that the ex-Chairman of Kabul Bank owns several properties in Dubai.
<b>October 20, 2009</b>	The National Directorate of Security advises Da Afghanistan Bank of information pointing to serious concerns at Kabul bank.
<b>November 2009</b>	The ex-Governor advises Deloitte of serious concerns regarding Kabul Bank.
<b>Late 2009</b>	Financial Transactions and Reports Analysis Centre of Afghanistan receives reports that Kabul Bank is moving money out of the airport and an unsuccessful sting operation is conducted.
<b>January – March 2010</b>	Da Afghanistan Bank performs a regular onsite examination of Kabul Bank, but examiners did not identify the fraud at Kabul Bank.
<b>February 10, 2010</b>	AF Ferguson conduct independent audit and provide a clean opinion.
<b>February 22, 2010</b>	A Washington Post article cites insider lending abuses and possible purchase of Dubai real estate with funds from Kabul Bank.
<b>February 24, 2010</b>	Ex-Governor and the International Monetary Fund meet and agree that a forensic audit of Kabul Bank is required.
	Ex-Governor writes to the President pleading for him to meet to discuss sensitive banking issues, indicates that he has been trying to reach the president for several months and that Afghanistan's banking system was at risk.
<b>March 4, 2010</b>	United States Treasury Department Assistant Secretary wrote to the ex-Chief Executive Officer highlighting the need for Kabul Bank to comply with the law.
<b>March 29, 2010</b>	Ex-Governor sends a request for technical assistance to the United States Treasury Department after unsuccessful attempts to secure the President's acquiescence.
<b>May 2010</b>	The President of Afghanistan affirms support for the forensic audit of Kabul Bank.
<b>June 6, 2010</b>	Da Afghanistan Bank passes a resolution prohibiting shareholders from holding top management positions and from constituting the majority of the Board of Supervisors within nine-months.
<b>July 2010</b>	The ex-Chairman went to the United States government to reveal fraud at Kabul Bank after it became clear that he was going to lose control of the Bank to an adversarial group of majority shareholders.
<b>August 2010</b>	The United States government advises the ex-Governor that Kabul Bank ownership had split into two antagonistic groups, with the Chief Executive Officer leading a group attempting to remove the ex-Chairman.
	Ex-Governor demands the resignation of ex-Chairman and ex-Chief Executive Officer.

Date	Event
<b>September 1, 2010</b>	There is widespread civil disorder as depositors run on Kabul Bank to retrieve their savings.
<b>September 5, 2010</b>	The Afghan government restores order by announcing that all deposits will be guaranteed. Da Afghanistan Bank puts Kabul Bank into conservatorship.
<b>September 5, 2010</b>	Da Afghanistan Bank sent an official letter to the City of Kabul demanding that it monitor properties in the capital owned by major Kabul Bank shareholders.
<b>September 5, 2010</b>	Ex-Governor wrote to the Deputy Minister of Interior, Kabul Bank Airport, seeking a travel ban for some Kabul Bank employees who are Indian citizens.
<b>September 7, 2010</b>	Ex-Chairman informs Da Afghanistan Bank of his personal holdings and guarantees that they will be transferred to Kabul Bank,
<b>September 8, 2010</b>	The ex-Governor wrote to the President highlighting that the ex-Chairman and the ex-Chief Executive Officer were a flight risk and sought permission to have them detained.
<b>September 15, 2010</b>	Key shareholders sign a letter indicating that they will work with the monitoring team of Da Afghanistan Bank to recover the amounts owing.
<b>September 19, 2010</b>	Da Afghanistan Bank sends letters in an attempt to freeze shareholder assets to Independent Local Government Directorate and to the heads of commercial banks in Afghanistan.
<b>September 2010</b>	The United States Agency for International Development, the United States Treasury, the International Monetary Fund, the World Bank, and Deloitte participate in the Financial Sector Working Group to coordinate a response to the crisis.
<b>September 2010</b>	International Monetary Fund Extended Credit Facility Program expires and is not renewed until key demands are met, including a forensic audit, an independent review of the Kabul Bank crisis, receivership and criminal prosecution.
<b>September 2010</b>	Forensic audit tender process is completed, but the Afghan government will not approve.
<b>October 10, 2010</b>	Da Afghanistan Bank passed a resolution setting out qualifications for the Boards of Supervisors and clarifying the definition of fit and proper to be a bank shareholder or administrator.
<b>October 30, 2010</b>	Conservator reports that Kabul Bank has serious issues and notes multiple violations of the law. Recommends that the Bank be put into receivership.
<b>April 2011</b>	The ex-Governor writes to many of his central agency counterparts around the world asking them to freeze assets of the shareholders and Kabul Bank loan beneficiaries.
<b>April 2, 2011</b>	The President of Afghanistan appoints an investigative commission to be led by the high Office of Oversight to investigate the causes of the Kabul Bank crisis.

Date	Event
April 11, 2011	President announces that Kabul Bank would be put under receivership.
April 15, 2011	The Attorney General's Office joins the Investigative Commission Evaluation of Kabul Bank.
April 20, 2011	Da Afghanistan Bank officially initiates receivership proceedings.
April 27, 2011	The ex-Governor appears before parliament and reads a list of names of people who defrauded the Kabul Bank and recommended prosecution, including politically exposed persons.
May 2011	An international forensic audit firm is selected by Da Afghanistan Bank to conduct the forensic audit of Kabul bank.
May 2011	Shareholders become aware of the ex-Governors efforts to freeze their accounts and the ex-Governor is confronted by some.
May 2011	Senior officials from the Attorney General's Office sign the original criminal indictment, but it is not filed with the Court.
May 16, 2011	The Kabul Bank Crisis Investigative Commission delivered its report after six-weeks of work. The report concludes that the crisis was caused by shareholder's failure and neglect of laws, violations of governance boards, and concealment of facts by Da Afghanistan Bank. A member of the commission – Head of the Attorney General Office's Monitoring of the Law implementation department states that the President will decide who to charge.
June 2011	The ex-Governor made his last speech to parliament and flees to the United States.
June 27, 2011	The ex-Governor issues his resignation stating that Da Afghanistan Bank's independence was compromised, issues were being politicized, and necessary reforms were rejected making it impossible to continue.
July 2011	The Serious Organized Crime Agency (United Kingdom) extends an offer of assistance to the Attorney General's Office to assist with international criminal cases to assist recovery.
July 6, 2011	The ex-Chairman and ex-Chief Executive Officer are detained for Kabul Bank related offences.
November 14, 2011	Extended Credit Facility Program for Afghanistan is approved by the Board of the International Monetary Fund after the key conditions of a forensic audit and receivership are met.
December 2011	The Attorney General's Office accepts the offer of the Serious Organized Crime Agency (United Kingdom).
March 14, 2012	The forensic audit report was submitted.

Date	Event
<b>April 17, 2012</b>	Special Tribunal of the Supreme Court established.
<b>April 2012</b>	The President issues a decree that allows debtors to repay the principle of their loans and have interest forgiven and protection from prosecution.
<b>June 2, 2012</b>	The Minister of Finance asks the Independent Joint Anti-Corruption Monitoring and Evaluation Committee to conduct a public inquiry into the Kabul Bank crisis.
<b>June 2012</b>	The Attorney General's Office indicts 21 people mostly from Kabul Bank and Da Afghanistan Bank.
<b>August 2012</b>	The split of good assets and bad assets is substantially completed clearing the way for the sale of New Kabul Bank.
<b>August 31, 2012</b>	Kabul Bank receivership reports that \$128 million in cash has been recovered, and assets with a book value of \$190.6 million have been recovered.
<b>November 14, 2012</b>	The Special Tribunal holds its first hearing into the Kabul Bank criminal case.
<b>November 15, 2012</b>	Independent Joint Anti-Corruption Monitoring and Evaluation Committee adopts the report of the public inquiry into the Kabul Bank crisis.

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