

DRAFT 22 JUNE 1991

XX June 1991

RA Barnes Esq
Assistant Director and Head
Of Banking Supervision Division
Bank of England
LONDON EC2R 8AH

Dear Sir

REPORT ON SANDSTORM SA UNDER SECTION 41 OF THE BANKING ACT 1987

In connection with our audit of Sandstorm SA ('The Company') and its related articles, including Sandstorm Holdings ('Holdings') and Sandstorm Overseas ('Overseas'), together with the Sandstorm Group ('Sandstorm', 'The Group' or 'the bank'), for the year ended 31 December 1988 certain irregularities were drawn to our attention and to that of the Bank of England ('The Bank') by
In January 1991.

In accordance with your letter of instruction of 4 March 1991 we have prepared a report on these irregularities and related matters which have come to our attention during the course of our work. This comprised work in connection with the audit of team, which included partners and staff of Price Waterhouse, review of correspondence and other files previously held by and interviews with senior management.

Many of the findings summarised on this report arise from examination of documentation and interviews with former management by members of the investigation team. Whilst the findings are inevitably based on incomplete information, and certain details have not been corroborated, we believe that the enclosed report provides a fair reflection of what has occurred, although detailed analyses of specific transactions given in this report should be treated with care. Work by the investigation team is continuing and it is expected that many of the matters reported will be refined further as this work progresses.

It should be emphasised that much of the information contained in this report is based on records which have previously been concealed from us, as auditors, and only came to light as a result of our insistence on the files of being sealed, such records having been in his personal possession.

The particular matter drawn to the Bank's attention by concerned potential deposits of approximately \$600 million not recorded in the books of the Company or any of its related entities. Our work to date, has confirmed that at least the major element of these deposits appear to be valid facilities of the Company or its

XX June 1991
 RA Barnes Esq
 Page 2

related entities. The Government of Abu Dhabi has issued to Holdings a comfort letter of \$600 million in the event that these liabilities become repayable, as part of a package of financial support arrangements concluded in May 1991.

The accounting records and financial position of the Group has been falsified in relation to the above transactions for a substantial number of years. In fact these transactions represent only a part of a wholesale deception to misrepresent and falsify the financial position of Sandstorm over the last decade through a series of complicated manipulations. These include the use of a related bank (Fork Overseas), which now appears to have been controlled by Sandstorm management nominee and hold harmless arrangements with a substantial number of prominent Middle Eastern Individuals: the irregular use of funds placed under management the formation of a significant number of companies and operation of bank accounts outside the Sandstorm Group used to disguise the nature of transactions and route funds: the creation of a further 70 or so companies to assist in the financing of agreements and unrecorded borrowings through third party banks and investment institutions : and a significant falsification of the accounting records (involving false loans, transactions and confirmations) on such a scale that the true financial history of Sandstorm is unlikely to be able to be recreated.

In order to place the unrecorded deposits in context we have briefly summarised the history of Sandstorm and the manner in which deception on such a scale was achieved with reference to some of the major customers and shareholder arrangements and relationships. Our report is divided into the following sections

- 1 History and Current Status of the Problems
- 2 Shares and Capital Notes
- 3 Routing arrangements
- 4 Treasury
- 5
- 6 WXYZ
- 7 Unrecorded deposits – Tumbleweed and others
- 8 Unrecorded deposits – Islamic banking

In addition, we have prepared a separate report for the Board in respect of our concerns in relation to Fork and its relationship which we enclose.

Please let us know if we can be of any further assistance

Yours faithfully,

REPORT ON SANDSTORM SA
UNDER S 41 OF THE BANKING ACT 1987

CONTENTS

	Pages
SECTION 1: HISTORY AND CURRENT STATUS OF PROBLEMS	1 – 11
SECTION 2: SHARES AND CAPITAL NOTES	12
SECTION 3: ROUTING ARRANGEMENTS	13 – 14
SECTION 4: TREASURY	15 – 21
SECTION 5:	22 – 24
SECTION 6: WXYZ	25 – 31
SECTION 7: UNRECORDED DEPOSITS – TUMBLEWEED AND OTHERS	32 – 36
SECTION 8: UNRECORDED DEPOSITS – ISLAMIC BANKING	37 – 44
APPENDIX I - HISTORY OF EXPOSURE	
[APPENDIX II] - HISTORY OF SANSTORMS' RESULTS	
APPENDIX III- STATEMENT BY OF FICTITIOUS PROFITS AND LOSSES	

	Exposure at 29.12.1990 \$ m	Estimated losses \$ m
<u>Company A1</u>		
- fictitious loans set up in connection with repurchase of shares	213	213
- extensive account manipulation resulted in misappropriation of deposits. When these had to be made good, fictitious loans were created.	135	135
- in 1985 deposited \$100 million to be invested in Sandstorm shares on a guaranteed return basis. The shares were transferred and the deposit was misappropriated. On 'disposal' and repayment the bank created these fictitious loans.	154	154
- owned by Fork through nominee shareholdings. Whilst had certain operative accounts, these accounts are non-operative and contain fictitious transactions and charges.	92	92
	<u>594</u>	<u>594</u>
- most of lending is non recourse. Significant nominee arrangements And hold harmless letters, including Arrangements of uncertain legality In relation to purchase of and Significant use of nor recourse Accounts for debt servicing: Routing of internal and external funds: and share transactions.	442	412 (highly uncertain)

	Exposure at 29.12.1990 \$ m	Estimated losses \$ m
- Appears to have acted in a nominee capacity in respect of SDCC (a UK bank) and as well as WXYZ.	249	199 (highly uncertain)
KIFCO - a non consolidated affiliate. Exposure relates to parked Loans to avoid provisioning and fictitious loans for debt servicing.	125	125
Other - largely accounts of no commercial substance set up for debt servicing.	201	201
	<u>1,017</u>	<u>937</u>
Total Company A1	<u>1,611</u>	<u>1,531</u>
	—	—
<u>Company B</u>		
	21	15
- exposure significantly understated due to the use of external funding.	783 (200) Provisions	
	<u>583</u>	513
	—	
Other - miscellaneous bad lending and accounts that have been manipulated. Some recovery prospects.	548 (136) Provisions	
	<u>412</u>	222
	—	
Total Company B	<u>1,106</u>	<u>750</u>
	—	—

Unrecorded deposit liabilities

1.18 As alleged by there appear to be material deposit liabilities not recorded in the books of any of the Sandstorm entities. At 31 December 1990 these totalled approximately [\$300 million] and it is clear that there have been significant 'out of book' deposits of fluctuating material amounts for the last ten years.

1.19 These unrecorded deposit liabilities fall into three categories:

	<u>\$ m</u>
(1) Unrecorded deposits which can be Linked back to treasury activities In the early 1990's (Tumbleweed and)	442
(2) Unrecorded deposits arising from account Manipulation in Islamic Business Unit (IBU) in UK Region during 1990	85
(3) Unrecorded miscellaneous deposits	42
	—
	569
	—

1.20 The Government of Abu Dhabi has issued a comfort letter to the Bank indicating that it will reimburse Sandstorm to the extent that these liabilities are proven to be liabilities of Sandstorm.

1.21 These matters are discussed in Sections 7 and 8 of our report, where with the exception of the miscellaneous items we conclude that these items appear to be genuine liabilities of the bank.

Fork

1.22 We have reported to the directors of Sandstorm our concerns about the relationship between Sandstorm and Fork and about the involvement of Fork in the transactions which have financial implications for Sandstorm. A copy of our report of 16 June 1991 is enclosed as an attachment to this report and includes examples of such transactions initiated by Sandstorm management. The information in the report is derived from a review of correspondence and other files held by [redacted] and from interviews with him and [redacted]. We have also had preliminary discussions with members of the investigation team who have recently visited Grand Cayman as part of the Sandstorm investigations.

Responsibility for and knowledge of the irregularities.

Management.

1.23 From the investigation work it is apparent that the senior management of Sandstorm have abused their responsibilities to depositors, shareholders, investors, regulators and to the bank itself. The strategic decisions to manipulate accounts, and in particular how to make use of the Fork relationship, the funds placed with Fork and the value within the shares of WXYZ are clearly those of [redacted] and [redacted].

1.24 The inflation of Treasury profits and use of unrecorded deposits by [redacted] to have been the sole responsibility of [redacted], however, it seems more likely that [redacted] was responding to the expectations of [redacted] and [redacted] particularly as in other areas, eg there is evidence that [redacted] was instrumental in account manipulation as far back as the late 1970's.

1.25 █████ surrounded himself with a core team who were largely responsible for the xxxxxx and falsification of documentation and fraudulent account entries and funds xxxxx as follows:

- * █████ (General Manager of █████ from 1986)
- █████ (account officer for WXYZ and █████)
- * █████ (account officer for Tumbleweed)
- * █████
- █████ (account officer for major customer accounts)
- █████ (account officer of █████ until he left in 1986: paid \$1.7 by █████)
- █████ (responsible for the banks relationship with █████ - left the bank in 1990)
- █████ (account officer for █████ and █████ now left the bank and received \$0.3 million)
- █████ (Head of █████ and General Manager of █████ up to 1986)
- █████ (General Manager of █████ until 1990)

*Currently employed by Sandstorm as part of the 'Advisors' office, the purpose of which is to assist the investigation team with its enquires.

1.26 From the scale and complexity of the deception it is clear that most of the senior management of the bank, who as noted were (and remain) extremely loyal to █████ and were or should have been aware of certain elements of the fraud. Many simply followed instructions they should have questioned. Failure to do so appears to have arisen from a blind loyalty to █████ and █████ brought about by the cultural background where it was unthinkable to question either █████ or █████ . It is also noteworthy that most of the senior management have been provided with significant loans from the bank which on the basis of previous experience are not necessarily repayable on leaving employment.

1.27 We have particular questions concerning the existing senior management of Sandstorm as listed below. We have not yet, however, interviewed all of them to obtain their version of events. Many of these senior executives have followed instructions from █████ apparently without question and many others are likely to be similarly implicated:

- █████ █████ (1) There is evidence of his approval of certain questionable transactions booked through the accounts of █████ and used to repurchase Sandstorm's shares from █████ Although his Knowledge of the transactions █████ Concerned is uncertain. █████ appears

to have accepted instructions in respect of this matter from [redacted] without question.

(2) Over the period from April 1990 to December 1990 we believe that [redacted] had substantial, if not full, knowledge of all the matters dealt with in this report, yet did not disclose them, even in response to direct questions, until much later.

(3) Over the last year he has given additional responsibilities to various individuals, including some of those listed below, who appear to have been involved in fraudulent transactions.

[redacted] General Manager [redacted]
Involvement in questionable transactions including nominee shareholdings, Fork loans and false confirmations.

[redacted] Joint executive for Asia/Middle East formerly general Manager for [redacted].
False accounting for loans subsequently found to be part of exposure.

[redacted] [redacted]
(1) Appears to have controlled Nominee share transactions particularly In the name of [redacted] booked in Fork.

(2) Involvement in side agreements under Which Sandstorm capital notes are Repayable on demand/

[redacted] General Manager [redacted]
Was the General Manager of [redacted] for the period [1984] to 1990 when raising funds was most significant.

[redacted] UK Region
Property transactions with [redacted] booked In the name of nominees. Misrepresentation with respect to Beneficial ownership.

[redacted] General Manager [redacted]
(1) On instructions from [redacted] created fictitious customer loans to cover up misappropriated funds in 1990.

(2) Responsible for the [redacted] and account officer for [redacted] and [redacted]

■■■■ Manager ■■■■ Now with ■■■■ n Lansen.
Now xxx ■■■■ Falsified audit confirmations.

■■■■ General Manager ■■■■ Creation of fictitious loans to
■■■■ finance nominee shareholdings in
an affiliated company in Thailand
during July 1990.

■■■■ Central Office Booking transactions in Fork.

■■■■ Legal Department Creating of fraudulent agreements.

1.28 The management of Fork, notably ■■■■ have also been integrally involved in the improper transactions and nominee arrangements: but inform us that everything they did was at the request of ■■■■ and ■■■■ .

Directors.

1.29 In the light of the scale and complexity of the deception it is difficult not to conclude that the Board failed to discharge its responsibilities properly. Nevertheless there is no indication with the possible exception of ■■■■ that the present Board of Directors was aware of the major irregularities within the Bank and it is clear that it has been consistency provided with misleading and inaccurate financial and other information. The Board had not been informed of the xxxxx harmless or nominee arrangements, or the bank's and its management's true relationship with a number of major customers and shareholders.

1.30 ■■■■ was a director from 1986 to 1988 and is implicated in irregular transactions relating to the purchase of his own shares in Sandstorm and CCAH.

1.31 All major loans had to be approved by the Board, but it appears that a significant number of xxxxxxxx went to the Board for approval after disbursement of funds and thus effectively avoiding its control. However, there is little evidence that the Board took any effective action to limit or reduce the exposure to individual customer groups, or monitor the implementation of the Credit Policy. Limits were often increased after the event without insistence on effective recovery action.

1.32 Overall the Board appear to have been taken in by and trusted, dominant and deceitful management, in the form of ■■■■ and ■■■■ .

Shareholders

1.33 The relationship between ■■■■ and ■■■■ latterly ■■■■ with the major shareholders, being the Ruling family of Abu Dhabi, goes back a substantial number of years, and has been a very close one. ■■■■ and subsequently ■■■■ acted as the Ruler's personal investment advisor and had his power of attorney. The extent to which ■■■■ was aware of the matters discussed in this report cannot be established. We are, however, informed that ■■■■ were briefed fully on all the problems in April 1990, notwithstanding that they allowed the 1989 accounts to be finalised in discussions with ourselves and the Regulators without disclosing this information. In addition, up until discussion of our Report to the Directors and Regulators of 3 October 1990. ■■■■ contended that the loans for collections by the shareholders' which have now been proven to be totally fictitious, were recoverable.

- 1.34 We have discussed with [redacted] his own accounts with Fork which show that the received funds in 1988 and earlier from transactions purporting to be dealing with Sandstorm shares where it now is apparent that he had no risk of loss. He has confirmed that he has benefited from such transactions arranged by [redacted] and that in April 1990 he informed other senior government officials of his involvement. We are unable to establish the extent to which his position in relation to [redacted] and [redacted] may have been compromised as a result of these transactions but we have become aware of his confirmation of what has now been revealed to be a fictitious loan in the name of the [redacted]. He could not recollect signing the confirmation that was presented to him [redacted] and suggested to us that his signature might have been forged.
- 1.35 We have also seen circumstantial evidence of a proposed share transaction with [redacted] in 1981 on a guaranteed return basis: and an 'out of book' loan from [redacted] in 1985 to finance the [unauthorised] buy-back of shares from [redacted].

SECTION 2: SHARES AND CAPITAL NOTES

- 2.1 Sandstorm was established in 1972 with an original share capital of \$2.5 million. Through a number of scrip and rights issues this had increased to \$8.5 million at 31 December 1990. It appears that over the bank's history extensive use has been made of nominee arrangements to finance these increases in share capital. Shareholdings appear to have been financed both directly by loans from Sandstorm and Fork, and also from accounts and companies under the control of and . The use of nominee arrangements through Fork entities has enabled Sandstorm to disguise the beneficial ownership of shares and has also provided a pool of shares for setting guaranteed yield obligations and other adjustments, including the generation of funds from share trading.
- 2.2 Some shareholders, including acquired shares on the basis of guaranteed rates of return and others acquired their shares on the basis of buyback arrangements. These seemed to have been a practice to gain the favour of influential people in the Middle East. There is a risk that remaining shareholders may make claims in respect of losses incurred on Sandstorm shares which were purchased by them on the basis of buyback or guaranteed rate of return, and to date one such claim has been made by a former shareholder.
- 2.3 Investigation work continues in this area but as at 31 December 1990 some four million shares (\$40 million nominal) are effectively owned by Sandstorm or Fork through a number of nominees, including and . We are informed that other nominee shares were purchased by and during 1990. If all these purchases were those of nominees, which may well have been the case, it would appear that some 45% of the share capital of Sandstorm was in the hands of nominees at 31 December 1989, whilst a further 11% was owned by Fork entities.
- 2.4 There is evidence that holders of capital notes entered into side agreements with Fork which provided for repayment on demand instead of in accordance with the terms of the capital note issue. There exists the possibility that the remaining note holders have entered into similar arrangements.

SECTION 3: ROUTING ARRANGEMENTS

- 3.1 's office in London was the source of instructions for the movement of funds in order to cover the exposures on loan accounts. These routings transactions were effected by the 'special duties' department on the instructions of and through a number of bank accounts including those controlled by at Fork.
- 3.2 From the routing bank accounts already identified it is possible to see that the initial transactions took place on a small scale in 1981 and remained fairly insignificant until 1984. Transactions appear to have ceased by 1990, with the exception of some accounts at controlled by of Fork which were used until [September 1990].
- 3.3 The level of activity reached its peak in 1985 when some \$1.6 billion was passed through bank accounts on the instructions of members of the special duties department. This seems to coincide with the disclosure of the increasing difficulties on the Treasury activities.
- 3.4 The end of the year 1986 also appears to have been a turning point in the method of operation of routing accounts with a significant reduction in activity passed through affiliated banks.
- 3.5 Funds were needed to manipulate the records of loan accounts as well as to make good the deficiencies of the treasury operations and it seems that to some degree these two problems were separately managed. A close relationship with Companies enabled the 'special duties' department to open accounts in customers names at a number of banks including BCP Luxembourg, . To date eleven such accounts have been identified but available documentation remains patchy and further accounts may well exist. Proper account opening forms and confirmatory letters of payment instructions were procured from in order to avoid any suspicion about the purpose and nature of the transactions.
- 3.6 Aside from these bank accounts, the 'special duties' department also needed to generate transactions for other customer loan accounts. Relationships were established with BCCI executives at other locations who would pass payments across their nostro accounts apparently without the need for a full customer mandate. These transactions were generally effected by tested telexes using the BCCI London test key or on the basis of personal telephone calls from members of the department. These arrangements with BCP Zurich, BCCI Spain – Madrid, KIFCO and National Bank of Oman and SDCC were made possible by the knowledge that they originated from the highest levels within the Bank and no doubt the staff felt that they were proving an essential service to . The recording of these transactions appears to have been irregular and they were either not entered in the ledgers or effected by single aided, but compensating entries.
- 3.6 Transactions passing through Spain, Kuwait and Oman all appear to have been identifiable to the ultimate beneficiary of the funds, however, transactions through BCP were marked 'PAY WITHOUT MENTIONING OUR NAME' with the result that the recipient was unable to identify the source of funds.
- 3.7 Accounts operated by management of Fork add a further dimension to these routing arrangements. Accounts were opened at BCP Luxembourg, and in the name of Fork 'client accounts' or in the name of companies which had come under the control of Fork management. It appears that almost all transactions were sourced by memo's or telephone calls from the 'special duties' department to who would instruct payments to be made by Fork staff in Cayman, or on the basis of

telephone calls to the branch managers. would, if needed, then visit Switzerland to sign confirmatory letters covering the execution of transactions.

- 3.8 The ability of the 'special duties' department to undertake transactions of this nature was undoubtedly facilitated by the corporate culture of the Group, and a general belief expressed by a number of those involved that whatever was being undertaken by had to be in the best interest of the Bank.

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SECTION 4: TREASURY

Background

- 4.1 Central Treasury was a division of the Head Office of Sandstorm Overseas. It was set up in London in 1982 to provide a centralised and coordinated vehicle for the investment of surplus funds generated by Sandstorm worldwide. On a day to day basis investment and liquidity management services were rendered within prescribed guidelines to Treasury by the central support office in London.
- 4.2 Treasury activities fell into two distinct functions:
- The investment function which traded in CD's, treasury bonds and various dealing activities: and
 - The liquidity management function which utilised surplus liquidity generated by the BCCI group. Any funds in excess of the investment requirements were placed on the inter bank market. The liquidity management functions were performed through the London Branch of SA under the overall direction of a manager within the Treasury.
- 4.3 Treasury activities were managed up until 1985 by who was also responsible for the branch of Sandstorm Overseas, which managed the accounts of a number of significant customers and shareholders. A Treasury Committee including and was set up to monitor treasury activities. The effectiveness of the treasury committee appears to have been compromised since these activities continued to be accounted for as part of the branch and was never called to account for treasury results separately. Because he appeared to be generating significant profit his activities continued in an uncontrolled manner, and he was given increased responsibilities in the use of all surplus Sandstorm funds for trading and investment purposes.
- 4.4 appears to have developed close links with a major customer of the bank. it appears that made funds available to for trading purposes on a profit share basis, in return for which he allowed to use his name and that of his companies and to be used for trading for the account of Sandstorm. traded in a number of markets, including commodities, futures and options, and to disguise the nature of his activities, he split Treasury into two as follows
- Normal treasury activities, as described above.
 - Number two account activities, which appear to have been carried out in the name of particular clients. These activities were physically segregated, performed by different staff and outside the scope of external audit on the basis that they were for the account of private clients. In actual fact, appears to have been trading in the name of private clients but for the account of Sandstorm. In so doing he exposed Sandstorm to significant risks and lost considerable sums of money.
- 4.5 Through false accounting using number two account funds, supplemented profits by the normal trading activities. In order to satisfy profit targets, created a number of pool accounts in the name of which used deposits credited to clients accounts,

loans drawn down in the name of xx xxx are xxxx xxxxxxxx xxxxxxxx's unrecorded deposits and certain external funds. Xx xxxxxxxx was xxxxx to segregate xxxxxx funds from those of Sandstorm.

- 4.6 reported increasing profits, particularly in the early 1980's. But in reality xxxxxx incurred significant losses on option and futures trading. From investigation work to date it appears that wrote options towards xxxxx ends and incorrectly accounted for the premium income. At the level of xxxxxxxx losses increased. Treasury staff appear to have written further options to conceal these losses and generate fictitious profits. When losses were incurred on closing out the positions they were not booked against the profit and loss account, but instead against client accounts, bogus loans or the other unorthodox sources of funding noted above. This activity appears to have been particularly prevalent in the years 1982 to 1985.
- 4.7 In late 1985 the IML requested a review of central treasury activities by the auditors. Management requested PW Cayman to carry out this work who in turn called on us for assistance. We discovered that significant losses were being incurred on option and futures trading but were not properly recorded. The exposure on loan contracts was considerable⁴ and significant losses were incurred in closing out the xxxxxxxx. We have formed the conclusion that the accounting methods adopted were due to incompetence. However, the benefit of hindsight, it appears more sinister in that it now seems to have been a deliberate way to fictitiously inflate income. As part of the review we did not examine accounting for closed contract of previous years since no significant losses appeared to have occurred – again with hindsight we now know that such losses were being incurred as noted above.

Methods of concealment of treasury losses

- 4.8 Investigation work to date has indicated that used a variety of techniques to fund and conceal the true nature of the transactions undertaken. These include:
- misappropriation of deposits with depositors knowledge to provide funds to adjust non-performing and bogus loan accounts and Treasury issues.
 - misappropriation of external funds deposited under trust with Sandstorm and Fork to be managed on behalf of a few prominent people who are the shareholders of Holdings.
 - the creation of loans with no commercial substance in the names of people without their knowledge.
 - getting certificates of deposit with the Central Treasury (without informing the depositor), and using the proceeds to fund adjustments.
 - Routing funds through Fork, BCP, KIFCO, SDCC and other affiliates and third parties freely by to make adjustments prior to accounting reference dates and audit confirmation dates, which are often reversed at a later date.
 - Maintaining a pool of funds in the private named accounts of which were used freely by to fund adjustments. The funds were never those of alone: his name appears to have been used only to classify the accounts as being for the general funding activities of the Treasury Division.

- 4.9 [redacted] left Sandstorm in 1986 shortly after the discovery of losses on option trading. He subsequently provided [redacted] with a statement in which he set out the losses he had apparently incurred in earlier years from treasury trading activities which he had effectively hidden from Sandstorm management together with a significant xxxxxxxx of the xxxxxx of Treasury activities. The inflation of profits was particularly significant in 1982, 1883 and 1984 when fictitious profits were supposedly \$108 million, \$136 million and \$234 million respectively. The full statement is attached in Appendix III. For the period 1977 to 31 December 1985 [redacted] claimed that the total amount of these losses/fictitious profits was \$633 million but this is before adjustment for losses of \$225 million booked in the 1985 accounts as a result of our treasury review.
- 4.10 Whilst the details of [redacted] statement are incapable of confirmation because the records from these earlier years are sparse and incomplete. It is clear that there was a major misappropriation of funds and falsification of accounting records in the early 1980's.
- 4.11 [redacted] took certain documents relating to his management of Treasury with him when he left. In 1985 he used this information to blackmail Sandstorm, which paid \$12 million to prevent him disclosing the true nature of the activities of Treasury Division. We have had no access to [redacted] who is currently [redacted] or any of the executive involved in the day-to-day management of Treasury under him.

Funding of treasury losses

- 4.12 On the basis of [redacted] own calculation of the accumulated losses concealed by him (including his assessment of the funding xxxxx), of \$849 million his fraudulent activities up to early [redacted] appear to have been financial xx xxxxx. This analysis should be treated with caution because we have not been able to identify a number of the components.

Funds utilised

			<u>\$ m</u>
Unrecorded deposits			400
Fork managed funds			250
WXYZ secured loans			126
BCC Emirates	:	deposits	80
		CD's	<u>78</u>
			138
Fork loans			94
Other loans	:	[redacted]	80
		Others	<u>110</u>
			190
[redacted]			80
BCP Luxembourg deposits			35
Other			<u>15</u>
			1,318
<u>Funds xxxxxx</u>			
Losses/fictitious profits			349
Loans adjusted			348
SDCC			62
Pxxxxxxxxx			38
Other			<u>21</u>
			1,318

Unrecorded deposits

4.13 In part funded his activities through 'out of book' deposits (which as explained in Section 7, form the basis of the unrecorded deposits at 31 December 1990).

4.14 Review of the Treasury pool accounts has indicated that certain deposits placed with Sandstorm and its affiliates, were routed into these accounts without being recorded as deposits by Sandstorm. Treasury appear to have used these deposits as free funds, with repayments and interest funded principally from the pool accounts themselves. The level of these unrecorded deposits appears to have fluctuated from \$32 million in 1982 to over \$800 million in 1984. The reduction to \$400 million in February 1985 was achieved through the increased use of external funds under management of fork entities made available by .

4.15 The make up of such unrecorded deposits at this time as summarised by was:

	<u>\$ m</u>
Tumbleweed	246
████████████████	61
██████████	45
██████	24
██████	18
██████████	6
	—
	400
	—

4.16 The Tumbleweed and deposits, remain as unrecorded liabilities at 31 December 1990 and to the current date, as discussed more fully in Section 7. The other deposits have since been reinstated and repaid.

WXYZ secured loans

4.17 By June 1985 the level of fictitious profits funded by adjustments was assumed to be over \$820 million. There also appears to have been a need to service xxxxxx in the books of Sandstorm (and Fork) at this time. As a result loans of \$225 million supposedly secured on the shares in WXYZ were drawn down in June 1985 in the name of:

	<u>\$ m</u>
████████	47
████████	31
████████	37
████████	10
████████ - numbered A/C	88
████████	8
████████	11
████████ - ██████████	<u>14</u>
	246
	—

4.18 These funds were applied in part to xxxxxxxx the accumulated losses of the Treasury division (\$129 million) with the remainder being applied to certain borrower accounts, including (\$50 million) and account by Fork (\$11 million). At the same time (25 June 1985) an amount of \$58 million was paid by [Treasury] to a subsidiary of a company [subsequently] controlled by for an unknown purpose.

Other affiliations

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

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

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

	<u>\$ m</u>
<ul style="list-style-type: none"> • provide cash to fund WXYZ share accumulations, Often in the name of nominees, particularly [redacted] and [redacted] 	92
<ul style="list-style-type: none"> • provide cash to fund share accumulations in Sandstorm Holdings in the name of nominees, particularly [redacted] and [redacted] 	115
<ul style="list-style-type: none"> • provide cash to fund purchase of capital notes in the name of [redacted] 	8
<ul style="list-style-type: none"> • investments in Credit and Commerce Insurance, SDCC and others 	25
<ul style="list-style-type: none"> • Other adjustments of bad loans 	120
<ul style="list-style-type: none"> • Unidentified 	<u>9</u>
	<u>368</u>
<ul style="list-style-type: none"> • Unidentified changes between 31 December 1984 and 1986 	(20)
	—
	348
	—

Brokers

4.22 The main brokers used by Treasury division were:



4.23 The investigation team has seen circumstantial evidence that these brokers did not always trade with Treasury at arms length, and may have facilitated [redacted] in manipulating profits, in particular [redacted] had a separate office to deal with Sandstorm and appears to have allowed Sandstorm to have a significant overdrawn balance at 31 December 1984 (\$10 million), which was possibly used to conceal losses/'perk' liabilities at the 1984 year end.

4.24 [redacted] was established in 1984 and rapidly became one of the most significant of the brokers used by Treasury. Its initial shareholders were dominated by major customers of Sandstorm, including [redacted] and [redacted] and some 70% of its share capital was registered in the names of people for whom [redacted] was retained as advisor, [redacted] joined [redacted] leaving Sandstorm in 1986, as did his deputy and subsequently on the advice from the then group auditors, two payments of \$50 million were made to [redacted] in March 1986 out of [external funds] for which no liability for repayment was recorded.

SECTION 5: [REDACTED]

Background

- 5.1 We understand that the Group's banking relationship with [REDACTED] began in 1972 when it placed relatively large deposits with Sandstorm in Luxembourg and London. There is little tangible evidence of other business until 1976 at which time trade finance lines and shipping loans were opened by the Group. Even at this time the scale of the bank's lending to [REDACTED] was significant in relation to its capital base, and the relationship became one of interdependence. A summary of the history of lending in relation to the capital base of Sandstorm is show at Appendix I. There is evidence that [REDACTED] used this position as a lever to obtain short-term funding and repayment of non Sandstorm bank debt.
- 5.2 As a result of the large exposure guidelines imposed by the Bank of England in 1977, the accounts were moved to Grand Cayman, and in 1978 when it became apparent that [REDACTED] was in financial difficulty [REDACTED] and [REDACTED] took direct responsibility for the accounts. It appears that account manipulation began at this stage, and to this end 'special duties' department was set up to oversee these accounts. This was a full-time occupation which involved the manufacture of documentation, inflation of account turnover, concealment of funds flow etc and involved some 750 accounts over a fifteen year period. Turnover in the period was some \$15 billion.
- 5.3 Management in collusion with [REDACTED] used sophisticated methods of deception to conceal funds flows including:
- use of [REDACTED] 'bank' accounts which received funds and then redistributed them around a number of accounts (particularly 1976 to 1983).
 - transfers between [REDACTED] locations in different parts of the world to create turnover and imply debt servicing, particularly just before year ends.
 - conduit accounts at external banks, under the control of Sandstorm officers (largely after 1985).
 - funds transfers through BCP and nostro accounts at various Sandstorm branches.
 - use of excessive interest and charges to provide profits.
- 5.4 The bank believed that the failure of [REDACTED] would have crystallised large losses which would have eroded the bank's capital base and put its very survival in doubt. To avert liquidation of [REDACTED], it would appear that Sandstorm worked very closely with [REDACTED] management to ensure that third party liabilities, many of which were rescheduled in 1984 to 1986, were met as they fell due.
- 5.5 By the early 1980's the position of the bank was so compromised by its reliance on [REDACTED] that more complicated manipulation was necessary. This involved the use of external funds managed by Fork entities. In part this was achieved by loans being repaid by short-term offshore accounts being drawdown in Sandstorm. In addition Fork appears to have utilised certain external funds available to it. Such funding was most significant in the period 1984 to 1986.

Analysis of funding

- 5.6 Bank employees working with [redacted] have now recreated a detailed analysis of the external funding utilised within [redacted] accounts as follows:

	Drawdowns \$ m	Repayments \$ m	Interest \$ m	Outstandings 31/12/90 \$ m
1981 – 1983	160	72	130	218
1984	222	-	13	235
1985	346	185	80	250
1986	300	237	97	160
1987	136	15	42	165
1988	63	15	23	71
1989	<u>21</u>	<u>-</u>	<u>-</u>	<u>21</u>
	1,248	524	385	1,120
	—	—	—	—
Net drawdowns		<u>725</u>		

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

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

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

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

	<u>\$ m</u>
Sandstorm Affiliates	-
BCP Zurich	225
BCP Luxembourg	164
BCC Grand Cayman	186
BCC London	57
BCCI Spain	92
NBO	95
Other	<u>25</u>
	<u>827</u>
Conduit accounts	203
Yet to be identified	<u>219</u>
	<u>1,249</u>

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

Offshore accounts

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

SECTION 6: WXYZ

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

History of operations in US

- 6.5 In the early years of its operation Sandstorm operated through a number of branches and agency operations. Management however perceived that if Sandstorm was to achieve the status of a global banking organisation in line with vision, it needed subsidiary operations in the United States. To this end a number of unsuccessful attempts were made to acquire a bank in New York.
- 6.6 Through contacts with Bert Lance, FAB, at that time FGB, was identified as a suitable acquisition target and in the period from 27 December 1977 to 19 February 1978 some one million shares in FGB, representing 18% of the ordinary capital were acquired on behalf of Sandstorm in the open market. Sandstorm contended that these shares were purchased on behalf of certain investors for whom it acted as Investment advisor. We have, however, seen evidence to suggest that this was not the case and that the four Investors were used to keep individual ownership below 5% and to ensure that Sandstorm's name did not appear.
- 6.7 The investors were:

██████████
██████████

██████████ (subsequently sold to)
██████████ (on behalf of)

Ownership of WXYZ

- 6.8 After various federal and state banking and regulatory approvals, agreements with the SED and FGB, a tender offer for the remaining FGB shares was made by First American Corporation (FAC) on 2 March 1982 and control of FGB was secured by WXYZ
- 6.9 The initial capital contribution into WXYZ (including the original investors' FGB shareholding) was \$180 million being 100,000 shares at \$1.800 each subscribed as follows:

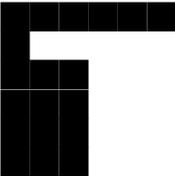
	<u>No of Shares</u>	<u>\$ m</u>	<u>%</u>
██████████	19,050	34.3	19.1
██████	13,720	24.7	13.7
██████	7,180	12.9	7.2
██████	8,240	14.8	8.2
██████ ████████	8,240	14.8	8.2
██████ ████████	8,240	14.8	8.2
██████	8,240	14.8	8.2
██████ ████████	7,860	13.8	7.7
██████ ████████	7,070	12.7	7.1
██████ ████████	6,480	11.7	6.5
██████	2,940	5.3	2.9
██████	1,470	2.6	1.5
██████████████████	680	1.6	0.9
██████	590	1.1	0.6
	<hr/>	<hr/>	<hr/>
	100,000	180.0	100
	<hr/>	<hr/>	<hr/>

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

	<u>No of Shares (000's)</u>	<u>Price \$'000</u>	<u>Amount \$ m</u>	<u>Main purpose</u>
02.03.82 Initial subscription	100.0	1.8	180	
18.08.82 Rights issue	16.7	1.8	30	Class A shares
22.12.83 Rights issue	30.4	1.9	75	FAB, NY
25.07.86 Rights issue	67.7	2.2	150	NBQ
17.08.87 Rights issue	47.3	2.4	115	NBQ
18.07.89 Rights issue	18.0	2.8	50	Repay loan from
	<hr/>		<hr/>	
	200.1		600	
	<hr/>		<hr/>	

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

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

	<u>No of Shares</u>	<u>%</u>	<u>Loan balance \$ m</u>
Possible nominees:			
			170
			298
			210
			181
			79
			100
			133
			6
	<hr/>	<hr/>	<hr/>
	XXXXXX	58.6	1,417
	<hr/>	<hr/>	<hr/>
			
	<hr/>	<hr/>	
Other shareholders			
			
	<hr/>	<hr/>	
	92,878	32.1	
	<hr/>	<hr/>	
Total issued shares	289,120	100	
	<hr/>	<hr/>	

6.13 The share held by  represent the shares repurchased from  under the terms of a buy back agreement nominally with  and guaranteed by Sandstorm Overseas. This repurchase was effected through payments to  in October 1989 and June 1990 totalling approximately \$180 million, funded by  from various sources.

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

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

Loans as above	1,417
[REDACTED]	15
WXYZ Debenture	18
Total to be assigned to Company A	1,450

Nominee arrangements

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

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

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

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

[REDACTED]	\$100,000	pa	1986 – 1989
	\$800,000		on 23 August 1990
[REDACTED]	\$300,000		on 5 August 1985
	\$341,000	pa	in 1986 – 1990
[REDACTED]	\$500,000		in August 1985
	\$380,000	pa	in 1985 – 1990
	\$111,000	pa	in 1988 – 1990
	\$ 42,000		in 1990
[REDACTED]	\$1 to \$2 million pa for use of his name for Treasury trading purposes (uncorroborated)		
	\$15 million in July 1987 (Source not identified)		
[REDACTED]	\$1 million pa in 1988 – 1990 (uncorroborated)		

- 6.19 In addition, payments of \$15.8 million and \$6.3 million respectively were paid to and supposedly in consideration for their original subscription of shares in WXYZ plus rolled up interest, notwithstanding that the shares continued to be registered in their names.

Use of WXYZ accounts for other purposes

- 6.20 Sandstorm management have used the security offered by the investment in WXYZ as a means to:
- (1) disburse funds for totally unrelated purposes. In particular to adjust unrelated loan accounts to avoid the need to book provisions.
 - (2) generate substantial amounts of fictitious income to enhance Sandstorm's reported profits.
- 6.21 This has been facilitated by the fact that the investment has increased in value over time, allowing capacity for extra loan drawdowns made possible because the account holders were indemnified against any liability for the loans. In addition a substantial number of new shares were issued by way of rights issues at net asset value thereby providing excess borrowing capacity, which was also utilised for other purposes.
- 6.22 The total amount of loans, supposedly secured on the shares of WXYZ at 29 December 1980, the effective date at which they were transferred to Company A by means of a sub-participation agreement concluded on 22 May 1981 of \$1,48 billion, noted above, was made up as follows:

	<u>\$ m</u>
Equity capital subscriptions relating to	
Nominee shareholders	307
Other WXYZ capital from non WXYZ accounts	39
	—
	348
	—
Servicing of non WXYZ loan accounts	589
Servicing interest on external borrowings	57
Other disbursements	89
Less: receipts from non WXYZ accounts	(214)
	—
	531
	—
	—
Interest and account charges	573
	—
	—
Total	1,450
	—

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

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

	<u>\$ m</u>
████████████████████	16.5
████████████████	161.4
██████████████	206.0
██████	130.5
██████████████	47.0
██████████████	28.0
██████████████	12.0
██████	<u>1.0</u>
	702.4
	—

6.25 These were disbursed as follows:

	<u>Date</u>	<u>\$ m</u>	<u>Borrower</u>
Adjustments of non WXYZ accounts	June 1985	181	Various
Repayment of █████ loan	Sept 1990	53	██████
Repayment of █████ loan	Oct 1990	138	██████
Repayment of █████ loan	Oct 1990	130	██████
Repayment of █████ loan	Oct 1990	78	██████
Various		4	
		—	
		584	
		—	

6.26 The adjustments in 1985 occurred in the period 25 –26 June when amounts totalling \$191 million drawn down in the names of █████, █████, █████ and █████ together with additional amounts drawn down in the accounts of █████ (\$25 million), █████ (\$10 million) and █████ (\$5 million), were paid to █████ (\$89 million) to adjust a number of █████ accounts and to █████ (\$142 million) to adjust various Treasury pool accounts. Notwithstanding that these drawdowns had nothing to do with the borrowers concerned, confirmation letters of account balances continued to be received by us as auditors.

- 6.27 In September/October 1990 four loans totalling \$104 million were draw down in the names of certain of the WXYZ borrowers to repay four loans previously granted by [redacted] to Sandstorm Overseas which had not been properly authorised. These [redacted] were not recorded in the books but had been used to service various Sandstorm loans accounts between July 1986 and April 1989. They were in part secured on 20% of the shares in WXYZ and cash collateral placed with [redacted]. Notwithstanding that the funds placed with [redacted] were there as security for these loans, Sandstorm management represented to us that these were bona fide bank placements, which were confirmed as such to us by [redacted]. The collusion of [redacted] and its owner [redacted] in the fraud perpetrated on Sandstorm appears to have been a major factor in allowing it to go undetected.

Interest and charges

- 6.28 Interest was levied on the accounts at broadly commercial rates (1.5% to 2.0% over USS LBCR) and in addition, to boost income further, significant management charges and fees were also levied. These totalled some \$150 million in the eight years to 31 December 1990, and to give the appearance that the nominee shareholders were agreeable to the charges letters drafted by Imran Imam, indicating acceptance were periodically obtained and provided to the auditors.
- 6.29 The total income booked in respect of the WXYZ loan accounts was \$573 million and is a material sum to Sandstorm's purported profitability over the last decade. If it is found that the bank does have a beneficial interest in the shares, classification of the balances as loans and advances would not be appropriate and alternative accounting treatment would be required.

Sandstorm Personnel

- 6.30 Control over the WXYZ accounts was exercised by [redacted] from London, who determined the uses to which the various loan accounts were put. [redacted] informs us that it was not until 1985 that these accounts were manipulated for other purposes.
- 6.31 [redacted] was initially assisted by [redacted] and, from [redacted] Mr [redacted] who exercised control over the accounts on a day to day basis and initiated many of the fraudulent transfers of funds and book entries. In addition because of Fork's involvement in the nominee relationships and frequent transfers of loan balances between Sandstorm and Fork, Mr [redacted] was closely involved. Otherwise, there is no clear evidence that the other staff who were involved in giving or receiving instructions, were aware of the true nature of the accounts or Sandstorm's relationship with the account holders.
- 6.32 Generally the borrowers provide audit confirmations however it is now clear that hold harmless letters were also dispatched, and that there was an orchestrated attempt by the senior management of Sandstorm, with the collusion of major customers and a third party bank, to deceive the auditors.

SECTION 7: UNRECORDED DEPOSITS – TUMBLEWEED AND OTHERS

Tumbleweed

- 7.1 Sandstorm's relationship with Tumbleweed dates back to the late 1970's when inter bank acceptances were taken by Overseas' Egyptian branches. When in 1982 Overseas sold its branches to the newly formed affiliate , BCC Mxxx, the sale did not include the transfer of Tumbleweed deposits of \$171 million as its size would have given local capital adequacy problems and because Tumbleweed wanted more confidentiality. Accordingly, the placements were transferred to Grand Cayman, although the customer relationship continued to be maintained by BCC Mxxx. The dealing operation in relation to Tumbleweed was performed at BCC Mxxx by an employee of Overseas, with transactions notified to London who determined the accounting to be effected in Grand Cayman.
- 7.2 The nature of these transactions was formalised in 1983 when a contract between Tumbleweed and Overseas was signed stating that these funds were to be invested in commodities in accordance with Islamic Law. Although prices for spot purchase and forward sale of commodities are always quoted on each deal we have seen no evidence to suggest that the bank actually entered any commodity contracts. Yields equate to term deposits.
- 7.3 We are told that there is an understanding between Sandstorm and Tumbleweed such that if Tumbleweed needs to withdraw funds at short notice it can do so interest free without breaking a deposit. At a later date Tumbleweed will reciprocate by placing an equal amount interest free for the same period. This agreement was apparently particularly beneficial to Tumbleweed in the Egyptian banking crisis of 1989 when \$20 million interest free deposits were made and the Group arranged shipment of dollars to Egypt to enable Tumbleweed to meet its customers needs.
- 7.4 Although the banking relationship is still maintained by BCC xxxxx the account has been controlled, since the resignation of [redacted] by [redacted] central team. Since 1988 the bank have employed [redacted] as a consultant at a retainer of \$75,000 per annum paid through Fork.
- 7.5 From the time that the account was transferred to Grand Cayman in 1982 it appears that all the funds from Tumbleweed passed through the Treasury pool accounts and were an integral part of the manipulation of funds within Treasury up to the resignation of [redacted] in 1986. Over this period interest paid to Tumbleweed on its placements was not expensed but instead debited to the same pool accounts. From March 1 1986 separate pool accounts for all Tumbleweed transactions were established, although as previously, interest continued to be debited tot he pool account rather than the profit and loss account.
- 7.6 Initially on the closure of the Treasury pool account it appears that an attempt was made to reinstate Tumbleweed's deposits, and \$190 million was injected into the Tumbleweed account in August 1986 [from funds under management with Fork], although within a few months these funds had again been utilised to service loans and make certain payments, as follows:

		<u>\$ m</u>
Fork Holdings	servicing of loans via BCP, Fork and SDCC: and payment of interest on borrowings from and in connection with repurchase of shares from .	70
██████████	- SDCC	32
	- ████████	15
Repayment of a █████ WXYZ related loan		30
Repayment of CD's of fork and Emirates 'utilised' by Treasury		14
Untraced items		38
		—
		190
		—

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

██████████	53
██████████████████	18
██████	25
██████████████████	5
██████	2

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

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

7.10 Whilst there are unusual features about the Tumbleweed account it appears from the Tumbleweed financial statements that some 25% of its total assets are placed with Sandstorm, and some \$170 million reaches back to pre-1982 and does appear that there is a significant facility to Tumbleweed which has not been recorded in the books. We have now received confirmation from Tumbleweed of outstanding transactions at 31 December 1990 totalling \$358 million in US Dollars not recorded in the books and \$38 million in other currencies which are recorded in the books.

■■■■

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

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

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

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

		<u>\$ m</u>	<u>Maturity</u>
Term deposit	1	15.7	15.5.91
Term deposit	2	27.3	06.1.91
Term deposit	3	9.5	06.3.91
		—	
		52.6	
		—	

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

Miscellaneous unrecorded deposits

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

	<u>\$ m</u>
[REDACTED]	10.4
[REDACTED]	16.6
BCP Luxembourg	9.6
[REDACTED] [REDACTED]	5.3
[REDACTED]	0.2
	42.1

[REDACTED]

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

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

[REDACTED]

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

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

BCP Luxembourg

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

SECTION 8: UNRECORDED DEPOSITS – ISLAMIC BANKING

Introduction

- 8.1 Sandstorm SA would seem to have commenced Islamic banking activities in its UK Region on behalf of certain Islamic customers in June 1984. Initial activity is believed to have been low building to a level of around £[50] million at the time that the current records commenced in May 1988. Thereafter volumes grew significantly and from 1 January 1989 all these transactions have been routed through 8 separate Islamic Banking Units ('IBU'). At its peak of activity at the end of 1989 amounts placed with IBU by Islamic customers for Islamic investment transactions totalled some \$1.4 billion in seven different currencies.
- 8.2 The most common type of Islamic banking Instrument is a Marubaha desi. This involves the purchase of a commodity and the immediate sale of that commodity with deferred receipt of the sale proceeds for a period determined by the Islamic customer. This eliminates any risk pertaining to holding the commodity and leaves the cost of the deferred payment to generate a higher selling price than purchase price. Not surprisingly the mark up usually bears a close relationship to prevailing interest rates. There is a risk to the Islamic customer that the counterparty will not pay on the due date, however it seems common practice for the Islamic customer to seek to avoid this as well by obtaining a bank guarantee/letter of credit securing the recovery of funds.

Sandstorm's approach to Islamic banking

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

Funds placed outside the BCC Group

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

- 8.6 UK management initially informed us that all these placements were done with Fork (Overseas), by reference to instructions from [redacted] regarding an overall level of placements identified for this institution of some \$90 to \$100 million. There is however no written evidence relating to this instruction. We have established that placements were also made into accounts controlled either by Fork Holdings or BCC Bahrain, on behalf of Fork Holdings. UK management say that they were not aware of this. The accounts in question are represented by Mr [redacted] to be Fork Holdings client accounts, albeit under the control of [redacted].
- 8.7 The following amounts were received from Islamic customers and on placed by UK Region with Fork (Overseas), Fork Holdings and BCC Bahrain at 31 December 1989 and 31 December 1990:

	31 December <u>1989</u> \$,000	31 December <u>1990</u> \$,000
Fork (Overseas)	46,502	
Fork Holdings	50,485	o/s
BCC Bahrain for Fork Holdings	<u>30,000</u>	<u>o/s</u>
Total	<u>126,967</u>	<u>84,451</u>

- Funds placed with Fork (Overseas)

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

- Funds placed with Fork Holdings

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

	<u>Placement date</u>	<u>\$ m</u>
[redacted]		
[redacted]	16.1.90	10.0
Interest		0.5
		<u>10.5</u>



19.1.90	X.X
06.3.90	X.X
07.3.90	2.5
13.3.90	3.3
13.3.90	5.1
26.3.60	X.X
Interest	X.X

32.3



27.12.89	10.0	
01.3.89	30.0	(Note)
Interest	2.4	

42.4

84.5

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

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

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

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

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

- Funds placed with BCC Bahrain

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

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

- 8.8 The inappropriateness of the on placements to Fork (Holdings) and BCC Bahrain is emphasised by the fact that the manager of IBU withheld or manipulated all third party confirmations from Islamic customers relating to these transactions from the external auditors at the time of the 31 December audit of UK Region. A total value of \$90.5 million. The informs us that he had no knowledge of this and that must have been clearly taking instructions from .

Application of certain on placements

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

Destination of Funds

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

8.12 The funds appear to have then been utilised by [REDACTED] and his team as follows:

	<u>\$ m</u>
[REDACTED] - amount used as repayment in January 1990 of a \$5.8 million loan in the name of [REDACTED] in connection with WXYZ	5.8
Interest on nominee loans at [REDACTED] in the Names of [REDACTED]	6.4
	6.1
	—
	12.5
<p>Those loans were secured by a placement from Sandstorm with [REDACTED] and relate to the financing of WXTZ shares.</p>	
Purchase of shares from Fork Foundation and Fork Staff Benefit Fund in the name of [REDACTED] as nominee.	4.0
Transferred via Fork and BCP to Bahrain to Repay interest and principal on unrecorded Deposits.	
	4.0
	1.2
	2.1
	—
	7.3
Various servicing of loans within BCP and Fork (not yet corroborated).	7.7
SDCC [REDACTED] (purpose as yet unknown)	10.6
[REDACTED] - apparently transferred via [REDACTED] and [REDACTED] in March 1989 (not yet corroborated).	11.5
[REDACTED] - loan servicing of account in Sandstorm Cyprus in Mark 1989.	3.0
Balance – used generally in [REDACTED] 500 account Pool utilised by Sandstorm and Fork.	17.8
	81.2
	—

Accounting for Islamic banking transactions

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

Disclosure in Prudential Returns

Prior to August 1990

- 8.17 As a consequence of UK Region's accounting policy which treated all aspects of Islamic banking as off-balance sheet for funds on placed to UK Region, the prudential returns submitted by UK Region tot he Bank of England during this period showed a significant understatement of assets and liabilities. At 31 December 1989 for example assets were understated by \$ 802.4 million due from banks and liabilities understated by \$802 million due to brokers, although as noted above adjustment was made in the legal accounts of Sandstorm SA. In addition \$176.3 million of deposits should have been classified as due to brokers (being amounts received and used within the UK Region itself).
- 8.18 In August 1990, at our insistence management decided to transfer the entire portfolio of investments from Islamic customers into the books of UK Region except for investments which were actually held by brokers and guaranteed by third party standby letters of credit (ie genuinely off-balance sheet). In practice this still excluded the transactions that had been on placed with London and , London. The impact on the prudential returns was a continuing but smaller understatement of assets and liabilities which at 31 December 1990 amounted to \$ 106.9 million and a misclassification of \$ 441.4 million as deposits rather than due to brokers at the same date. In addition, because of their classification as deposits the Islamic customers with the four largest aggregate investments were also disclosed in the 7 return as depositors with more than 5% of total deposits.

- 8.19 The amounts placed with Fork Holdings and BCC Bahrain amounting to \$84.5 million at 31 December 1990 were correctly reflected in the books of UK Region from 27 March 1991. Funds totalling \$ 22.5 million placed with two other institutions noted above are still not reflected in the books of UK Region.
- 8.20 The accounting adopted for the shortfall of funds was even more inappropriate. Rather than recognising a debt from Fork (Holdings), UK Region used loan accounts opened for [redacted] and [redacted] to 'disguise' the recording of amounts due from Fork Holdings. As a result, credit facilities and relevant loan accounts authorised by BCC Central Credit Committee for these banks were effectively used by UK Region for purposes other than for those for which they were actually approved.
- 8.21 To 'disguise' the amounts due from BCC Bahrain a loan account in the name of [redacted] was opened by UK Region in September 1990 to record investments repaid by UK Region to this customer but not recovered from BCC Bahrain. This credit facility for [redacted] was not authorised by BCC Central Credit Committee.
- 8.22 The loan accounts were then subsequently adjusted by crediting them with new funds received from the same Islamic customers up to the amount of the shortfall, rather than crediting those new funds to the liabilities xxx of the balance sheet, thereby, falsely understating assets and liabilities.

Disclosure in the Prudential Returns

- 8.23 The impact of these accounting entries on the amounts disclosed in the prudential returns was an understatement of both assets and liabilities. At 31 December 1990 assets should have included a sundry debtor for \$ 84.5 million being the amounts due from Fork Holdings, and liabilities a due to brokers of a similar amount, although the recoverability from Fork is uncertain.
- 8.24 Those Islamic investments shown in the [redacted]7 return as large deposits, whilst not correctly classified as deposits, would also have been understated by a total of \$ 84.5 million.

Management control

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

- 8.27 With respect to the placement of funds with Fork Holdings and BCC Bahrain, represents that he was acting under instruction from . There is however no documentation supporting instructions given by or instructions given by to IBU. Furthermore, represents that at the time of the transactions he was led to believe by and others that the funds were being placed with Fork (Overseas). There is however no documentation supporting notification by UK Region to Fork (Overseas) or any other entity in respect of funds placed through BCC Bahrain and . The only documentation available, according to UK Region management, is a memorandum sent by Mr to Mr . (Fork Foundation, based at 100 Leadenhall Street) outlining details of the funds so placed. claims that the routing of placements (ie through Grand Cayman, BCC Bahrain,) was determined and notified by or Mr . However, there is no written evidence to support this statement.
- 8.28 Mr represents that he is seeking recovery of the debt from BCC Central office in Abu Dhabi. With respect to the misuse of on placements as security for third party loans and advances represents that he had no knowledge of this until it was recently identified and that the manager of IBU must have acted under direct instruction probably from Mr , the account officer for .
- 8.29 In relation to the general accounting for these transactions has now recognised that the original accounting treatment was incorrect although it should be noted that the bank placed reliance for some time on illegal advice that lent support to their earlier practice. However the precise accounting classifications for Islamic transactions that have been outlined above still need to be adopted.
- 8.30 With respect to the accounting practices adopted to cover up the non repayment of certain on placements acknowledges that this was inappropriate but represents that whilst against his better judgement he was again acting under instruction from . The knowledge of other members of the UK Management Committee with respect to these transactions is unclear, but it seems unlikely that these entities went unnoticed by the UK Region's credit department.

Conclusion

- 8.31 From a customers point of view all Islamic investment transactions have been properly executed and funds repaid on the due date. UK Region's approach to covering its own guarantee risk whilst acceptable was not adequately researched from an accounting view point and was misguided with respect to where funds were ultimately placed.
- 8.32 The resulting catalogue of errors with regard to the non repayment of some placements and the misuse of other placements as security reflects at the very least a lack of any proper independent management control in UK Region. The accounting adopted for the non repayment is indefensible and lends weight to the conclusion that UK management have acted irresponsibly in allowing the events outlined above to occur. Whether UK management and particularly and Mr have acted in good faith under instruction from senior officers within BCC Group has been impossible to determine but it is difficult to imagine that every transaction could go through unchallenged by them.

SANDSTORM

APPENDIX 1

HISTORY OF

EXPOSURE

		Recorded Balance Sheet Exposure \$ m	Sandstorm Consolidated Capital \$ m
		<u> </u>	<u> </u>
31 December	1977	80	113
	1978	110	171
	1979	180	226
	1980	183	292
	1981	254	462
	1982	221	641
	1983	211	808
	1984	186	1,008
	1985	246	1,190
	1986	370	1,308
	1987	437	1,409
	1988	597	1,417
	1989	705	1,075

Price Waterhouse

4 July 1991

PRIVATE AND CONFIDENTIAL

Bank of England
Threadneedle Street
London
XXXX XXH

For the attention of Mr X Xxxxx

Dear Sir,

DRAFT REPORT ON SANSTORM SA UNDSER S 41 OF THE BANKING ACT 1987

At our meeting yesterday with the Deputy Governor you requested that we should provide you with confirmation of the status of the draft report sent under our covering letter of 22 June 1991.

As we have already explained, the document was a draft provided in order to check whether in your view the scope of our work needed to be expanded. It summarises the results of examination of a large volume of files and records, held personally by are previously concealed from us, which have now provided evidence of the fraudulent nature of the problem transactions discovered by us and first reported to you early last year. These files revealed widespread fraud and manipulation of accounting records conducted in collusion with

Our draft report is also based on the review of banking records from several locations and interviews conducted over a number of months. The findings are inevitably based on incomplete information and, moreover, certain details and their interrelationship have not been corroborated.

Additional work has been carried out since 22 June which has a bearing on some of the detail. We have, however, not been able to complete our verification procedures, nor, having summarised the information gathered, to re-interview past and present management to ensure that our interpretation of individual transactions is appropriate. Accordingly, we are not able to fully support the detailed information provided in the draft report nor to confirm its completeness. However, we believe that the report reflects the general scale and complexity of the deception and falsification which have undoubtedly taken place over many years.

4 July 1991
Bank of England
Page 2

We understand that the background to the principle matters in our draft was known to
in xxxx 1990.

The draft report has not been discussed with either Sandstorm or the controlling
shareholders who are unaware that our draft report has been delivered to you.

Yours faithfully

Price Waterhouse