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The Federal Reserve's Views on BCCI[†]

We are pleased to appear before the Committee to describe the Federal Reserve's role in the supervision of the Bank of Credit and Commerce International (BCCI) and the Federal Reserve's investigation of BCCI's secret acquisition of the shares of several U.S. banking organizations.

This testimony will focus first on the operations of BCCI around the world, particularly BCCI's use of a fragmented, unsupervised structure operating in foreign jurisdictions with minimal supervision and strong bank secrecy laws; second, on the Federal Reserve's efforts to deny BCCI entry into this country; third, on the Federal Reserve's continuing investigation, which has detected and produced hard evidence of BCCI's secret acquisition of the stock of U.S. banks; and finally, on the very valuable lessons learned from the Federal Reserve's experience with BCCI.

In considering these matters, we believe that five major points should be stressed.

First, the Federal Reserve has never approved any presence by BCCI in this country, and for that reason BCCI has never been authorized to take deposits from U.S. citizens through an insured bank. Our investigation indicates that BCCI was aware that the Federal Reserve presented a serious obstacle to acquisition of banks in this country—a fact that may well explain BCCI's campaign to acquire illegally and surreptitiously the shares of U.S. banking organizations through a complex web of nominees and sham loan arrangements.

Second, in 1987 and 1988, the Federal Reserve detected money laundering and operational problems at the state-licensed agencies BCCI established in this country. Through the action of the Federal Reserve and state regulators, BCCI's

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U.S. agencies were eliminated or substantially wound down over the next three years. By the time of BCCI's seizure on July 5, 1991, BCCI's U.S. operations had shrunk from about \$1 billion to \$250 million, and BCCI's two remaining U.S. agencies had less than \$25 million in liabilities to third parties. Thus, at the time of BCCI's closing, the vast majority of funds at its two remaining U.S. agencies were its own. This sets the United States apart from numerous other countries in which local depositors have lost their funds, or access to their funds, as a result of the seizure of BCCI.

Third, the Federal Reserve did act to prevent an illegal BCCI presence in this country when Middle Eastern investors applied in 1978 and 1980 to acquire Financial General Bankshares, now renamed First American Bankshares. In considering the application in 1980, the Board sought to make certain that BCCI did not have a stake in the holding company formed to make the acquisition, Credit and Commerce American Holdings, N.V. (CCAH), and was not funding the acquisition.

Although the Federal Reserve did not have at that time any evidence of fraud or illegality in BCCI's overseas banking operations, the Federal Reserve nevertheless was concerned by BCCI's unregulated character and rapid growth. Concerned also because BCCI was acting as adviser to the investors, the Federal Reserve sought to ensure that BCCI would not gain control of First American. The Federal Reserve received explicit commitments from BCCI, the investors, and their representatives that the acquisition of First American was being made with the investors' own funds and that BCCI would not acquire any CCAH shares or finance the investors. The Federal Reserve did not accept these representations without question, but made substantial efforts to verify what it was being told.

The Federal Reserve requested and received from the investors financial statements and other documentation confirming the various representations. The numerous materials submitted by the banks and accounting firms of the principal shareholders indicated that the investors were persons of substantial wealth fully able to make the investment using their own funds and without borrowing from BCCI or anyone else. Even today, it is undisputed that some of the principal investors are persons of great wealth. Further, the Federal Reserve conducted background investigations of the investors: the Departments of State and Commerce stated that the investors were persons of substance and, along with the CIA, reported no adverse information on the investors. Finally, the Federal Reserve took the unusual step of holding a hearing on the application at which the largest investor, three other investors, and the investors' representatives appeared and further denied any BCCI involvement in the investment or its financing.

Throughout this process, there was no evidence that the shareholders and their representatives were being untruthful in their written and oral statements that BCCI was not involved in the financing of the acquisition. Under the Bank

Holding Company Act with its due process requirements, the Federal Reserve is not authorized to act on suspicion or rumor, but must have evidence to support its decision. The Federal Reserve had no grounds at the time to deny and, operating under this statutory standard, approved the application. The necessary state authorities approved as well.

Fourth, since allegations of an illegal BCCI-CCAH link reached the Federal Reserve in late 1988 from the IRS and another source, the Federal Reserve has continuously investigated the relationship between the two, detecting and producing, in our view, substantial evidence of violations by BCCI and others of the Bank Holding Company Act and other statutes.

In January 1989, following receipt of these allegations, the Federal Reserve conducted a special review of CCAH and its relationship to BCCI, examining the financial relationship between BCCI and the First American banks. The Federal Reserve continued to make inquiries into any possible link through 1989 and 1990. BCCI and CCAH representatives consistently denied that such a link existed, and the records available to the Federal Reserve at that time provided no evidence to refute their assertions.

The Federal Reserve asked regulators in Luxembourg and the Cayman Islands, where the principal BCCI bank subsidiaries were chartered, to verify the reports of a BCCI-CCAH link. In 1990, the Luxembourg regulator advised that it would investigate the matter, but was having difficulty obtaining the necessary information. Cayman regulators stated that they had no relevant records on the matter.

The Federal Reserve also sought information from law enforcement agencies conducting probes of BCCI. In June 1989, while the U.S. Attorney's Office in Tampa was continuing its investigation of BCCI, a Federal Reserve official met with attorneys from that office, offered the assistance of examiners and indicated that the Federal Reserve wished to obtain information on the investigation when completed. On February 7, 1990, two days after BCCI was sentenced for money laundering, two experienced Federal Reserve counsel went to Tampa to determine from the U.S. Attorney's Office whether their investigation had unearthed any evidence that BCCI owned or controlled CCAH. The U.S. Attorney's Office referred Federal Reserve counsel to IRS investigators, who indicated that a report of the findings on their investigation had been prepared. The IRS did not provide a copy of the report, or mention any tapes made during its investigation, due to considerations of grand jury secrecy and witness safety. The Federal Reserve investigators were told of the existence of an informant, whose credibility the IRS said it seriously doubted, and of another lead. In April 1990, the IRS provided the name of the informant and arranged for him to call the Federal Reserve. The Federal Reserve was unsuccessful in repeated attempts to contact the informant until 1991.

In further efforts to obtain information on the alleged control by BCCI of CCAH, the Federal Reserve, in the spring of 1990, pursued another avenue of the investigation. In June 1990, the Federal Reserve reached an information sharing

agreement with the New York County District Attorney's Office, and subsequently obtained access pursuant to a New York Supreme Court order to certain of the materials presented to a state grand jury investigating BCCI. This agreement and the information sharing and ongoing collaboration of the Federal Reserve and D.A.'s Office were to be of great benefit to both agencies in uncovering evidence of what Mr. Morgenthau, the New York County District Attorney, has characterized as the largest banking fraud in history.

In the fall of 1990, the Federal Reserve, acting on information provided to us by the New York County D.A., demanded and—after initial refusals by BCCI's auditors, Price Waterhouse—was able to review at BCCI's London offices a report confirming the existence of over \$1 billion in nonperforming loans by BCCI secured by CCAH shares. Based on the evidence gathered by Federal Reserve investigators, the Board, on January 4, 1991, formalized and broadened the investigation, authorizing use of discovery and subpoena powers. Later that month, the Federal Reserve initiated examinations of the entire First American banking organization, focused on determining whether there were any financial dealings with BCCI.

The Federal Reserve's investigation has been intense and thorough, encompassing seizure and review of tens of thousands of pages of documents both here and abroad, weeks of depositions, interviews of more than fifty different persons in the United States and overseas, and cooperation with federal, state and foreign law enforcement agencies. The evidence unearthed by our staff establishes the nature and extent of numerous violations of law, the methods by which the violations were engineered and implemented, and the nature and whereabouts of the evidence establishing the violations.

The quality and quantity of evidence uncovered by the Federal Reserve's investigation is evident from our 110-page July 29 Notice of Charges and the boxes of relevant documents turned over to the Committee under its subpoena. In that Notice and one other issued on July 12 relating to Independence Bank, the Federal Reserve has assessed a civil money penalty of \$200 million against BCCI and initiated actions to bar nine individuals associated with BCCI from involvement with U.S. banks. At the request of the U.S. Attorney for the District of Columbia, the Board has deferred temporarily the assessment of substantial civil money penalties against the individuals involved pending completion of the U.S. Attorney's criminal inquiry. Finally, after discussions with the Federal Reserve, First American and its parent holding companies have recently changed management in order to further distance the First American banks from the taint of any association with BCCI.

Fifth, in assessing the BCCI matter, it is important to keep in mind that this is essentially a case of systematic and deliberate criminal fraud. Although our bank examination powers allowed the Federal Reserve to detect poor operating controls as well as evidence of money laundering at BCCI's U.S. agencies, more extensive and intense efforts were required to uncover BCCI's ownership of

stock in U.S. banking organizations. BCCI took maximum advantage of an unsupervised cooperate structure to conceal and warehouse in bank secrecy jurisdictions billions of dollars in fraudulent transactions.

The Federal Reserve does not have the power to coerce truthful testimony from uncooperative criminal conspirators. Nor can the Federal Reserve offer immunity to those willing to come forward. Using the authorities available to it, the Federal Reserve continued to investigate the matter both here and abroad, and we now know that BCCI's top management was seriously concerned with the supervisory initiatives of the Federal Reserve. Eventually our efforts paid off, and we uncovered the truth. Once the Federal Reserve obtained credible evidence, we acted quickly to marshal the facts and move against BCCI and others involved in the alleged illegal activity. We have also taken care, in accordance with the due process requirements under which we operate, to bring actions only when we have sufficient evidence to support them, thereby avoiding any misstep at this stage that might allow BCCI and others to escape the consequences of their actions.

The Federal Reserve recognizes that one of the best ways to deter the kind of fraud that occurred at BCCI is through criminal punishment that sends a loud and clear message to would-be offenders. Throughout the Federal Reserve's investigation of BCCI, we have made criminal referrals whenever we discovered illegal activity, and have provided to criminal investigators the evidence and investigative leads that we have gathered, as well as our hard-won knowledge and expertise regarding the BCCI case. We believe that this will be vital to any prosecution of BCCI and others involved in BCCI's illegal acquisitions of U.S. banks. We are greatly encouraged that the New York County District Attorney's Office has secured indictments against BCCI and two of its senior officers, and that the Tampa U.S. Attorney's Office has indicted senior BCCI officers for racketeering involving money laundering. We are continuing to work with the U.S. Department of Justice and New York County D.A., who are actively pursuing the BCCI fraud.

I. Bank of Credit and Commerce International

A. STRUCTURE OF BCCI

BCCI was founded in 1972 and until recently operated principally under the leadership and management of individuals from Pakistan. Initial equity financing of BCCI was provided by Middle Eastern investors and Bank of America. Bank of America sold its ownership interest in 1980. In April 1990, in order to bolster BCCI's sagging financial position, the ruling family and the government of Abu Dhabi provided additional capital that increased their ownership interest in BCCI shares from about 30 percent to 77 percent.

BCCI's operations eventually encompassed subsidiaries, branches, and affiliates in sixty-nine countries, with the largest concentration of local deposits in the

United Kingdom. BCCI's total assets of about \$20 billion ranked it as about the 200th largest bank in the world, roughly the size of a major regional bank in this country.

At the apex of the BCCI organization was the parent holding company, BCCI Holdings (Luxembourg) S.A., which was chartered and headquartered in Luxembourg. Below the parent were two principal banking subsidiaries: Bank of Credit and Commerce International S.A., and Bank of Credit and Commerce International (Overseas) Limited, which were chartered in Luxembourg and the Cayman Islands, respectively. Although BCCI was headquartered in Luxembourg, Luxembourg authorities did not supervise BCCI on a consolidated basis, thereby allowing BCCI to escape normal banking oversight.

Under Luxembourg law, holding companies are not subject to supervision. Thus, BCCI's holding company was able to establish an elaborate and extensive network of subsidiaries and affiliates to carry out its activities. Our investigation indicates that when BCCI encountered a legal impediment, it would often create another affiliate or use one of its myriad existing or affiliated entities to circumvent it. In one instance, BCCI apparently created an affiliate whose sole purpose was to serve as BCCI's alter ego in warehousing fraudulent transactions in which BCCI could not safely engage directly. BCCI was able to do this in substantial part because there was no consolidated home country supervision of its banking activities.

In this regard, it is instructive that during the late 1960s, when U.S. banks began to form holding companies to engage in activities that the bank was not permitted to conduct directly, Congress responded with amendments to the Bank Holding Company Act that provided for increased supervision, regulation and examination of U.S. bank holding companies to ensure that the companies were financially responsible and that their activities were consistent with federal banking laws. No such system was in place with respect to BCCI's holding company.

B. SUPERVISION OF BCCI'S OPERATIONS IN THE UNITED STATES

As noted, BCCI has never been permitted to operate a branch in the United States or to accept deposits from the general public; nor was it authorized to operate or control an insured bank. BCCI at one time maintained state-licensed agencies in New York, San Francisco, Los Angeles, Miami, Tampa, and Boca Raton and representative offices in other U.S. cities, including Washington, D.C., and Houston, Texas. Representative offices can be established simply by obtaining the consent of the state and registering with the Treasury Department, but such offices are severely limited in their activities and may not accept deposits. Agencies may hold credit balances from customers associated with international banking transactions but may not accept deposits from U.S. residents.

As we will discuss later, the unrestricted ability of foreign banks to establish branches, agencies and representative offices without federal review has prompted legislative proposals by the Federal Reserve that would require federal approval of, and establish prudential standards for, foreign bank offices in the United States.

Under current law governing foreign bank operations in the United States, established in the International Banking Act of 1978, the states are the primary regulators of the branches and agencies they license, and the Federal Reserve is directed under the Bank Holding Company Act to rely on state reports of examination insofar as possible, just as the Federal Reserve is directed to rely on reports by the comptroller of the Currency for national banks and the Federal Deposit Insurance Corporation (FDIC) for nonmember banks. BCCI's agencies in the United States were licensed and supervised by state authorities, and therefore primary supervision was in the respective states. As the residual supervisor of U.S. branches and agencies of foreign banks, the Federal Reserve participated in some state examinations and conducted some examinations of its own. During one of these examinations of the Miami agency of BCCI, in April 1987, the Federal Reserve identified money laundering activities, and a criminal referral was filed with the Internal Revenue Service, the Federal Bureau of Investigation, and the U.S. Attorney in Miami.

On October 8-9, 1988, as a result of an undercover operation by Customs and IRS dating back to 1986 (Operation C-Chase), BCCI and several of its U.S. employees were indicted for money laundering through BCCI's Tampa office. The IRS had advised Federal Reserve staff in September 1988 of the projected seizure and the Federal Reserve had, in coordination with the IRS, scheduled an examination to commence after the seizure so as not to compromise the IRS operation. On October 11, the Federal Reserve, with cooperation from state banking authorities, commenced the coordinated examination of all of BCCI's U.S. agencies through the New York, Atlanta, and San Francisco Reserve banks. The examinations of the New York and Boca Raton offices revealed other money laundering activities, and the Federal Reserve made additional criminal referrals in October and November of 1988.

The examinations also revealed that internal controls and lending practices of the BCCI agencies were quite poor and that remedial action was required. The Federal Reserve issued a cease and desist order against BCCI on June 12, 1989, designed to strengthen the U.S. banking operations of BCCI and enforce compliance with currency reporting requirements. This order was issued by the Federal Reserve notwithstanding concerns expressed by foreign and state bank regulators over the potential effect of the action.

Moreover, the U.S. Attorney in Tampa incorporated this cease and desist order into the plea agreement reached with BCCI regarding its illegal money laundering activities. Thus, compliance with the Federal Reserve's order was made a condition of BCCI's probation. This was a unique arrangement, which enhanced the Federal Reserve's ability to enforce its corrective cease and desist order.

The indictment for money laundering in the United States further weakened BCCI's already fragile reputation in the world financial community. In the period following the indictment, Federal Reserve staff was advised that BCCI was experiencing some outflow of deposits in London and was encountering difficulty in finding counterparties for its banking transactions. In these circumstances and in the face of large losses being discovered in the bank in early 1990, the government and ruling family of Abu Dhabi provided new capital of nearly \$400 million to BCCI, increasing their ownership of BCCI from 30 percent to about 77 percent.

BCCI's problems, however, continued to worsen significantly. On October 3, 1990, Price Waterhouse delivered a secret report to BCCI's board of directors that identified massive additional problem loans. This report gave rise to an intensification of discussions among BCCI management, BCCI's principal shareholder, and European banking authorities concerning possible approaches to a broad-based restructuring of the bank. These discussions continued into 1991.

On March 4, 1991, the board issued a second cease and desist order against BCCI in part to address concerns about the funding of its U.S. agencies. The order required that BCCI have sufficient liquid assets to cover liabilities in its U.S. agencies. A corollary action by the Richmond Reserve Bank required that First American terminate any residual business with BCCI.¹

Because of actions taken by the Federal Reserve and state supervisory authorities, BCCI's U.S. operations had been substantially curtailed by the time of its seizure. Four of the six agencies were closed by January 1991, and the representative offices were closed by August 1990. Under the Federal Reserve's March 4 order, operations at BCCI's two remaining agencies—in Los Angeles and New York—were scaled back, and the company was also ordered to terminate its activities in the United States by year-end 1991.

C. THE SEIZURE OF BCCI ON JULY 5

By early 1991, information received by the Bank of England about BCCI's financial condition and integrity prompted the Bank of England to commission Price Waterhouse to undertake a special audit under the provisions of British banking law. The resulting so-called section 41 report was made available to the Bank of England on June 22, 1991. The Bank of England's filings in British courts indicate that the report disclosed evidence of a complex and massive fraud at BCCI, including substantial loan and treasury account losses, misappropriation of funds, unrecorded deposits, the creation and manipulation of fictitious accounts to conceal bank losses, and concealment from regulatory authorities of BCCI's mismanagement and true financial position.

1. The divestiture provisions and other aspects of this cease and desist order are discussed in the next section.

Based on this report, foreign regulatory authorities in England, Luxembourg and elsewhere decided to seize BCCI. The Federal Reserve was informed of this decision and in turn briefed other U.S. regulatory agencies. The Federal Reserve dispatched senior officials to London to participate in a special unit established at the Bank of England to coordinate global regulatory actions and to provide a central point of supervisory information and advice. A parallel unit, focusing particularly on payment and settlement issues, as well as activities in U.S. banking markets more generally, was established at the Board and the New York Reserve Bank. The primary concern of the Federal Reserve was to take all reasonable steps to ensure that the seizure of the BCCI banks did not precipitate serious disruptions in U.S. banking markets or in dollar-based payment and clearing systems here or abroad.

The main seizure of BCCI occurred on July 5, 1991, with the Federal Reserve coordinating information necessary for the closing of BCCI's remaining U.S. agencies by state regulators in California and New York. As of July 6, governments of eighteen countries had closed or restricted the activities of BCCI operations in their jurisdictions. By July 29, 1991, a total of forty-four countries had closed BCCI offices in their respective jurisdictions.

Because of the international cooperative supervisory effort and earlier actions by the Federal Reserve and state authorities to scale back BCCI's limited operations in the United States, the seizure of BCCI caused virtually no adverse effects on U.S. markets or institutions. As a result of earlier regulatory action, BCCI was funding its business in the United States from other non-U.S. BCCI offices and *not* from U.S. sources at the time BCCI's U.S. agencies were closed by the states of California and New York. As of July 30, about \$17 million of the \$252 million in liabilities on the books of the U.S. agencies of BCCI was owed to creditors not affiliated with BCCI. Because of the care and precision with which the seizure of BCCI and its affiliates was coordinated among U.S. and foreign authorities, there were in fact no problems of any consequence encountered in the operation of the payments system as a result of the seizure.

We will now proceed to discuss how BCCI, apparently frustrated in its efforts to establish a substantial legal presence in this country, acquired illegally the stock of U.S. banking organizations.

II. The First American Banks and Other U.S. Institutions

Financial General—the predecessor to First American Bankshares—was one of a handful of bank holding companies that were grandfathered under the Bank Holding Company Act to retain ownership of banks acquired in more than one state. In 1966, Financial General owned banks in Virginia, Maryland, Georgia, Tennessee, New York, and the District of Columbia.

A. INITIAL STOCK PURCHASES IN 1977-1978

On April 29, 1977, an investor group led by J. William Middendorf II acquired control of Financial General. Within a few months, dissatisfaction with his leadership developed among some of the investors, who then went in search of a buyer for their shares. They discussed a purchase of Financial General's shares with the chief executive officer of BCCI, Agha Hasan Abedi.

In late 1977 and early 1978, BCCI, allegedly acting for four of its clients, began to purchase shares of Financial General. These investors eventually acquired approximately 20 percent of its voting shares, but none purchased more than 5 percent of the shares. The investors were two prominent citizens of Saudi Arabia and Kuwait and two sons of the ruler of Abu Dhabi. In various official filings, BCCI stated that it acted only as investment advisor to these individuals in connection with their purchases of Financial General shares and did not itself own, control or vote any of the shares.

When the purchases were made public, the Securities and Exchange Commission filed a complaint alleging that each of the four Middle Eastern investors, BCCI, Mr. Abedi, and certain U.S. shareholders of Financial General had acquired, as a group, control of more than 5 percent of Financial General's shares in violation of the Williams Act. The investors denied these allegations. In March 1978, the investors, without admitting fault, entered into a consent decree with the SEC whereby the investors agreed to proceed with a tender offer for all of Financial General's shares.

Three of the original four investors proceeded with the tender offer, joined by eleven additional individual and corporate investors from the Middle East who were also advised by BCCI. The investors formed CCAH, a Netherlands Antilles corporation, in order to make the tender offer.²

B. CCAH'S APPLICATION TO ACQUIRE FINANCIAL GENERAL: 1978-1981

CCAH could not proceed to acquire Financial General's shares without board approval under the Bank Holding Company Act. On October 19, 1978, CCAH filed an application seeking such approval. The application was opposed by Financial General and its Maryland subsidiary bank. On February 16, 1979, the Board dismissed the application, concluding that the acquisition would be unlawful under a Maryland law that forbade any hostile acquisition of a Maryland bank.

2. There were two other companies in the ownership chain: Credit and Commerce American Investment, B.V. (CCAI), a Netherlands company and a wholly owned subsidiary of CCAH; and FGB Holding Corporation, a District of Columbia corporation and wholly owned subsidiary of CCAI. FGB Holding Corporation was subsequently renamed First American Corporation and was the entity that acquired Financial General Bankshares.

The applicants challenged the Board's decision, but before the matter was adjudicated, the investors and Financial General's management negotiated an agreement for the acquisition of Financial General by CCAH. In November 1980, CCAH again sought Board approval to acquire Financial General.

In reviewing such an application, the Board is required by statute to consider the competitive effects of the proposal, the financial and managerial resources and future prospects of the companies concerned, and the convenience and needs of the relevant communities. The statutory factors do not distinguish between foreign and domestic acquirers, and thus these factors were applied to the CCAH application as they would be to a domestic holding company application. Under the Bank Holding Company Act, the Board does not have discretion to deny applications as it chooses. Its decision must be made on the basis of the statutory factors and must be supported by evidence.

The application specified that the Middle Eastern investors were to be passive and would take no part in the management or operation of Financial General. The management of Financial General was vested in a board of directors that would include former Senator Stuart Symington, former Secretary of Defense Clark M. Clifford, and retired Lieutenant General Elwood R. Quesada. Investors controlling over 50 percent of CCAH's shares transferred the power to vote their shares to Senator Symington for a period of five years. An experienced banker was to be selected as president and chief executive officer of Financial General, and this person was identified before the Board acted on the application.

As a result of the SEC case, the Board focused great attention on the relationship between CCAH and BCCI, specifically whether BCCI had a stake in the planned acquisition, either directly or indirectly. The Board's concern was sufficiently serious that the Board took the unusual step of convening a hearing on this and other questions raised by the application, requesting that the principal shareholders of CCAH appear and testify at the hearing.

In response to the Board's questions, CCAH and its principal shareholders stated that BCCI would not be involved in the acquisition other than as investment advisor to the CCAH investors and, in particular, would not fund the acquisition. At the hearing and in written submissions, CCAH shareholders and their counsel, Clark Clifford and his partner, Robert A. Altman, of the law firm of Clifford & Warnke, made the following statements:

- The application filed by CCAH stated: "BCCI owns no shares of FGB, CCAH or CCAI, either directly or indirectly, nor will it if the application is approved. Neither is it a lender, nor will it be, with respect to the acquisition by any of the investors of either FGB, CCAI or CCAH shares."
- In a letter submitted to the Board in response to questions about the relationship between BCCI and CCAH, counsel for CCAH stated: "With regard to the stockholders of CCAH, all holdings constitute personal investments. None are held as an unidentified agent for another individual or organization."

- Kamal Adham, the largest shareholder of CCAH, stated at the Board's hearing, "There is . . . no understanding or arrangement regarding any future relationship or proposed transactions between Financial General and BCCI." He further stated, "[I]t appears that there is doubt that there is somebody or BCCI is behind all of this deal. I would like to assure you that each one on his own rights will not accept in any way to be a cover for somebody else."
- CCAH counsel, when asked at the hearing about the relationship among CCAH and CCAI and BCCI, stated, "[T]here is no connection between those entities and BCCI in terms of ownership or other relationship."
- Asked about the function of BCCI in the proposal, CCAH counsel stated, "None. There is no function of any kind on the part of BCCI." He added, "I know of no present relationship. I know of no planned future relationship that exists"

The same representations were made to the other regulators involved in the application. The comptroller of the Currency was advised by investors' counsel that "none of the investors are borrowing to finance their respective equity contributions" and that "BCCI will have no involvement with the management and other affairs of Financial General nor will BCCI be involved in the financing arrangements, if any are required, regarding this proposal."

The Board did not rely solely on these representations that the investors were acting for themselves. The Board requested detailed information from the investors regarding their financial resources and affiliations, including financial statements prepared by accounting firms, some of which were affiliated with the largest accounting firms in the world. Financial statements were submitted, and, in the case of the largest shareholders, a statement about the source of funds to be used to make the acquisition was required. The Board also obtained letters from the largest investor's banks confirming balances and containing references. All these materials indicated that the investors were persons of considerable means and the purchases were to be made from their own personal resources.

To further verify that the representations being made were accurate, the Board conducted background checks on the shareholders, soliciting information from the Central Intelligence Agency, the Departments of State and Commerce, and a foreign bank supervisor. The Board also obtained information from the SEC regarding the original acquisition and two CCAH shareholders.

None of the agencies performing background checks—the CIA and State and Commerce Departments—reported any adverse information on the investors, and the Departments of State and Commerce reported that the investors were persons of substance. Neither the Board nor any other regulator received any evidence from other sources that the representations made to them were false. The Comptroller's Office wrote to the Board stating that its earlier concerns about the application had been addressed by the responses of the investors and their

representatives. The Maryland Banking Board approved the acquisition of the Maryland bank on June 25, 1981.

On August 25, 1981, after considering the hearing record, reports from staff, and the views of federal and state agencies, the Board approved CCAH's acquisition of Financial General. Consummation of the acquisition was delayed, however, pending approval of the New York State Banking Department of the acquisition of Financial General's New York banks. The department initially disapproved the application, principally because of an alleged lack of reciprocity for American banks in the investors' home countries. However, on March 2, 1982, the department granted its approval following CCAH's commitment to divest one of the New York banks. In a subsequent letter, the department stated that it had made a thorough investigation, that "all the information we received indicated that the investors were prestigious and reputable people," and that "the investors' character and financial responsibility warranted approval of the application." The department further noted that "this application received more scrutiny from more regulatory agencies than any other application in recent memory."

The acquisition was consummated on April 19, 1982. Financial General was renamed First American in August 1982.³ Mr. Clifford became chairman of the board of First American, and Mr. Altman was named president of First American Corporation and secretary and a managing director of CCAH.

C. THE PERIOD 1982-1987

In the years immediately following the acquisition, the Board received no indications to suggest that CCAH and First American were functioning other than in accordance with the statements made to the Board and the other regulators. The investors adhered to their commitment to inject \$12 million in new capital into First American, and no dividends were paid to the investors in keeping with another commitment. On several occasions, the investors made very substantial additional capital injections, in the hundreds of millions of dollars, to support First American's activities. Both federal and state examinations of First American and its subsidiary banks by the comptroller of the Currency, FDIC, and the states of Maryland, Virginia, Tennessee, and New York, and of the U.S. offices of BCCI conducted during this period, detected no evidence that BCCI and CCAH were improperly linked. The fact that substantial fresh capital was supplied at various times and that the investors did not take dividends from the CCAH was consistent with the representations made by the investors at the time of the acquisition that this was intended to be a personal investment.

3. During the course of the takeover, prior Financial General management had renamed most of the subsidiary banks First American banks.

D. THE MONEY LAUNDERING PERIOD: 1987-1989

As discussed previously, the Federal Reserve through its examination function detected evidence of money laundering in 1987, and appropriate criminal referrals were made. The coordinated examinations conducted following the October 1988 indictment stemming from Operation C-Chase led to further criminal referrals. It is now apparent that the publicity surrounding BCCI's illegal money laundering activities in the United States had the understandable effect of beginning to shake loose insights into other aspects of BCCI's activities and operations in the United States and around the world that only recently have been more fully understood by the international community of bank supervisory and law enforcement officials. Insofar as the Federal Reserve was concerned, the first indications of more widespread wrongdoing in the United States began to surface in the period between late December 1988 and the summer of 1989.

E. FEDERAL RESERVE INVESTIGATION OF THE BCCI-CCAH LINK: 1989-PRESENT

The information described in this section is based on recent interviews with a number of persons involved in this matter and we are continuing in our efforts to reconstruct the events of two-and-a-half to three years ago. Based on this information, we know that, in early September 1988, an IRS special agent investigating BCCI contacted a supervisory official of the Board for technical assistance in connection with the proposed seizure of BCCI's Florida offices and indictment for money laundering. He stated that the IRS was investigating BCCI's money laundering in Florida. The agent explained that this was a sensitive undercover operation and that any leaks could jeopardize lives and compromise the investigation.

The Board staff member had a number of follow-up conversations with the IRS agent in late 1988 and early 1989. Probably during a telephone call in December 1988, the agent mentioned an allegation that he had received during the undercover operation from a "banker" that BCCI owned First American. The Federal Reserve staff member's calendar reflects a December 27, 1988, call from the IRS agent and that First American and the National Bank of Georgia were mentioned. The staff member recalls that, at some point during their telephone conversation, the IRS agent mentioned the allegation. According to the agent, the Federal Reserve staff member requested the evidence, but was not given the name of the person or other details because the information was not then public. As noted above, during late 1988, the agent and the staff member also discussed and agreed on the timing of the Federal Reserve's coordinated examination of the BCCI agencies to occur after the indictment.

The agent states that, on December 27, 1988, he telephoned the Federal Reserve staff member, and during the conversation, which was brief, asked what kind of information the Federal Reserve would need to order BCCI from the

country. The staff member had told the agent earlier that BCCI was an issue for the Federal Reserve and that, if the evidence were available, the Federal Reserve would order BCCI out of the country. The agent states that he asked, hypothetically speaking, whether a case could be made if he could provide the Federal Reserve with the names of five or six former BCCI officials who would testify that at an annual meeting of BCCI, a high level official stated BCCI owned and controlled First American. The Federal Reserve staff member is reported to have said that such statements would not be enough—that documentary evidence would be needed. The Federal Reserve staff member recalls that the agent at some point in their discussions mentioned a hypothetical, but does not recall that the agent's hypothetical included mention of five or six witnesses. The IRS did not provide the name of any witness until 1990, as discussed below.

The IRS agent indicates that on February 2, 1989, he had to travel to Washington for other purposes and decided to meet with the Federal Reserve staff member principally for the purpose of obtaining Federal Reserve information on BCCI and our investigation of the original CCAH application and to secure the Federal Reserve staff member's input into the agent's thinking on the investigation. According to the agent, he was interested in historical information on BCCI and any relationships between BCCI, the National Bank of Georgia, and First American because of earlier information he had obtained during the undercover operation about such relationships. There were several follow-up calls by the IRS to arrange access to Federal Reserve information and subpoenas for examination material. Also, in late December 1988, a Richmond Reserve Bank staff member received a press inquiry in which the reporter referred to an affidavit for a search warrant by an undercover agent stating that, during the undercover operation, a BCCI employee said that BCCI controlled the National Bank of Georgia and other banks.

A Federal Reserve investigator has subsequently interviewed this witness, who was the source of the allegation mentioned by the IRS agent to the Federal Reserve staff member in December 1988 and who was one of the BCCI employees indicted in October 1988 and convicted in May 1990. The witness stated, consistent with a transcript of his conversation with the undercover agent in September of 1988, that he has no direct evidence that BCCI owns First American and that his statement was based on rumor within the BCCI organization. This witness produced no evidence to support the Federal Reserve's case.

In the spring of 1989, the IRS talked to Richmond Reserve Bank staff regarding information on CCAH and First American and subsequently the Tampa U.S. Attorney's Office subpoenaed all relevant records, including Federal Reserve examination reports and internal documents. During the spring and summer of 1989, Richmond Reserve Bank personnel met with and provided information to the IRS regarding CCAH. The San Francisco and Atlanta Reserve Banks provided information as well.

F. RICHMOND RESERVE BANK REVIEW: JANUARY 1989

Because of these allegations raised by the IRS and because CCAH at that time had before the Federal Reserve an application to acquire another subsidiary bank, the Richmond Reserve Bank undertook in January 1989 a fresh review of any relationships between BCCI and CCAH. During a review, senior management of CCAH and First American stated that the relationship between CCAH and BCCI was no different than as represented to the Board in 1981 at the time of the original application, and that BCCI did not exercise a controlling influence over CCAH. The Richmond Reserve Bank examiner requested that Mr. Altman write to the president of each First American bank subsidiary, requiring a report on the relationship of the bank to BCCI and on any transactions conducted with BCCI by the bank. This survey of presidents disclosed no unusual relationships or transactions between the banks and BCCI. New York State authorities had also recently completed an examination of the New York bank subsidiary, during which the examiners focused closely on BCCI correspondent accounts and transactions and detected no irregularities. Moreover, again according to the IRS agent, the Federal Reserve staff member called him sometime in early 1989 requesting any information the IRS had on BCCI links with First American because of a then-pending application. The agent said he told the staff member he did not have anything, believing that the request related only to documentary evidence.

In its report on February 8, 1989, the Richmond Reserve Bank found no evidence of irregular or significant contacts between the First American banks and BCCI, or of failure by CCAH to adhere to the commitments it made to the Board in 1981. The Reserve Bank noted that the common ownership of CCAH and BCCI had increased. The Bank Holding Company Act does not prohibit common ownership of banks or nonbanks by individuals, as it does for companies.

G. CONTINUING INVESTIGATION

During 1989 and continuing into 1990, Federal Reserve efforts to pursue reports of a BCCI/First American link were often frustrated by our inability to obtain the documentary or corroborating evidence necessary to initiate actions against individuals or institutions that we now allege have violated laws and regulations. The Federal Reserve's investigation persisted into 1991, and it was the complex chain of information developed over this period that ultimately led to the needed evidence and our criminal referrals and civil enforcement actions.

During this period, Federal Reserve personnel made inquiries of law enforcement authorities and foreign bank supervisors seeking information. As we noted in the introduction, on June 1, 1989, a Federal Reserve official met with the Tampa prosecutors and stated that the Federal Reserve would be interested in the results of their investigation and would send staff down when the investigation was completed. The official offered the assistance of Federal Reserve examiners.

In the summer of 1989, during the course of a meeting on another matter, a senior official from the New York County D.A.'s Office informed a Federal Reserve official of certain unsubstantiated reports that BCCI owned CCAH through nominees. No concrete or specific information as to particulars or evidence was provided. On February 7, 1990, two experienced Federal Reserve counsel followed up these contacts by meeting with the U.S. Attorney's Office and IRS investigators who were investigating BCCI and, in June 1990, by arranging an information-sharing agreement with the New York County D.A., who was also investigating BCCI. We have described in the introduction the information on the BCCI/CAAH relationship that these agencies provided to the Federal Reserve during those contacts in 1990.

Also in the fall of 1989, Federal Reserve staff inquired of and received informal advice from a Luxembourg banking supervisor that BCCI had loans outstanding to certain CCAH shareholders. The supervisor did not know when the loans were booked and whether they were for the purchase of CCAH stock or for other business activities of the shareholders. Federal Reserve staff wrote to Mr. Altman on December 13, 1989, asking for information on any loans by BCCI or its affiliates to the original or subsequent investors in CCAH, either directly or indirectly and regardless of the purpose of the loan. Mr. Altman forwarded the letter to BCCI for response.

In February 1990, Mr. Altman responded with a letter stating that no pledge or security interest had ever been recorded on CCAH's share register by any lender. Mr. Altman did not mention the security interest BCCI had held in his and Mr. Clifford's shares from 1986 to March 1988. Mr. Altman also attached the response from the acting chief executive of BCCI, Mr. Naqvi, stating that BCCI had not financed the acquisition of Financial General in any respect and that none of the CCAH shareholders had personal loans from BCCI during the acquisition, secured by the CCAH shares. Mr. Adham, the principal shareholder of CCAH, also confirmed by letter in March 1990 that his CCAH acquisition was primarily from personal funds and was not financed by BCCI. In order to check the statements by Mr. Naqvi, Federal Reserve staff subsequently requested the assistance of the foreign bank supervisor who had originally provided information to the Board. The supervisor responded that he had encountered difficulties in obtaining the necessary information but would continue his investigation. An inquiry was also made of the Cayman supervisor, who reported he had no relevant records.

During August and September 1990, Federal Reserve investigators continued to meet with investigators from the New York County D.A.'s Office and obtained access to grand jury materials. In October 3, 1990, the New York County D.A.'s Office informed us that a confidential source had stated that a report prepared on October 3, 1990, by BCCI's outside auditors, Price Waterhouse, indicated that BCCI had made substantial loans to CCAH shareholders, secured by CCAH shares. The D.A.'s Office did not have the report, and Federal Reserve staff

immediately requested access to it from the United States general manager of BCCI. After a delay occasioned by the refusal of the auditor to permit the report to be examined by the Federal Reserve, BCCI agreed that a member of the Federal Reserve's supervision staff could review the report at BCCI's London office. The review was conducted on December 10, 1990.

The auditor's report and a conversation on that date with the new chief executive officer of BCCI indicated that BCCI had over \$1 billion in loans outstanding, secured by CCAH stock, and that these loans were nonperforming. This confirmed that BCCI held CCAH shares as collateral for substantial loans to CCAH shareholders. Shortly thereafter, attorneys from a U.S. law firm representing BCCI and its Abu Dhabi shareholders contacted the Board's general counsel to request a meeting. At a meeting on December 21, 1990, BCCI's counsel confirmed that a substantial amount of the stock of CCAH had been pledged to BCCI as collateral for hundreds of millions of dollars in loans to certain shareholders of CCAH. BCCI's counsel identified the borrowing shareholders and the amount of the loans. BCCI's counsel was advised of the seriousness of the matter under the Bank Holding Company Act, and was asked to provide all information regarding the loans and BCCI's arrangements with the borrowers.

Based on this and the other information uncovered during the Federal Reserve's investigation during 1989 and 1990, the Board, on January 4, 1991, issued an order formalizing our ongoing investigation and authorizing the use of subpoena powers. The Federal Reserve's investigation has been wide ranging but directed chiefly into the circumstances of BCCI's acquisition of control of CCAH and whether false or misleading statements had been made to the Board during the application process in 1981 and subsequently. Thus far, the investigation has included taking weeks of depositions, interviewing more than fifty witnesses, and seizing and reviewing a very large number of documents, including all CCAH records in the United States and the Netherlands Antilles and BCCI loan and other records relating to CCAH located abroad. The investigative team spent a week in Abu Dhabi reviewing BCCI's loan files on CCAH and conducting numerous interviews with BCCI officers.

The Federal Reserve's investigation has uncovered evidence of extensive and secret loan and nominee arrangements between BCCI and customers of BCCI designed to allow BCCI to acquire, in the name of these customers, the stock of the First American banking organization as well as other depository institutions in the United States. These arrangements in many cases involved sham loans to the BCCI customers with side agreements that the customers would not be required to repay or service the loans and that BCCI could sell the shares and retain the profits. In return for their services, the customers received fees and indemnities. These nominee arrangements are described in detail in the Board's civil money penalty and prohibition actions of July 12 and 29, 1991.

Many of these CCAH loans were never serviced or repaid except through other loans from BCCI. From the evidence available, it appears that these arrange-

ments, particularly in later years, enabled BCCI to generate hundreds of millions of dollars in fictitious assets to conceal massive losses in its trading and lending accounts.

Our investigation has also revealed more about how BCCI's ownership of CCAH stock was concealed from the Federal Reserve and other investigators. The shareholder register and other CCAH records in the United States and the Netherlands Antilles that were subject to Federal Reserve examination or review indicated that the individuals and companies listed in CCAH's filings with the Federal Reserve were in fact the owners of the shares of CCAH. There was no record of a security or other interest by BCCI in the CCAH shares. The documents that evidence the arrangements between CCAH shareholders and BCCI were all maintained outside the United States by the most senior management of BCCI in files that we understand were not available to the bank's auditors. Moreover, documents reviewed during the investigation suggest that BCCI deliberately structured various transactions so as to conceal from the Federal Reserve the relationship between BCCI and CCAH. Finally, there were the numerous denials by BCCI and CCAH representatives that any link existed.

H. 1991 CEASE AND DESIST ORDER REQUIRING DIVESTITURE OF CCAH SHARES

To terminate the illegal relationship between BCCI and CCAH, the Federal Reserve, on January 22, 1991, sent a proposed cease and desist order to counsel for BCCI and made criminal referrals to the Department of Justice. The cease and desist order, which was consented to by BCCI on March 4, had five principal components: requiring BCCI to divest promptly its CCAH shares; significantly restricting business transactions between BCCI and the First American banks; ensuring that BCCI had sufficient liquid assets to cover liabilities in the U.S. agencies; terminating BCCI's residual business presence in the United States; and requiring that BCCI cooperate in the Federal Reserve's investigation.

The order required BCCI promptly to divest its interest in CCAH through a plan to be submitted to the Board for its approval. The order, and a similar one on February 1, 1991, against CCAH, also prohibited transactions between BCCI and the First American banks (other than capital injections into the banks and certain clearing transactions in the ordinary course of business). After entry of the CCAH order on February 1, 1991, the Federal Reserve informed the First American Bank of New York that its clearing transactions for BCCI should be wound down and terminated. As a result of these actions, transactions between BCCI and the First American banks have been steadily eliminated. The relationship between BCCI and the First American Bank of New York—with which BCCI had maintained a correspondent relationship—was substantially wound down by July 5.

I. ADDITIONAL ACQUISITION OF U.S. DEPOSITORY INSTITUTIONS

The Federal Reserve's investigation continued after issuance of the March 4 order and discovered evidence that BCCI acquired interests in three additional U.S. depository institutions. Our evidence indicates that BCCI in 1985 acted through a nominee, Ghaith Pharaon, to acquire the Independence Bank, Encino, California, in violation of the Bank Holding Company Act. Independence Bank is a state nonmember bank supervised by the FDIC. The Federal Reserve's investigation also uncovered substantial evidence indicating that BCCI, acting through Mr. Pharaon, acquired during the 1980s a substantial interest in the National Bank of Georgia, a bank supervised by the comptroller of the Currency. NBG was purchased by First American in 1987 with funds the Board believes were provided to First American by BCCI. Finally, later in the investigation, we uncovered evidence that BCCI financed and acquired control of shares of Cent-Trust Savings Bank, Miami, Florida, in 1988-89, again acting through or with Pharaon.

On May 3, the Federal Reserve issued a second cease and desist order requiring BCCI to submit to the Federal Reserve a plan for the divestiture of any shares of Independence Bank within its control. A criminal referral relating to this violation was also filed.

In conjunction with the investigation, the Federal Reserve has also taken steps to monitor through the examination process the operations of the First American banks, and to determine what relationship the banks have with BCCI. Examinations and special reviews were undertaken by the Federal Reserve starting in January 1991. Over fifty senior Federal Reserve examiners have for the past nine months closely reviewed the First American banking organization, and these efforts continue. In addition, Federal Reserve investigators are working with other federal and state agencies to review transactions that may involve BCCI and related persons.

J. STATUS OF DIVESTITURE ORDERS

Recent events have made the requirement that BCCI divest the shares of CCAH and Independence Bank under its control the most difficult part of the cease and desist order to achieve. On May 3, BCCI submitted to the Federal Reserve a proposed divestiture plan for the CCAH shares, and on July 3, BCCI submitted a divestiture plan for the Independence Bank shares. The CCAH plan called for transfer of the shares of CCAH held by BCCI, and possibly shares held by other CCAH shareholders, to a trust administered by an independent trustee acceptable to the Federal Reserve. The trustee would vote the stock and negotiate its sale within a time frame agreed to by the Federal Reserve. We found the trust arrangement to be acceptable, but considered the proposal to be deficient because it failed to set forth the timing of the sale—specifically, there were no guarantees that the divestiture would be a prompt one, as required in the Federal Reserve's

order. We therefore rejected BCCI's proposal by letter of May 10, and required BCCI to submit within ten days a revised plan that addressed this concern.

On May 20, BCCI did submit a revised plan, which also relied on a trust arrangement. Although this new plan did not contain a timetable, it did contain details and conditions that appeared to expedite the sale. A preliminary draft of the trust agreement was submitted by BCCI on June 6.

Implementation of BCCI's proposed divestiture plans has been delayed by the seizure of BCCI by regulatory authorities. After those authorities seized control of BCCI on July 5, the officers and directors of BCCI were no longer able to negotiate or effectuate a divestiture of CCAH or Independence Bank stock on behalf of BCCI.

In our view, the July 5 seizure order does not void the Federal Reserve's divestiture orders, however. The orders remain effective and legally binding. The seizure shifts the task of implementing the orders from BCCI to the receivers for BCCI. We have been in contact with the receivers, explaining to them the need to achieve total divestiture as soon as possible, and requesting that they submit promptly a revised divestiture plan. The receivers have indicated a willingness to achieve divestiture through the trust arrangements, and our discussions are continuing.

K. FEDERAL RESERVE ENFORCEMENT ACTIONS TO DATE

As part of its investigation, the Federal Reserve is proceeding with enforcement actions as the evidence to support such actions is accumulated. On July 12, the Federal Reserve issued a notice of intent to bar from U.S. banking individuals participating in the Independence Bank violation. Those individuals are Agha Hasan Abedi and Swaleh Naqvi, two former senior officers of BCCI; Kemal Shoaib, a former officer of BCCI and the former chairman of Independence Bank; and Ghaith Pharaon, the owner of record of Independence Bank and a shareholder of BCCI.

More recently, on July 29, the Federal Reserve issued a notice of assessment of a \$200 million in civil money penalty against BCCI for its illegal acquisition of CCAH, the National Bank of Georgia, and CenTrust Savings Bank. The Federal Reserve also issued a notice of intent to bar permanently nine individuals associated with BCCI from any future involvement with U.S. banking organizations. On the same day, the District Attorney's Office for the County of New York secured indictments of BCCI and Messrs. Abedi and Naqvi. As noted, the U.S. Attorney in Tampa has also recently indicted senior officials of BCCI for racketeering involving money laundering.

The Federal Reserve is continuing to cooperate with law enforcement agencies, and will of course consult those agencies before taking enforcement action so as to avoid prejudicing any criminal investigation. Thus, at the request of the United States Attorney for the District of Columbia, the Federal Reserve has

deferred temporarily the assessment of substantial civil money penalties against the individuals already charged, pending completion of the United States Attorney's criminal inquiry.

III. The Lessons of the BCCI Affair

A. DOMESTIC INITIATIVES

As a result of the BCCI matter and other recent compliance problems with foreign banks, the Federal Reserve reviewed the statutes, regulations, and supervisory policies governing foreign bank operations in the United States. To help prevent a recurrence of such problems, the Federal Reserve has sent to Congress proposals to control the entry of foreign banks into the United States and strengthen the supervision and regulation of foreign banks once they have entered. Those proposals, collected as the Foreign Bank Supervision Enhancement Act of 1991, have been incorporated into comprehensive banking reform bills that have been reported out of this Committee and its counterpart in the Senate.

This legislation would establish uniform federal standards for entry, operation and expansion of foreign banks in the United States. The proposed legislation includes, importantly, requirements of consolidated home country supervision and supervisory access to information regarding the banking organization, and the application to foreign banks of the same financial, managerial, and operational standards that govern U.S. banks. The proposal would also grant federal regulators the authority to terminate the U.S. presence of a foreign bank that is engaging in illegal, unsafe, or unsound practices.

As the BCCI affair amply demonstrates, continuing consolidated supervisory oversight of a bank's operations is essential to maintaining the integrity of the bank's operations and preventing adverse effects on the financial system. BCCI operated without a supervisor who could regulate and examine the consolidated financial organization, and BCCI was therefore able to manipulate its books and conceal its actual financial condition with minimal chance of detection.

Of course, the Federal Reserve's legislative recommendations would not guarantee that criminal activity by foreign banks would not recur. Fraud is extremely difficult for any regulator to detect, especially when transactions are deliberately and illegally structured to conceal relationships and when the relevant information is maintained secretly outside the United States. The Federal Reserve's proposals attempt to address the potential for illegal activities by creating a bar to U.S. entry by weakly capitalized, poorly managed or inadequately supervised organizations.

As a result of recent experience, the Federal Reserve is devoting more resources to examining, tracking, and monitoring foreign bank operations and will need to increase resources in this area if the legislation is enacted. In addition, we believe that it would be useful to establish a small unit of trained investigators

to handle cases where examination procedures and methods are not sufficient to detect or prove the wrongdoing.

B. IMPROVING INTERNATIONAL COOPERATION

The BCCI case also highlights the pressing need for greater international cooperation among bank regulators.

The vehicle for improved international banking supervision is the Basle Supervisors Committee, comprised of the Federal Reserve and other central banks and bank regulators. That Committee's achievements so far have included the adoption of the Concordat, which is the statement of fundamental principles governing supervision of banks operating across borders, and the establishment of international capital standards.

At its meeting in Stockholm in early September, the Committee, under the guidance of President Corrigan, its newly elected chairman, began discussions of the important lessons to be learned from the BCCI matter. The Committee has commissioned, and hopes to have finished by its December meeting, an issues paper that will consider a range of subjects stemming from the BCCI matter. These include: (1) standardized criteria for the establishment by foreign banks of branches or subsidiaries; (2) what steps can be taken to strengthen procedures for the cross-border sharing of supervisory information, especially in times of stress; (3) whether contagion problems are of such a nature as to render distinctions between branches and subsidiaries of little utility in times of stress; (4) the relationship between home country and host country supervisors as it pertains to the supervision of branches; (5) whether consolidated supervisory responsibility should rest in a single home country supervisor or be shared among several supervisors acting as a college; and (6) whether and to what extent supervisors may require changes in corporate structures where such structures may, by their nature, hinder effective supervision.

One major practical issue confronts the Federal Reserve and other U.S. regulatory agencies in efforts to cooperate with foreign regulators. Whereas certain other Western nations have statutes that protect confidential bank supervisory information obtained from foreign regulators from release to the public or even to the legislature, information obtained by U.S. regulators from foreign sources does not enjoy the same confidentiality. Because as U.S. regulators we may not assure our foreign counterparts that the information that we receive from them will be held confidential, those governments may be less willing, or legally unable, to share information with us fully or completely, or to do so on a regular or timely basis. While we are sensitive to and respectful of the prerogatives of the legislature to seek and obtain necessary information, we also believe that the conflict between U.S. regulators' need for international cooperation, particularly with increasing globalization of banking and the need of the Congress to access information for its oversight and investigatory responsibilities, is a question that merits careful consideration.

IV. Conclusion

The Federal Reserve is actively engaged in dealing with the BCCI matter and has deployed its most experienced and proven staff to the task. The Federal Reserve will continue to cooperate with federal, state, and foreign bank supervisors and law enforcement agencies. Our immediate goals are to conclude our investigation; to make the current separation in fact between BCCI and U.S. banks a complete separation in law, so that these banks can be relieved of any remaining BCCI taint and operate free and clear of this controversy; and to ensure that all wrongdoers are prosecuted civilly and criminally to the extent permitted by law.