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International Commentary

Breaking the Bank

Through all the years of delay and distrust, the depositors of the failed Bank of Credit and Commerce International (BCCI) have been asking the same question: Why didn't the Bank of England shut down the renegade bank sooner?

The defrauded depositors -- including thousands of Pakistani immigrants to the United Kingdom and a score of local councils in Britain -- have tried hunger strikes, letters and lawsuits to emphasize their plight. A decade later, they may finally get answers from the Bank of England -- thanks to a recent ruling by the Law Lords, Britain's supreme court. For the first time in its 307-year history, the Bank of England will answer a civil lawsuit about its duties. To understand the charges of lax oversight, we need to go back to the beginning of the largest bank scandal in the history of money.

BCCI was founded by a mysterious Pakistani, Agha Hasan Abedi, in Abu Dhabi in the early 1970s. He signed up oil sheiks to publicly guarantee the bank's deposits, but in reality, BCCI had secret contracts to protect the sheiks from any losses.

By the late 1970s, the bank was expanding into the United States and Western Europe. BCCI's quiet takeover of a Washington, D.C. bank -- later known as First American Bankshares Corp. -- raised regulators' eyebrows. The Middle-Eastern parties had not properly disclosed their stakes to the U.S. Securities and Exchange Commission. But, with some adroit lobbying, BCCI got a pass.

Meanwhile, new legislation in the U.K. forced BCCI to petition the Bank of England for a license in 1980. BCCI, which had more branches in the U.K. than in any other nation, needed that license to maintain its links to Europe's largest financial center.

At the time, BCCI's corporate structure was worth a closer look. It was incorporated in Luxembourg, which is famous for its bank-secrecy laws. BCCI was operating as an essentially offshore bank in London. Indeed, BCCI was designed to be "offshore everywhere" -- with holding companies in Luxembourg, the Cayman Islands (another haven of bank secrecy), and the Netherlands Antilles (ditto), and operations spread over dozens of jurisdictions from Hong Kong to Abu Dhabi to Washington, D.C. But BCCI got its U.K. license.

Critics now claim that the U.K. subsidiary of BCCI was not lawfully entitled to a banking license. The Bank of England says it relied on the fact that BCCI was already licensed in Luxembourg.

Throughout the 1980s, BCCI made a number of questionable moves that might have seized the attention of British regulators if they had been more alert. There were the persistent rumors of money laundering at the bank and payoffs to regulators. Panama's strongman Manuel Noriega was a BCCI customer as were a raft of the unsavory characters from around the world. In banking circles, BCCI became jokingly known as the "Bank of Crooks and Corruption International."

In 1987 the Luxembourg government notified British authorities that it no longer had the resources to supervise BCCI's far-flung operations. A senior Bank of England official responded on April 8, 1987: "your letter poses a particular problem for us." Why? "We believe that the incorporation of the 45 U.K. branches, combined with the presence in London of a large part of BCCI's overall administration, is likely to draw us in practice into the position of lead supervisor which we seek to avoid."

If the Bank of England became the lead supervisor of BCCI -- essentially the regulator that other nations relied on -- it would have to reconsider BCCI's banking license. "We are not all certain that we would feel able to grant a license by applying the criteria under the U.K. Banking Act to any part of the [BCCI] operation at this stage." To grant such a license under British law would require that the Bank of England find that BCCI is "run with integrity -- and our experience with BCCI in the past make such a judgment difficult."

The BCCI stink kept growing. A 1989 sting operation at a BCCI branch in Tampa, Florida uncovered proof of money laundering on a global scale. Then BCCI's accounting firm, PriceWaterhouse, which later merged with another firm and became PriceWaterhouseCoopers, discovered what it called an "Aladdin's cave" of secret documents in Abu Dhabi. When tipped off by the accountants, the Bank of England launched an investigation in April 1990. But it did not shut down BCCI.

At the same time, New York District Attorney Robert Morgenthau was probing BCCI. During the crucial months in 1990 and 1991 before the closure of BCCI, the Bank of England failed to turn over documents concerning BCCI to American authorities and even initially refused to send a copy of its own internal investigation. That difficulty was remedied later by Eddie George, now the bank's governor, and the U.S. authorities say they got excellent cooperation after Mr. George stepped in.

In July 1991, BCCI's fraudulent activities were fully exposed. BCCI's 400 branches in 70 countries were seized; depositors and creditors were facing losses totaling more than $9 billion.

Thanks to the doggedness of liquidators, the creditors and depositors have received three interim payments totaling more than $7 billion -- more than 60% of the money they are owed (including interest owed). That's not bad, considering that initial recovery estimates ranged from zero to 10%. (American liquidators actually recovered $540 million more than U.S. creditors were owed; the surplus was remitted to overseas depositors.)

This case against the Bank of England promises to be one of the most costly in British legal history. The Law Lords repeatedly barred attempts to sue the bank for negligence, citing the Bank's parliamentary grant of immunity. So liquidators brought suit on the grounds of "misfeasance" -- what plaintiff's attorney Neil Dooley calls "an ancient and little-used tort" that requires litigants to prove deliberate recklessness or wrongdoing. That may be hard to do. The Bank of England denies the charges.

Whatever the merits of the case against the Bank of England, one lesson emerges for bank regulators everywhere: More vigorous enforcement might have saved a lot of money and embarrassment.

-- *From The Wall Street Journal Europe*