

**The Kabul Bank Scandal
and the
Crisis that Followed**

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Acronyms

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| ASFF | Afghanistan Security Forces Fund |
| AIC | Afghan Investment Company |
| AGO | Attorney General's Office |
| ARTF | Afghanistan Reconstruction Trust Fund |
| DAB | Da Afghanistan Bank |
| ECF | Extended Credit Facility |
| EGGI | Economic Growth and Governance Initiative |
| FSWG | Financial Sector Working Group |
| HOOAC or HOO | High Office of Oversight and Anti-Corruption |
| IMF | International Monetary Fund |
| LOTFA | Law and Order Trust Fund for Afghanistan |
| MLR | Material Loss Review |
| USAID | United States Agency for International Development |
| UNCAC | United Nations Convention Against Corruption |

Executive Summary

This paper tells the story of the Kabul Bank scandal and the crisis that followed it. The Karzai administration's response to the crisis is described, particularly its efforts to protect the main individuals behind the scandal, or the Kabul Bank shareholders, from criminal prosecution. The Karzai administration stalled the proper resolution of the banking crisis and the criminal activity, searched for scapegoats, and exonerated the accused.

Kabul Bank was Afghanistan's largest private bank with member deposits totaling \$1.3 billion in the summer of 2010. The Kabul Bank scandal began in late-August 2010 after the Afghan public learned that Kabul Bank posted a \$300 million loss and that its two top executives and leading shareholders, Chairman of the Board of Supervisors Sherkhan Farnood and Chief Executive Officer Khalilullah Ferozi, were fired. A bank run ensued from September 1st to the 8th. During this time, the Karzai administration enabled Kabul Bank to honor the flood of withdrawals through an \$820 million bailout from the government's reserve fund.

The magnitude and nature of the Kabul Bank fraud was learned first in July 2010 when Chairman Farnood himself reported the details of the scam to U.S. authorities after he and CEO Ferozi had a falling out. Two important central bank documents for understanding the Kabul Bank fraud are a May 2010 report and an October 31, 2010, Material Loss Review, neither of which are available to the public. The MLR found that Kabul Bank committed 18 violations of Afghan banking law and that all four of Kabul Bank's leadership and administrative bodies participated in the fraud.

The Kabul Bank fraud resembled a Ponzi scheme. Farnood and Ferozi directed the fraud by creating fictitious companies and then writing loans to these companies. Instead the money was doled out to Kabul Bank's shareholders and other members of the Afghan elite, including leading business figures, Cabinet ministers, members of Parliament, and former politicians. These individuals spent the money on business ventures, family members, luxurious living, President Karzai's 2009 re-election campaign and political agenda, and more.

The nonexistent companies were created to hide the scam. Hundreds of millions of dollars were "loaned" to about 200 fake companies. This money was then transferred to the Shaheen Exchange, a Farnood-owned money transfer business in Dubai. Next, the money was returned to Afghanistan under fictitious names to the actual recipients.

Auditors failed to catch the Kabul Bank fraud for several reasons. First, the perpetrators of the Kabul Bank fraud deliberately hid their criminal activity. Second, Kabul Bank had two sets of books: a fake set in Kabul and a real set at the Shaheen Exchange. Auditors worked with the fake books. Third, Kabul Bank regularly bribed various government officials (maybe even the independent auditors and the central bank examiners) to look the other way.

Fourth, Kabul Bank was protected from government regulatory scrutiny due to its political ties to the Karzai administration through two of its shareholders, Mahmoud Karzai, the president's brother, and Abdul Haseen Fahim, the first vice-president's brother. Central bank examiners that tried to conduct rigorous on sight inspections in January 2010 were intimidated and threatened, as was an international banking advisor attached to the central bank in 2008.

The IMF refused to renew its Extended Credit Facility program with Afghanistan in September following the Kabul Bank scandal, and this triggered an international aid crisis. Many donor countries will not give to low-income countries that do not have an active IMF program.

The IMF issued several demands to the Afghan government before the Extended Credit Facility program would be renewed. The demands included: conducting forensic audits of Kabul Bank and Azizi Bank (another bank suspected of corruption), reforming banking and lending laws, prosecuting those responsible for the Kabul Bank fraud, devising an acceptable plan to recapitalize the government's reserves for the \$820 million bailout, and placing Kabul Bank into receivership.

As of early December 2011, only the last two demands were met. On April 18, 2011, Kabul Bank was dissolved as a legal entity, through a process known as receivership, and the "good" part of the bank was renamed "New Kabul Bank." On October 15, 2011, the Afghan Parliament passed a tax bill to recapitalize the government's reserves over the next eight years.

The Attorney General's Office investigation into Kabul Bank began late and was marred by "a lack of technical capacity to understand the transactions" and "by political pressure from President Karzai's office." Instead, the Attorney General's Office searched for scapegoats by targeting lesser-ranking Kabul Bank staff as opposed to the shareholders.

In February, the Afghan Ministry of Finance blamed auditors and international advisors in part for the Kabul Bank scandal, alleging that they bore some responsibility for failing to prevent the fraud. President Karzai echoed the allegations in April and took the additional step of calling for their prosecution. A March USAID report faulted the international advisors contracted to work at the central bank for failing to report "fraud indicators." However, the report also noted that the advisors were not mandated "to supervise private banks," but "to provide trainers and technical experts to build the capacity of the Bank Supervision unit within the Central Bank...."

Farnood and Ferozi were arrested at the end of June, indicted at the end of July, and then released in September without standing trial. The legal ground for their release is unclear. It is increasingly unlikely that neither Farnood and Ferozi, nor any other of the Kabul Bank shareholders, will ever go to trial for the Kabul Bank fraud. On November 15, 2011, the IMF's Executive Board approved a new ECF program, effectively bringing the Kabul Bank crisis to an end in so far as the unfreezing of foreign aid was concerned.

Introduction

In February 2010, the Washington Post published two articles about two separate cases of corruption in Afghanistan. The cases involved powerful political and business figures that were stealing billions of dollars from the Afghan people.

The February 22nd Washington Post article described the reckless management practices and outright theft at Kabul Bank.¹ The February 25th Washington Post article revealed that each year billions of dollars leave Kabul International Airport and are flown to Dubai in the United Arab Emirates.²

The Wall Street Journal followed up the airport story in June.³ Within days of the article, a U.S. congresswoman temporarily froze \$3.9 billion in aid to Afghanistan until, as the congresswoman put it, "... I have confidence that U.S. taxpayer money is not being abused to line the pockets of corrupt Afghan government officials, drug lords, and terrorists."⁴ Then, in September, Kabul Bank nearly collapsed –hundreds of millions of dollars in deposits by the Afghan public had vanished.⁵

Corruption is defined as "the abuse of public position for private gain."⁶ High corruption in Afghanistan, or the corruption committed by senior government officials such as Cabinet ministers, governors, members of Parliament, military commanders, police chiefs and the like, can be more than just isolated and unconnected cases of bribery. In Afghanistan, corruption among the Afghan elite often works through networks that connect government and private actors across the country.⁷

Former Afghan Foreign Minister and current National Security Advisor Rangin Dadfar Spanta described Afghanistan's high corruption in this way: "In this government, we have mafia networks..." and they "...begin with the financial banking system, with

¹ Andrew Higgins, "[In Afghanistan, Signs of Crony Capitalism](#)," Washington Post, February 22, 2010.

² Andrew Higgins, "[Officials Puzzle Over Millions of Dollars Leaving Afghanistan by Plan for Dubai](#)," Washington Post, February 25, 2010. Not all of the money leaving the airport is from corruption. A large part of the money is likely from US government payments to contractors and subcontractors because the amount of money leaving the airport is too large to be associated with anything else. See: Mark Landler, "[Envoy Says Corruption Helps Taliban Win Recruits](#)," New York Times, July 28, 2010; Maria Abi-Habib, "[U.S. Checks Afghan Cash Flow](#)," Wall Street Journal, July 22, 2010. For how money from the US government flows through the Afghan economy, see: Office of the Special Inspector General for Afghanistan Reconstruction, "[Limited Interagency Coordination and Insufficient Controls Over U.S. Funds in Afghanistan Hamper U.S. Efforts to Develop the Afghan Financial Sector and Safeguard U.S. Cash](#)," SIGAR-Audit-11-13, July 20, 2011.

³ Matthew Rosenberg, "[Corruption Suspected in Airlift of Billions in Cash from Kabul](#)," Wall Street Journal, June 25, 2010.

⁴ The congresswoman was Nita Lowey, who at the time was the Chairwoman of the Subcommittee on State, Foreign Operations, and Related Programs, which is part of the House Committee on Appropriations. See: Peter Spiegel and Matthew Rosenberg, "[Afghan Aid on Hold as Corruption is Probed](#)," Wall Street Journal, June 28, 2010.

⁵ Dexter Filkins, "[Troubles at Afghan Bank Iolt Financial System](#)," New York Times, August 31, 2010.

⁶ USAID, "[Assessment of Corruption in Afghanistan](#)," 2009, p. 1. Low-level corruption, or corruption experienced by the general public when seeking government services, is also a big problem in Afghanistan. See: United Nations Office on Drugs and Crime, "[Corruption in Afghanistan: Bribery as Reported by the Victims](#)," unodc.org, January 2010; Integrity Watch Afghanistan, "[Afghan Perceptions and Experiences of Corruption, a National Survey 2010](#)," iwaweb.org, 2010. For a brief overview of what was done to fight corruption in Afghanistan during President George W. Bush's presidency, see: "[Fighting Corruption in Afghanistan: a Roadmap for Strategy and Action](#)," unodc.org, February 17, 2007. Note that the link to this last source is a direct PDF download link.

⁷ In this paper, the Afghan elite refers to both high ranking government officials and powerful non-government figures.

corruption networks, with reconstruction and security firms and also with drugs and with the Taliban; they are in parliament and they are in government.”⁸

While the U.S. government has known that many Afghan officials are corrupt, it only learned the actual extent of the corruption a couple of years ago “when a powerful wiretapping system came online as part of efforts to disrupt Taliban financing networks.”⁹ The wiretaps intercepted calls from the Afghan elite and Taliban insurgents.

A U.S. official describing what the wiretaps revealed, stated, “All these people talking about bribes and pretty much any kind of corruption you can imagine started coming up.... It was all connected.”¹⁰ Another U.S. official said, “We looked around and realized how deep all this ran. The corruption went from the top [of the government] to the bottom.... It ran sideways to the Taliban. It went in every direction.”¹¹

From the wiretaps, the U.S. government drew up charts and made PowerPoint slides to physically map out the corruption networks. Confirming Spanta’s description of “mafia networks” within the Karzai government, the charts and slides vividly illustrated “webs of connections between members of President Hamid Karzai’s family, businessmen, corrupt officials, drug traffickers and Taliban commanders.”¹² The Kabul Bank scandal is an example of one of these corruption networks because it connected over a hundred political leaders and other members of the Afghan elite in a vast corruption scandal.

To date, no U.S. officials have stated publically, or off the record, that President Karzai himself is stealing money, and the two scandals described in the Washington Post’s February 2010 articles do not directly connect Karzai to theft either. However, analysis of the two scandals demonstrates that President Karzai protects these crooks and their corruption networks. This paper examines only the Kabul Bank scandal and the crisis associated with it.

The Kabul Bank scandal is important for many reasons. Locally, the scandal was about hundreds of millions of dollars that were stolen from the Kabul Bank depositors. Given Afghanistan’s modest economy, the scandal is “the biggest per capita fraud in history.”¹³ Politically, the scandal implicated ministers in the Karzai government and many members of Parliament. Economically, the scandal threatened to bring down Afghanistan’s fledgling financial system because the Afghan public’s faith in its banks was shaken.

The Kabul Bank scandal ignited a budgetary crisis as the Afghan government scrambled to replenish its monetary reserves to cover the Kabul Bank bailout at a time when donor aid to the Afghan government’s operating budget was scheduled to decline in the coming

⁸ Matthew Rosenberg, “[‘Malign’ Afghans Targeted](#),” Wall Street Journal, December 29, 2010. Spanta himself was accused of corruption in 2009 by then Deputy Attorney General Fazel Ahmed Faqiryar. See: “[Karzai Defends Cabinet Under International Ire](#),” USA Today, December 20, 2009.

⁹ Matthew Rosenberg, “[‘Malign’ Afghans Targeted](#),” Wall Street Journal, December 29, 2010.

¹⁰ Ibid.

¹¹ Ibid. Words in brackets added by the Wall Street Journal.

¹² Ibid.

¹³ Jon Boone, “[Kabul Bank Fraud: Consultants Ignored Warning Signs, Report Says](#),” Guardian, May 11, 2011.

fiscal years. Complicating the budgetary crisis, the Kabul Bank scandal triggered the freezing of a significant portion of international aid to Afghanistan.

Analysis of the Kabul Bank scandal also demonstrates that there is a pattern to the high corruption. It illustrates how President Karzai and his administration respond when members of the Afghan elite are caught in criminal activity. They stall the proper resolution of the crime (-s), search for scapegoats, and exonerate the accused.

How it Happened

Kabul Bank (now “New Kabul Bank”) was Afghanistan’s largest private bank. It opened on June 24, 2004, and in 2010 had 68 branches with at least one bank in each of Afghanistan’s 34 provinces.¹⁴ By September 2010, Kabul Bank had received about \$1.3 billion in deposits from the Afghan public.¹⁵ Kabul Bank also managed a \$1.5 billion annual contract to pay the salaries of about 80% of Afghanistan’s government workers.¹⁶ (New Kabul Bank retained the contract.)

The public first learned of Kabul Bank’s financial problems in the February 22nd Washington Post article. The Washington Post collected evidence on Kabul Bank’s mismanagement by carefully studying land registration data and public records, as well as conducting interviews in Kabul, Dubai, Abu Dhabi, and Moscow.¹⁷

The Kabul Bank scandal began at the end of August 2010, after word spread in Afghanistan that Kabul Bank reported a \$300 million loss and that its two top executives, Chairman of the Board of Supervisors Sherkhan Farnood and Chief Executive Officer Khalilullah Ferozi (also spelled Frozi or Fruzi), were fired for financial mismanagement.¹⁸ Afghan central bank Governor Abdul Qadir Fitrat denied that the two men were fired and said that they resigned to meet a new central bank requirement.¹⁹ Afghanistan’s central bank is called “Da Afghanistan Bank” (DAB) and is the main banking regulatory body in the country. Frantic and angry Kabul Bank depositors rushed to withdraw their money from the bank starting on Wednesday, September 1st.

That Kabul Bank was a disaster waiting to happen was an “open secret.”²⁰ In 2008, legislatures warned Fitrat, that the crash of the Dubai real estate market would hurt Kabul

¹⁴ For more factual information about Kabul Bank, visit its website at <http://www.kabulbank.af/html/AboutUs.html>. Retrieved on December 1, 2011.

¹⁵ Joshua Partlow and Andrew Higgins, “[Afghan Authorities Take Over Largest Bank to Avoid Meltdown](#),” Washington Post, August 31, 2010.

¹⁶ This money is foreign aid. Kabul Bank made money for managing the contract and earned a significant amount in interest for holding the money, perhaps as much as \$10 million a year. See: Dexter Filkins, “[Letter From Kabul: The Great Afghan Bank Heist](#),” The New Yorker, February 14, 2011.

¹⁷ Andrew Higgins, “[In Afghanistan, Signs of Crony Capitalism](#),” Washington Post, February 22, 2010.

¹⁸ Matthew Rosenberg, “[Withdrawals Continue at Afghanistan’s Largest Bank](#),” Wall Street Journal, September 6, 2010; Adam B. Ellick and Dexter Filkins, “[Political Ties Shielded Bank in Afghanistan](#),” New York Times, September 7, 2010.

¹⁹ Abdul Qadeer Siddique, “[Kabul Bank not Under DAB: Fitrat](#),” Pajhwok Afghan News, September 1, 2010.

²⁰ Joshua Partlow and Andrew Higgins, “[U.S. and Afghans at Odds over Kabul Bank Reform](#),” Washington Post, October 7, 2010.

Bank's investments in that market.²¹ Member of Parliament Aziz Ahmad Nadem, asked Fitrat to appear before the Parliament's National Economic Committee to respond to questions about "the impact of the collapsing real estate market in Dubai and about the bank's finances."²² In a September 2010 interview, Nadem stated:

We warned him [Fitrat] and said that we knew one day that Kabul Bank might have a problem. We told him that Kabul Bank was collecting money from lots of people and they [Kabul Bank] were investing outside the country. Well, he [Fitrat] told us, 'We are regularly monitoring Kabul Bank and they are doing business and everything is normal and according to international standards.'²³

Similarly, in 2009, then chairman of the High Office of Oversight and Anti-Corruption (HOOAC, or 'HOO' in this paper), Mohammad Yasin Usmani, reportedly wrote Governor Fitrat a letter and sent a delegation to see him about Kabul Bank. Usmani claims that Fitrat rejected the HOO team and said that "everything" was "okay" at Kabul Bank.²⁴

Also in 2009, a Kabul Bank audit "documented several irregularities."²⁵ Afghan banking law requires banks to submit quarterly and annual audits to the central bank, which must include information on "nonperforming loans and loan losses."²⁶ Banks also are required to have "independent external" auditors.²⁷ Kabul Bank's independent auditor was A.F. Ferguson & Co, a Pakistani-based affiliate of PricewaterhouseCoopers.

In late 2009, Fitrat's opinion of Kabul Bank reversed. That November, Fitrat "raised serious concerns" about Kabul Bank with the lead advisor of Deloitte, a consulting and accounting company contracted to work at the central bank by the U.S. Agency for International Development (USAID).²⁸

In January 2010, the central bank took more seriously than before its regular inspections of Kabul Bank, and instructed its examiners "to look for insider trading."²⁹ The inspection team was "indirectly threatened by Kabul Bank management."³⁰ In March, "efforts to intimidate DAB's examiner's intensified" as the central bank continued probing into Kabul Bank.³¹

²¹ Alissa J. Rubin, Charlie Savage, and Rod Nordland, "[Regulators Ignored Warnings About Afghan Bank](#)," New York Times, September 18, 2010.

²² Ibid.

²³ Ibid. Words in brackets added for clarification.

²⁴ Heidi Vogt and Rahim Faiez, "[Afghan Probe: Monitors at Fault in Bank Crisis](#)," Associated Press, Boston Globe, May 29, 2011.

²⁵ Ibid. This was probably an A.F. Ferguson quarterly audit and it is not located on the Kabul Bank website.

²⁶ For audit requirements, see: "Law of Banking," Article 42.4-5. A PDF copy of Afghanistan's banking law may be downloaded from the DAB's website at: <http://www.centralbank.gov.af/laws-and-regulations.php>. Select "Law of Banking in Afghanistan." Retrieved on May 11, 2011.

²⁷ "Law of Banking," Article 43.

²⁸ USAID, Office of the Inspector General, "[Review of USAID/Afghanistan's Bank Supervision Assistance Activities and the Kabul Bank Crisis](#)," Report No. F-306-11-003-S, March 16, 2011, p. 5.

²⁹ Ibid, p. 6. The "insider trading" probably refers to insider loans.

³⁰ Ibid.

³¹ Ibid.

A February 13, 2010, U.S. Embassy cable, obtained by Wikileaks, stated that Kabul Bank was “the least liquid bank operating in Afghanistan” and that it took “more than two days to process withdrawals and [Kabul Bank] has delayed paying government employee salaries by two weeks in order to place those funds in overnight accounts to collect interest.”³²

Also in February, Fitrat asked the U.S. Treasury Department “to arrange a forensic audit of Kabul Bank and Azizi Bank.”³³ A forensic audit is the preferred audit in corruption cases because the evidence collected by it can be used for prosecution.³⁴ Azizi Bank is Afghanistan’s second largest private bank and is suspected of impropriety, although the Afghan government denies it.³⁵ Afghanistan’s other private commercial banks also are suspected of “accounting irregularities and questionable loans” similar to those of Kabul Bank.³⁶

The central bank issued a report on Kabul Bank in May, based on its January inspection and subsequent investigation, and the report identified numerous problems.³⁷ The report concluded with the ominous warning: “Ignoring the mentioned failures and shortcomings and failing to fix them will result in serious challenges and problems for the bank in the future.”³⁸ In July 2010, pressure mounted on the central bank to intervene at Kabul Bank, but it could do so only with President Karzai’s approval, since the bank was protected politically.

Quite unexpectedly that month, Kabul Bank Chairman Sherkhan Farnood visited the U.S. Embassy in Kabul and blew the whistle on Kabul Bank, telling the U.S. embassy staff “everything.”³⁹ Farnood told all because he and CEO Ferozi had a falling out that summer and, consequently, Farnood was reported to have feared losing his influence at Kabul Bank.⁴⁰

Two other significant events occurred in July. First, the new U.S. Commander in Afghanistan, General David Petraeus, met with Fitrat and President Karzai to discuss Kabul Bank.⁴¹ At the meeting, Fitrat presented Karzai with evidence of Kabul Bank

³² Words in brackets added. Alissa J. Rubin and James Risen, “[Losses at Afghan Bank Could be \\$900 Million](#),” New York Times, January 30, 2011. About the same time as the US embassy cable was written, CEO Ferozi boasted that Kabul Bank had \$400 million in “liquid assets.” See: Andrew Higgins, “[In Afghanistan, Signs of Crony Capitalism](#),” Washington Post, February 22, 2010.

³³ “USAID, Office of the Inspector General, “[Review of USAID/Afghanistan’s Bank Supervision Assistance Activities and the Kabul Bank Crisis](#),” Report No. F-306-11-003-S, March 16, 2011, p. 6.

³⁴ For a basic description of a forensic audit, see: Andy Pasquesi, “[What is a Forensic Audit?](#),” eHow.com, Retrieved on June 13, 2011.

³⁵ Hamid Shalizi, “[No Crisis at Second Afghan Bank –Central Bank](#),” Reuters, July 16, 2011.

³⁶ Matthew Rosenberg, “[Afghanistan Rejects U.S. Aid for Bank Audits](#),” Wall Street Journal, November 26, 2010.

³⁷ “USAID, Office of the Inspector General, “[Review of USAID/Afghanistan’s Bank Supervision Assistance Activities and the Kabul Bank Crisis](#),” Report No. F-306-11-003-S, March 16, 2011, p. 6. See also: Joshua Partlow and Andrew Higgins, “[U.S. and Afghans at Odds over Kabul Bank Reform](#),” Washington Post, October 7, 2010. The May 2011 central bank report is not available to the public; however, the Washington Post obtained a copy of it.

³⁸ Ibid.

³⁹ Andrew Higgins, “[Kabul Bank Crisis Followed U.S. Push for Cleanup](#),” Washington Post, September 17, 2010.

⁴⁰ Ibid. The Farnood-Ferozi schism might have occurred because of Kabul Bank’s financial troubles.

⁴¹ Ibid.

fraud, and Petraeus urged the president to take action.⁴² Second, Fitrat sought approval from the Parliament for a \$200 million “safety net trust fund for private banks,” which essentially was a bailout tool.⁴³ The safety net scheme likely had Kabul Bank in view and signaled Fitrat’s alarm over the bank’s financial condition.

On August 29, Fitrat met with the Kabul Bank shareholders in a meeting whose tone is described as having “little sense of urgency.”⁴⁴ Farnood and Ferozi agreed to resign “at some unspecified time in the near future.”⁴⁵ However, the following day, Monday, August 30, President Karzai is reported to have summoned his brother, Mahmoud, the third leading shareholder of Kabul Bank, to the presidential palace and “berated him over the state of affairs at Kabul Bank.”⁴⁶ Karzai’s anger was likely triggered by the bank’s posting of a \$300 million loss.⁴⁷

On the same day, Fitrat went to Kabul Bank and demanded the immediate resignation of both Farnood and Ferozi under the threat of imprisonment. While Fitrat was the administration official that fired Farnood and Ferozi, given the Afghan political context, it is certain that Fitrat acted under President Karzai’s direct orders. Members of the Afghan elite who are connected to President Karzai cannot be fired, arrested, or prosecuted without the president’s approval.⁴⁸ Farnood later recalled, “It was an easy choice. I resigned.”⁴⁹ In their place, the central bank installed its own chief financial officer, Masood Ghazi, to oversee Kabul Bank.

The government’s radical action of removing Farnood and Ferozi and appointing Ghazi to oversee Kabul Bank was part of a banking corrective process known as “conservatorship.”⁵⁰ Under Afghan banking law, the legal ground for placing a bank in conservatorship (the reason why it is done) is bankruptcy.⁵¹

Word of Farnood and Ferozi’s dismissal and Kabul Bank’s mismanagement leaked out and caused a panic. The next seven business days witnessed a stampede of angry Kabul Bank members withdrawing all their money as quickly as possible. One Kabul Bank member declared, “If they do not listen to us we will break all the windows of Kabul

⁴² Joshua Partlow and Andrew Higgins, “[Afghan Authorities Take Over Largest Bank to Avoid Meltdown](#),” Washington Post, August 31, 2010.

⁴³ Alissa J. Rubin, Charlie Savage, and Rod Nordland, “[Regulators Ignored Warnings About Afghan Bank](#),” New York Times, September 18, 2010.

⁴⁴ Andrew Higgins, “[Kabul Bank Crisis Followed U.S. Push for Cleanup](#),” Washington Post, September 17, 2010. Assuming this was the same event, then previously it was reported to be a “stormy and inconclusive meeting.” See: Joshua Partlow and Andrew Higgins, “[Afghan Authorities Take Over Largest Bank to Avoid Meltdown](#),” Washington Post, August 31, 2010. Note that Higgins is associated with both articles.

⁴⁵ Andrew Higgins, “[Kabul Bank Crisis Followed U.S. Push for Cleanup](#),” Washington Post, September 17, 2010.

⁴⁶ Ibid.

⁴⁷ Adam B. Ellick and Dexter Filkins, “[Political Ties Shielded Bank in Afghanistan](#),” New York Times, September 7, 2010. Ellick and Filkins reported that it was Kabul Bank’s posting of a \$300 million dollar loss that triggered Farnood and Ferozi’s firing.

⁴⁸ Greg Miller and Ernesto Londono, “[U.S. Officials Say Karzai Aides are Derailing Corruption Cases Involving Elite](#),” Washington Post, June 28, 2010; Dexter Filkins and Allissa J. Rubin, “[Graft-Fighting Prosecutor Fired in Afghanistan](#),” New York Times, August 28, 2010.

⁴⁹ Andrew Higgins, “[Kabul Bank Crisis Followed U.S. Push for Cleanup](#),” Washington Post, September 17, 2010.

⁵⁰ “Law of Banking,” Articles 53 through 60.

⁵¹ “Law of Banking,” Article 53.1.

Bank, we will loot all the branches and even ... the presidential palace.”⁵² Another irate member asserted, “I used to trust the bank but not anymore. You put your money in, you don’t know if you’ll get it out.”⁵³

The Kabul Bank leadership and top Afghan government officials greeted the opening days of the Kabul Bank crisis with a chorus of denial. Like the infamous “Baghdad Bob,” the Minister of Finance, Omer Zakhilwal, stated confidently on day two of the run, “We know the money is there, they must not panic. We are sure, a hundred percent, that the bank is safe.”⁵⁴

A whopping 14% of Kabul Bank’s deposits, or \$180 million, was withdrawn by the end of the second day.⁵⁵ In response to the run on the bank, Zakhilwal calmly declared that the withdrawals were “more than usual” but “it’s not a crisis.”⁵⁶ Likewise, central bank Governor Fitrat brushed off reports that the Afghan central bank had seized control of Kabul Bank as “baseless information and rumors.”⁵⁷

Mahmoud Karzai dismissed the crisis as unfounded and denied that Kabul Bank’s losses were as high as \$300 million.⁵⁸ Mr. Karzai stated, “This is nothing but a panic. People are under the impression that the bank is failing, and it’s not.”⁵⁹ President Karzai also downplayed the crisis by blaming it on the media: “The Western press has been covering it in a negative and provocative way.”⁶⁰

Abdullah Abdullah, who ran against President Karzai in the 2009 election, wondered if Kabul Bank was receiving state funds and stated emphatically that the government and the Kabul Bank shareholders were responsible for the bank’s failure.⁶¹ Abdullah said, “The government of Afghanistan and the shareholders are responsible for this issue. ... If the bank was acting illegally for five years, why didn’t the central bank take any action against it?”⁶²

⁵² Tim Gaynor, “[Guards Beat Customers at Crisis-Hit Afghan Bank](#),” Reuters, September 8, 2010.

⁵³ Ibid.

⁵⁴ Sayed Salahuddin, “[Afghanistan Assures Bank Customers Amid Graft Fears](#),” Reuters, September 2, 2010. Baghdad Bob, whose real name is Mohammed Saeed al-Sahhaf, was Saddam Hussein’s former spokesperson during the second Gulf War. His propaganda-filled press conferences are on YouTube and elsewhere.

⁵⁵ Dexter Filkins, “[Depositors Panic Over Bank Crisis in Afghanistan](#),” New York Times, September 2, 2010.

⁵⁶ Andrew Higgins and Ernesto Londono, “[Karzai’s Brother Calls on US to Help Avert Afghan Bank Run](#),” Boston Globe, September 3, 2010.

⁵⁷ Sayed Salahuddin, “[Afghanistan Assures Bank Customers Amid Graft Fears](#),” Reuters, September 2, 2010; Abdul Qadeer Siddique, “[Kabul Bank not Under DAB: Fitrat](#),” Pajhwok Afghan News, September 1, 2010.

⁵⁸ Jon Boone, “[Afghan Officials Resist Clean-Up of Kabul Bank as Scandal Engulfs Elite](#),” Guardian, September 3, 2010. Interestingly, Ferozi also denied that the bank’s losses were as high as \$300 million. This suggests that Farnood himself ordered the posting of the loss. See: Dexter Filkins, “[Depositors Panic Over Bank Crisis in Afghanistan](#),” New York Times, September 2, 2010.

⁵⁹ Ibid.

⁶⁰ Ibid.

⁶¹ Andrew Higgins, “[Officials Freeze Assets of Kabul Bank Shareholders, Excepting Karzai’s Brother](#),” Washington Post, September 5, 2010.

⁶² Ibid.

On Monday, September 13, calm returned to Kabul Bank following a four-day holiday.⁶³ Mr. Abdullah's suspicions were realized as Kabul Bank honored the flood of withdrawals thanks to an \$820 million government bailout, or almost an entire year's worth of the Afghan government's revenue.⁶⁴

The only legal action taken against the shareholders at this time was that several of them were banned from selling any of their properties located in Kabul, but the government did not freeze or seize their other assets.⁶⁵ The government seized passports of other lower-ranking Kabul Bank staff, but not the shareholders' passports.⁶⁶

Shareholder Shenanigans

As a matter of practice, banks retain only a fraction of their depositors' money in cash form. The rest of the money is lent out to the public in order for the bank to earn a profit through the interest that it charges on the loans. In fact, in a bank's financial records, the loans that it makes are actually considered assets. Conversely, a bank's deposits from its members are considered liabilities because the bank owes this money to the depositors.

In Kabul Bank's case, its loan assets were overvalued in its books. Most of Kabul Bank's loans were essentially "grants" because they were interest-free with no repayment schedule and no collateral, and they were not expected to be repaid.⁶⁷ Put another way, the main problem with Kabul Bank as of September 1, 2010, was not that it did not have enough of its own money to cover the bank run. The problem was that Kabul Bank's loan assets were worth a fraction of its liabilities. Kabul Bank was "insolvent."⁶⁸ Its financial mess prompted the bank to post the \$300 million loss (which was later discovered to be a \$925 million loss) and the central bank to fire Kabul Bank's two top executives, news of which leaked to the public and caused the panic.

⁶³ Kabul Bank's main branch in Kabul was the only branch to open on September 8, and it was opened for half a day. All of Kabul Bank's branches were closed on September 9-12 for the memorial of Ahmad Shah's Massoud's death and the end of Ramadan.

⁶⁴ Jon Boone, "[Afghanistan Facing Insolvency Within a Month, Say Officials](#)," Guardian, June 17, 2011; Joshua Partlow, "[Afghan Delays in Addressing Banking Problems Imperil Foreign Aid](#)," Washington Post, June 29, 2011. Afghanistan's 2010 GDP was \$15.61 billion with annual government revenues totaling about \$1 billion. See: Central Intelligence Agency, "[The World Factbook](#)," cia.gov, 2011. In mid-September, the New York Times reported that Kabul Bank depositors had withdrawn between \$400 to \$600 million. In late-November 2010, the Wall Street Journal reported that the bailout totaled \$500 million, but Afghan Finance Minister Zakhilwal insisted that the bailout was "far lower" than \$500 million. As with so many other details in the Kabul Bank scandal, the truth emerges with time and initial government statements often prove to be grossly inaccurate. See: Alissa J. Rubin, Charlie Savage, and Rod Nordland, "[Regulators Ignored Warnings About Afghan Bank](#)," New York Times, September 18, 2010; Matthew Rosenberg, "[Afghanistan Rejects U.S. Aid for Bank Audits](#)," Wall Street Journal, November 26, 2010. It should also be noted that during the run Kabul Bank had to pay \$100 million in government worker salaries. See: "Dexter Filkins, "[Depositors Panic Over Bank Crisis in Afghanistan](#)," New York Times, September 2, 2010.

⁶⁵ Andrew Higgins, "[Officials Freeze Assets of Kabul Bank Shareholders, Excepting Karzai's Brother](#)," Washington Post, September 5, 2010.

⁶⁶ Jon Gambrell, "[Afghan Central Bank Denies Fault in Banking Crisis](#)," Associated Press, Boston Globe, May 30, 2011.

⁶⁷ Allisa J. Rubin and Rod Nordland, "[Afghan Elite Borrowed Freely from Kabul Bank](#)," New York Times, March 28, 2011.

⁶⁸ Joshua Partlow, "[IMF Wants Afghanistan's Troubled Kabul Bank Sold Off](#)," Washington Post, February 16, 2011.

Kabul Bank's mismanagement was criminal in nature consisting of criminal and banking law violations, the latter to be discussed shortly. Legally speaking, the Kabul Bank shareholders committed "embezzlement," a form of theft, which in Afghan law is punishable by five to 10 years of imprisonment for each offense.⁶⁹ Embezzlement occurs when an "official of public services" -in this case banking services- steals "goods" -in this case currency- belonging to people or to the state.⁷⁰ In addition to imprisonment, Afghan law also demands that the embezzler return the stolen goods and "pay a cash fine equivalent to the embezzled goods."⁷¹

The theft at Kabul Bank was accomplished through a complex scheme of mass fraud. Chairman Farnood and CEO Ferozi directed the fraud by creating fictitious companies and then writing loans to these companies.⁷² Instead, the money was doled out to Kabul Bank's shareholders and other members of the Afghan elite, such as leading business figures, Cabinet ministers, members of Parliament, and former politicians.⁷³ These individuals spent the money on business ventures, family members, President Karzai's 2009 re-election campaign and political agenda, multi-million dollar villas, and "girls, money, cars... whatever the human weakness."⁷⁴

The nonexistent companies were created to hide the scam. Hundreds of millions of dollars were "loaned" to about 200 fake companies.⁷⁵ This money was then transferred to the Shaheen Exchange, a Farnood-owned money transfer business, called a "hawala," in Dubai.⁷⁶ Next, the money was returned to Afghanistan under fictitious names to the actual recipients.⁷⁷ For example, Mahmoud Karzai received \$22 million from Kabul Bank through 10 separate loans and 10 fake names such as "Abdul Rahim" and "Dawood and Sultan Mohammad Hafizullah LTD."⁷⁸

⁶⁹ "The Penal Code of Afghanistan," Article 268. Article 268 specifies "long imprisonment" for embezzlement, which ranges from five to 15 years (See Article 100). However, Article 268 tops out tops out the maximum imprisonment for embezzlement at 10 years, which means that an act of embezzlement brings five to 10 years of imprisonment. The IMF has also referred to the theft at Kabul Bank as embezzlement. See: "[IMF Reaches Staff Level Agreement with the Islamic Republic of Afghanistan on a US\\$129 Million Extended Facility Arrangement, and Concludes the 2011 Article IV Consultations Staff Mission](#)," Press Release No. 11/358, imf.org, October 6, 2011. Afghan law demands that each offense should be punished (Article 158), so long as the one criminal act did not directly cause other criminal acts (Article 155).

⁷⁰ "The Penal Code of Afghanistan," Article 268.

⁷¹ Ibid, Article 273.

⁷² "USAID, Office of the Inspector General, "[Review of USAID/Afghanistan's Bank Supervision Assistance Activities and the Kabul Bank Crisis](#)," Report No. F-306-11-003-S, March 16, 2011, p. 14.

⁷³ Allisa J. Rubin and Rod Nordland, "[Afghan Elite Borrowed Freely from Kabul Bank](#)," New York Times, March 28, 2011; Allisa J. Rubin and James Risen, "[Losses at Afghan Bank Could be \\$900 Million](#)," New York Times, January 30, 2011; Abasin Zaheer and Abdul Qadir Siddiqui, "[Kabul Bank's Corrupt Shareholder's Named](#)," Pajhwok Afghan News, April 27, 2011. Kabul Bank's 16 shareholders were: Sher Khan Farnood, Khalilullah Ferozi, Farida Farnood (Farnood's wife), Mahmoud Karzai, Haji Sherin Khan, Mohammad Taheer, Ghulam Farooq Naseeb, Ahmad Javid, Jamal Khil, Abdul Rab, Zahed Faheem (Haseen Fahim's son), Mohammad Ihsan Rafet, Shokrullah Shokran (Farnood's cousin), Rabiulla Kakar, Hayatullah, and Nesar Ahmad. The shareholders' list, with each shareholder's stock holding, is found in the following Kabul Bank audit: "[Independent Auditors' Report to the Shareholders](#)," A.F. Ferguson & Co, February 2010, p. 20. Retrieved on July 25, 2011. From <http://www.kabulbank.com/html/index.aspx> go to: Financials>"Notes to Audited Financial Statements." A PDF file will download. Note that the shareholder list is numbered to 18 but two numbers are missing.

⁷⁴ Dexter Filkins, "[Letter From Kabul: The Great Afghan Bank Heist](#)," The New Yorker, February 14, 2011.

⁷⁵ Joshua Partlow, "[Elaborate Ruse Behind Vast Kabul Bank Fraud](#)," Washington Post, June 30, 2010.

⁷⁶ Ibid.

⁷⁷ Ibid.

⁷⁸ Ibid; Andrew Higgins, "[In Afghanistan, Signs of Crony Capitalism](#)," Washington Post, February 22, 2010.

Some of the illegal loans were registered under the names of real people who could not have possibly received the money. A prominent Afghan businessman described how these fraudulent transactions worked:

Sometimes they would bring a loan document to someone who was a gardener or a cleaner and just ask them to sign it, and they would pay him 500 Afghani [the equivalent of about \$11] and the person could not read or write more than his name. Then, when the new bank managers go to look for the money, they go to the gardener's house and they look around and they see there is nothing worth \$100, and they have no idea where the money went.⁷⁹

News reports characterized the Kabul Bank fraud as an attempt to bypass three Afghan banking laws: lending limits to individuals, loans to banking-related businesses only, and no lending outside the country.⁸⁰ However, the nature of the scam and its political connections suggest that the fraud had a larger goal in mind than merely funding the legitimate, but non-banking, shareholder businesses or the mansions in Dubai for the Afghan elite. The fraud's larger goal was to win continued support for the Karzai administration through Kabul Bank handouts. Put another way, Kabul Bank's money was a presidential slush fund that roped in northern and southern politicians alike.

Farnood, Ferozi, and Mahmoud Karzai –the three largest Kabul Bank shareholders, and consequently, the three most powerful members of Kabul Bank- all deny any wrongdoing.⁸¹ Farnood claims he is a victim of a government conspiracy, and Mr. Karzai denies knowing that his loans were issued under fictitious names.⁸² Asked at the beginning of the Kabul Bank run why the bank's money was being transferred through a hawala, Mahmoud Karzai replied, "This is a legitimate question. You should ask Sher Khan."⁸³ Ironically, however, many of the lesser shareholders have confessed that they knew they were receiving Kabul Bank's money illegally.⁸⁴

According to a USAID-commissioned "Material Loss Review" (MLR) by Afghanistan's central bank that was issued on October 30, 2010, the shareholders "engineered extensive violations" and used their "influence" with the two top shareholders, or Farnood and Ferozi, in order to gain access to Kabul Bank's money.⁸⁵ As the money ran out, Kabul

⁷⁹ Words in brackets added. Allisa J. Rubin and James Risen, "[Losses at Afghan Bank Could be \\$900 Million](#)," New York Times, January 30, 2011. The "new bank managers" is probably a reference to the new Kabul Bank management installed after the central bank removed Farnood and Ferozi.

⁸⁰ Allisa J. Rubin, Charlie Savage, and Rod Nordland, "[Regulators Ignored Warnings About Afghan Bank](#)," New York Times, September 18, 2010.

⁸¹ Afghan's banking law states, "Shareholders shall have voting rights corresponding to their holding of shares of capital stock of the bank." See: "Law of Banking," Article 23.2. Farnood and Ferozi each had 28.16% shares of stock, and Mahmoud Karzai, the third largest shareholder, had 7.41%. See footnote 73.

⁸² Joshua Partlow, "[Elaborate Ruse Behind Vast Kabul Bank Fraud](#)," Washington Post, June 30, 2010.

⁸³ Dexter Filkins, "[Troubles at Afghan Bank Jolt Financial System](#)," New York Times, August 31, 2010.

⁸⁴ Abasin Zaheer and Abdul Qadir Siddiqui, "[Kabul Bank's Corrupt Shareholder's Named](#)," Pajhwok Afghan News, April 27, 2011; "[Afghan Banker: I Have Evidence of Death Plot](#)," Aljazeera, June 29, 2011.

⁸⁵ The MLR was entitled "Report of Kabul Bank in Conservatorship." See: USAID, Office of the Inspector General, "[Review of USAID/Afghanistan's Bank Supervision Assistance Activities and the Kabul Bank Crisis](#)," Report No. F-306-11-003-S, March 16, 2011, pp. 1, 14. The New York Times obtained a copy of the MLR. See: Allisa J. Rubin and Rod Nordland, "[Afghan Elite Borrowed Freely from Kabul Bank](#)," New York Times, March 28, 2011. The New York Times article incorrectly dates the review's release on October 20.

Bank's executives pushed marketing schemes, such as a lottery, to encourage more people to open bank accounts. Consequently, the Kabul Bank fraud resembled a Ponzi scheme.⁸⁶ As one Western diplomat stated, "The bank had to keep marketing and getting more deposits to fund the loans that they weren't getting interest on."⁸⁷

The MLR found that "[a]ll administrative bodies, supervisory bodies and decision-making bodies" participated in the fraud.⁸⁸ This last statement is sobering. According to Afghan banking law, every Afghan bank must have the same administrative structure, which includes four leadership bodies: the General Meeting of Shareholders, the Board of Supervisors, the Management Board, and the Audit Committee.⁸⁹ According to the MLR, each one of these bodies was complicit in the fraud at Kabul Bank. On the outside, Kabul Bank looked like a successful, Afghan-led, modern financial institution, but on the inside it was thoroughly corrupted.

Perhaps the next two influential shareholders were the brothers of the president and vice-president, Mahmoud Karzai (already noted) and Abdul Haseen Fahim (brother to First Vice-President Muhammad Fahim).⁹⁰ Farnood and Ferozi are thought to have sought out Karzai and Fahim to join Kabul Bank because of the political influence these two men offered.

In Mahmoud Karzai's case, Farnood and Ferozi enabled him to become a shareholder effortlessly: they lent Karzai \$5 million from Kabul Bank in order for him to purchase a 7.41% share in Kabul Bank.⁹¹ They calculated that having the president's brother as one of the shareholders would by extension acquire for Kabul Bank the protection of President Karzai. One Afghan political figure explained the arrangement this way:

In Afghanistan, you cannot become a successful business if you are not linked to the political caste. The only way to get contracts and protection is to have support in the political system, and that is the reason why these two guys [Mahmoud Karzai and Haseen Fahim] were able to get shares in Kabul Bank. They gave Mahmoud a loan of \$5 million. That was political survivalism. They knew they needed a Karzai.⁹²

The practice of businesses in Afghanistan seeking out members of the "political caste" is likely widespread. For example, Haseen Fahim is reported to be a shareholder in three businesses that together took out a combined total of \$182 million in loans from Kabul

⁸⁶ Ibid.

⁸⁷ Ibid.

⁸⁸ Ibid.

⁸⁹ For the administrative structure of banks, see: "Law of Banking," Article 22.

⁹⁰ Afghanistan has two vice-presidents.

⁹¹ See footnote 73 for the shareholders. Abdul Haseen Fahim owned a 2.96% share through his son, Zahed Fahim. See: Martine Van Bijlert, "[The Kabul Bank Investigations: Central Bank Gives Names and Figures](#)," Afghanistan Analysts Network, May 2, 2011.

⁹² Words in brackets added. Adam B. Ellick and Dexter Filkins, "[Political Ties Shielded Bank in Afghanistan](#)," New York Times, September 7, 2010. In May 2011, a presidential commission listed Mahmoud Karzai's bank share obligation as \$6 million. That higher figure may include accumulated interest and applicable taxes. See: Rod Nordland, "[Afghan Bank Commission Absolves President's Brother in Fraud Case](#)," New York Times, May 29, 2011.

Bank.⁹³ Curiously, in each of these three businesses, Fahim is reported to own a mere single share of stock –or just enough to attach the “Fahim” name to these businesses.⁹⁴ The MLR also determined that Kabul Bank committed 18 violations of Afghan banking law.⁹⁵ While the report is not available to the public, some of the violations have been reported and others might be deduced from what is known about the banking laws themselves.

One of Kabul Bank’s reported banking law violations was that it routinely lent to non-banking businesses in such industries as transportation, fuel delivery, mining, real estate, and construction material.⁹⁶ Most of the businesses that received Kabul Bank money also had Kabul Bank shareholders either on their boards or owning shares in the companies.⁹⁷ Moreover, many of these businesses were so poorly managed that the loan money often was unproductive. A few examples of Kabul Bank lending to non-banking businesses include loans written to Kabul Oil Company, Pamir Airways, Afghan Cement, and Karkar Coal Mine.

Kabul Bank lent \$21 million to Kabul Oil Company, which never began its operations, and now that money is gone and is not expected to be repaid.⁹⁸ Both Sher Khan Farnood and Haseen Fahim were Kabul Oil shareholders.⁹⁹ Pamir Airways, whose motto is “Fly With Confidence,” received up to \$98 million from Kabul Bank.¹⁰⁰ Part of this money was used to cover the operational costs of the airline, and this had the effect of a subsidy, which Pamir’s management used to its advantage by lowering its plane ticket prices to try to force out its competition.¹⁰¹

The Afghan government suspended Pamir’s operating license in March 2011 after an investigation into the crash of Pamir Airways Flight 112 revealed serious safety violations.¹⁰² Flight 112 crashed on May 17, 2010, killing all 44 people.¹⁰³ The doomed aircraft was 37 years old, and its registration had been forged to enable the plane to avoid safety inspections.¹⁰⁴ The black box was not even functioning at the time of the crash.¹⁰⁵

⁹³ Allisa J. Rubin and Rod Nordland, “[Afghan Elite Borrowed Freely from Kabul Bank](#),” New York Times, March 28, 2011.

⁹⁴ Ibid.

⁹⁵ Ibid.

⁹⁶ Martine Van Bijlert, “[The Kabul Bank Investigations: Central Bank Gives Names and Figures](#),” Afghanistan Analysts Network, May 2, 2011. For non-banking prohibited activities, see: “Law of Banking,” Article 34. For a list of a bank’s legal activities see: “Law of Banking,” Articles 32 and 33.

⁹⁷ Martine Van Bijlert, “[The Kabul Bank Investigations: Central Bank Gives Names and Figures](#),” Afghanistan Analysts Network, May 2, 2011.

⁹⁸ Allisa J. Rubin and Rod Nordland, “[Afghan Elite Borrowed Freely from Kabul Bank](#),” New York Times, March 28, 2011.

⁹⁹ Ibid.

¹⁰⁰ Ibid.

¹⁰¹ Ibid. A September 26, 2009, US embassy cable obtained by Wikileaks discusses the subsidy issue. See: Allisa J. Rubin and James Risen, “[Losses at Afghan Bank Could be \\$900 Million](#),” New York Times, January 30, 2011.

¹⁰² Bradley Hope, “[Suspended Afghan Airline ‘Owes Kabul Bank \\$90M’](#),” The National, March 18, 2011.

¹⁰³ Initial reports listed 43 people as being on the plane but that figure was later updated to 44. The plane’s wreckage was found on May 20. Golnar Motevalli, “[Airplane with 43 on Board Crashes in Afghanistan](#),” Reuters, May 17, 2010.

¹⁰⁴ Bradley Hope, “[Suspended Afghan Airline ‘Owes Kabul Bank \\$90M’](#),” The National, March 18, 2011; Molly Hennessy-Fiske, “[Relatives of 2010 Afghan Air Crash Victims Lobby for Redress](#),” Los Angeles Times, April 29, 2011.

¹⁰⁵ Ibid.

Sherkhan Farnood was Pamir's chairman. Farnood and Ferozi were Pamir shareholders.¹⁰⁶

Mahmoud Karzai established Afghan Investment Company (AIC) in February 2006 in the hope of winning the government leasing rights for Afghan Cement and Karkar Coal Mine, two important state-owned assets that deal in natural resources. Farnood and Fahim also are investors with AIC. It is believed that President Karzai fired Mir Mohammad Sediq, the Minister of Mines, in March 2006 after Sediq refused to award the cement and coal mine leases to AIC.¹⁰⁷ Sediq was waiting for a feasibility study to be finished, which eventually concluded that the two projects needed an investment of about \$570 million.¹⁰⁸

Sediq's successor, Mohammad Ibrahim Adel, awarded AIC the leases in April, just days after he took over the Ministry of Mines.¹⁰⁹ (In November 2009, Adel was accused of taking a \$30 million bribe from Metallurgical Group Corporation, a Chinese state-run company, in exchange for the awarding of a copper mine lease.¹¹⁰) Today, the cement factory and coalmine are barely functioning since AIC could only secure around \$45 million, or just under 8% of the needed capital; consequently, Afghanistan's reconstruction depends on Pakistani cement.¹¹¹

Commenting on AIC's winning of the cement and coal leasing rights, a Ministry of Mines advisor stated, "It was such a bad deal. It was just wrong, wrong, wrong. Everyone was complicit. It's tragic. It was a sham."¹¹² Rasoul Khan, the Provincial Council Chairman of Baghlan Province where the two projects are located, agreed: "They [AIC] are just thieves. They got this mine and cement factory through deception. They are doing the same with the coal mine and the cement factory as they did with Kabul Bank."¹¹³

Afghan banking law also forbids bank lending outside of the country, which Kabul Bank did freely in the Dubai real estate market. Kabul Bank invested up to \$160 million on two "towers" and "luxury villas" for "members of President Hamid Karzai's family, his government and his supporters."¹¹⁴ Most of the villas were purchased on Palm Jumeirah,

¹⁰⁶ Bradley Hope, "[Suspended Afghan Airline 'Owes Kabul Bank \\$90M'](#)," The National, March 18, 2011.

¹⁰⁷ Jonathan S. Landay, "[Factor, Coal Mine Show Connections Matter Most in Afghan Business](#)," McClatchy, November 14, 2010. Abdul Ghafar Dawi (or "Dawee"), an influential Afghan businessman, husband of Member of Parliament Shukria Barezai, and a Kabul Bank borrower, has confirmed President Karzai's direct involvement in awarding AIC the leases. See: Mir Sediq Zaliq, "[A Loss-Making Cash Cow](#)," Afghanistan Today, July 6, 2011. The article notes that Mahmoud Karzai has since sold his AIC shares to help pay off his Kabul Bank loans.

¹⁰⁸ Jonathan S. Landay, "[Factor, Coal Mine Show Connections Matter Most in Afghan Business](#)," McClatchy, November 14, 2010. Box International Consulting issued its report in August 2006.

¹⁰⁹ Ibid.

¹¹⁰ Joshua Partlow, "[Afghan Minister Accused of Taking Bribe](#)," November 18, 2009.

¹¹¹ Mir Sediq Zaliq, "[A Loss-Making Cash Cow](#)," Afghanistan Today, July 6, 2011; Jonathan S. Landay, "[Factor, Coal Mine Show Connections Matter Most in Afghan Business](#)," McClatchy, November 14, 2010.

¹¹² Ibid.

¹¹³ Ibid. Acronym in brackets added. For more on Mahmoud Karzai's business dealings and their impact on Hamid Karzai's presidency, see: James Risen, "[Another Karzai Forges Afghan Business Empire](#)," New York Times, March 4, 2009; Ben Farmer, "[Karzai Family's Wealth 'Fuelling Insurgency'](#)," Daily Telegraph, August 7, 2009.

¹¹⁴ Andrew Higgins, "[In Afghanistan, Signs of Crony Capitalism](#)," Washington Post, February 22, 2010. Estimates on Kabul Bank's investment in Dubai real estate range from \$140 to \$160 million. The two towers appear to be business real estate,

a man-made island in the shape of a palm tree.¹¹⁵ In early 2010, the cheapest villa on Palm Jumeirah was reportedly over \$2 million.¹¹⁶ The total value of Kabul Bank's investment in Dubai real estate plummeted when that market crashed a few years ago.¹¹⁷

Some of Kabul Bank's Dubai villas were investment properties that were purchased for profit-making through quick reselling. Mahmoud Karzai stated in September 2010 that Chairman Farnood was "flipping" Dubai villas "like hamburgers."¹¹⁸ However, others were purchased for the shareholders, the politically connected, and President Karzai's relatives. The details of the non-investment properties are odd because almost all of the villas -the investment properties and those belonging to the Afghan elite- are registered in Farnood and his wife's names.

Moreover, there appears to be a deliberate attempt to deceive and mislead in regards to the true ownership of the non-investment properties. For example, former Vice-President Ahmad Zia Massoud, brother of deceased Northern Alliance leader Ahmad Shah Massoud, lives in one of the Palm Jumeirah villas. Massoud's villa was first purchased in his wife's name, but then was re-registered in Farnood's name so that, according to public records, Farnood is the true owner of Massoud's villa.¹¹⁹

However, in an interview five months before the Kabul Bank scandal began, Chairman Farnood insisted that although the villa was in his name, "in reality," he said, it belonged to Massoud.¹²⁰ "These people don't want to reveal their names," explained Farnood.¹²¹ CEO Ferozi agreed. Defending Kabul Bank, Ferozi stated that if the bank's money is used to buy homes in "Dubai, or Germany or America," that is not Kabul Bank's responsibility since the bank "doesn't give loans directly for Dubai."¹²² Ferozi's statement implies that the Kabul Bank borrowers who live in these villas, own them, and paid for them with the bank's money, but not with the bank's complicity.

Massoud, who was interviewed around the same time, contradicted them. Massoud stated that Farnood was always the true owner of the villa but since he and Farnood were close friends, Farnood rented out the villa to him for two years rent-free, thus inferring that Massoud is paying rent now to live in the villa.¹²³ Who is telling the truth?

The villa likely belongs to Massoud. He probably wanted to buy the villa so he contacted his friend Farnood to take out a loan (read "grant") from Kabul Bank. Hiding what he did, Massoud concealed the villa's ownership by re-registering it in the Farnood name.

perhaps for leasing. See: Joshua Partlow and Andrew Higgins, "[Kabul Bank Employees Flee to Pakistan Amid Investigation into Lending, Officials Say](#)," Washington Post, January 31, 2011.

¹¹⁵ For more on Palm Jumeirah, see: <http://www.palmjumeirah.ae/>.

¹¹⁶ Andrew Higgins, "[In Afghanistan, Signs of Crony Capitalism](#)," Washington Post, February 22, 2010.

¹¹⁷ Liz Alderman, "[Real Estate Collapse Spells Havoc in Dubai](#)," New York Times, October 6, 2010.

¹¹⁸ Alissa J. Rubin, Charlie Savage, and Rod Nordland, "[Regulators Ignored Warnings About Afghan Bank](#)," New York Times, September 18, 2010.

¹¹⁹ Andrew Higgins, "[In Afghanistan, Signs of Crony Capitalism](#)," Washington Post, February 22, 2010.

¹²⁰ Ibid.

¹²¹ Ibid.

¹²² Ibid.

¹²³ Ibid.

Kabul Bank was complicit since not just Massoud's villa, but the other villas too, are in Farnood's name, and none of the villa loans are recorded in Kabul Bank's books.¹²⁴ The money that purchased Massoud's villa likely was recorded in Kabul Bank's books as a loan to a fictitious company. The Afghan criminal law forbids the concealment of objects—in this case the villas—acquired through crime.¹²⁵

Another Kabul Bank banking law violation involves record keeping. Keeping a bank's books in order is the most fundamental banking activity. Deposits must be carefully recorded and withdrawals and loans meticulously documented. Not surprisingly, Kabul Bank was required by law to “maintain adequate accounting and other records of business” and to keep “on file for at least ten years the pertinent documents for each one of their transactions.”¹²⁶

However, the MLR states that Kabul Bank kept two sets of books: “a fake set in Kabul and a real set in Dubai” at the Shaheen Exchange.¹²⁷ Kabul Bank's auditors used the fake set of books in Kabul and this in part explains why Kabul Bank appeared healthy in audits, with the exception of the 2009 audit mentioned earlier. The fake set of books recorded the fictitious loans.¹²⁸

In January 2011, one of the most troubling revelations of the Kabul Bank investigation was reported: “Nearly everyone in the cabinet got money from the bank” including members of Parliament.¹²⁹ Kabul Bank's “Senior executives” -Farnood and Ferozi- “made tens of millions of dollars in bribes and other payoffs to Afghan officials, including some with close ties to the U.S.”¹³⁰ The bribes were recorded in Kabul Bank's books as expenses.¹³¹ Evidence for the allegations against the ministers and legislatures came from Kabul Bank's books, Chairman Farnood's “personal records,” and people with direct knowledge of the bribes.¹³²

A portion of the bribes went to government officials so that they would shield Kabul Bank from scrutiny.¹³³ The bribes worked because the government officials that took the bribes “repeatedly blocked inquiries into Kabul Bank.”¹³⁴ CEO Ferozi once bragged to a former Karzai official: “None of the ministers have the guts to speak against us. They are ours.”¹³⁵

¹²⁴ Ibid.

¹²⁵ “The Penal Code of Afghanistan,” Article 474. The maximum punishment for concealment of stolen objects, or medium imprisonment, is one to five years of imprisonment. See also Article 101.

¹²⁶ “Law of Banking,” Articles 32.2 and 39.

¹²⁷ Allisa J. Rubin and Rod Nordland, “[Afghan Elite Borrowed Freely from Kabul Bank](#),” New York Times, March 28, 2011.

¹²⁸ Ibid.

¹²⁹ Joshua Partlow and Andrew Higgins, “[Kabul Bank Employees Flee to Pakistan Amid Investigation into Lending, Officials Say](#),” Washington Post, January 31, 2011.

¹³⁰ Matthew Rosenberg, “[Afghan Minister Denies Bribery Allegations](#),” Wall Street Journal, February 3, 2011.

¹³¹ Joshua Partlow, “[Elaborate Ruse Behind Vast Kabul Bank Fraud](#),” Washington Post, June 30, 2010.

¹³² Matthew Rosenberg, “[Afghan Minister Denies Bribery Allegations](#),” Wall Street Journal, February 3, 2011.

¹³³ Matthew Rosenberg and Maria Abi-Habib, “[Afghan Officials Probed Over Bank](#),” Wall Street Journal, February 1, 2011.

¹³⁴ Ibid.

¹³⁵ Dexter Filkins, “[Letter From Kabul: The Great Afghan Bank Heist](#),” The New Yorker, February 14, 2011.

Among the cabinet ministers who allegedly took bribes to block Kabul Bank from scrutiny, three of them were considered by Western diplomats to be reformers: Omer Zakhilwal, the Minister of Finance, Farouk Wardak, the Minister of Education, and Hanif Atmar, the Minister of Interior.¹³⁶ All three men deny taking bribes.

The other portion of the bribes was given to members of Parliament to further the president's legislative agenda, that is, to buy votes.¹³⁷ The Karzai administration was so dependent on Kabul Bank's money that Ferozi appraised the relationship in this way: "If there is no Kabul Bank, there will be no Karzai, no government."¹³⁸

Resistance to Cleaning up the Mess

The Kabul Bank scandal's immediate consequence was a loss of faith in Kabul Bank, which the Karzai administration answered with a bailout of the institution. However, questions remained. Who was responsible for Kabul Bank's missing money? Would those responsible be arrested and prosecuted? What could be done to prevent another similar banking scandal?

In September, USAID and the U.S. Treasury Department started the Financial Sector Working Group (FSWG) to coordinate the U.S. response to the Kabul Bank crisis.¹³⁹ The FSWG also included the Department of Defense, but it was more than an interagency body because it included representatives from outside the U.S. government, such as the International Monetary Fund (IMF), the World Bank, and Deloitte.¹⁴⁰ The FSWG's weekly meetings permitted each member to update the others and to foster a coordinated international effort.¹⁴¹

Another consequence of the Kabul Bank scandal was that it triggered a financial crisis in regards to the donor aid given to Afghanistan. The Kabul Bank scandal coincided with the expiration of the IMF's balance of payment's program with Afghanistan known as the Extended Credit Facility (ECF).¹⁴² The IMF was scheduled to extend the ECF and give the Afghan government a \$120 million credit line in September, but froze the payment because of the scandal.¹⁴³

¹³⁶ Matthew Rosenberg, "[Afghan Minister Denies Bribery Allegations](#)," Wall Street Journal, February 3, 2011. Presumably, the Education Minister would be able to exert his influence in financial matters during Cabinet meetings. Zakhilwal is accused of a corruption scheme involving Bank-e-Millie Afghan, a state-owned bank. See: Matthew Rosenberg and Maria Abi-Habib, "[Afghan Officials Probed Over Bank](#)," Wall Street Journal, February 1, 2011.

¹³⁷ Dexter Filkins, "[Letter From Kabul: The Great Afghan Bank Heist](#)," The New Yorker, February 14, 2011.

¹³⁸ Andrew Higgins, "[In Afghanistan, Signs of Crony Capitalism](#)," Washington Post, February 22, 2010.

¹³⁹ Office of the Special Inspector General for Afghanistan Reconstruction, "[Limited Interagency Coordination and Insufficient Controls Over U.S. Funds in Afghanistan Hamper U.S. Efforts to Develop the Afghan Financial Sector and Safeguard U.S. Cash](#)," SIGAR-Audit-11-13, July 20, 2011, p. 7.

¹⁴⁰ Ibid.

¹⁴¹ Ibid.

¹⁴² The IMF program expired on September 25, 2010. For information on the ECF program see: "[IMF Extended Credit Facility](#)," imf.org, March 31, 2011; "[IMF Backs New Package to Support World's Poorest During Crisis](#)," imf.org, July 29, 2009.

¹⁴³ Joshua Partlow and Andrew Higgins, "[U.S. and Afghans at Odds over Kabul Bank Reform](#)," Washington Post, October 7, 2010.

Before it would release the funds, the IMF wanted the Afghan government to investigate Kabul Bank and, as a first step, that meant conducting a forensic audit of Kabul Bank.¹⁴⁴ A senior U.S. military official stated, “The IMF is putting pressure on Karzai...to look effectively at Kabul Bank and legitimately find out what happened.”¹⁴⁵ The IMF also demanded that the Afghan government implement “stricter bank supervision” and reform its “lending practices” to prevent the reoccurrence of a similar banking scandal.¹⁴⁶

However, the IMF’s decision not to renew the ECF program with Afghanistan had a secondary impact: it risked forcing donor states to freeze their monetary aid to Afghanistan. Many countries will not lend to low-income countries that do not have an active IMF program.

In March 2011, six months after the scandal began and after the Karzai administration still had not met the IMF’s demands, the British government froze almost \$137 million in aid to Afghanistan.¹⁴⁷ Following its decision, the British government noted the importance of an IMF program: “An IMF programme is used by donors as an indicator of sound economic and financial management, and ensures that sufficient steps are taken to safeguard public funds, including aid.”¹⁴⁸ In September, Norway did the same by freezing \$49 million in aid.¹⁴⁹ Without the ECF program, Afghanistan risked losing more aid from other donors.

The Afghan government likely was stalling on the audit because it did not want to be forced to prosecute the shareholders. A forensic audit of Kabul Bank would be damning to the shareholders, especially if its findings were made public. The U.S. wanted the forensic audit because it is designed to expose corruption, and the evidence collected by it can be used for prosecution.¹⁵⁰ President Karzai would not allow the U.S. to pay for the audit, otherwise the U.S. would be entitled to view the audit report and perhaps use its evidence to pressure the Karzai government to act against the shareholders.¹⁵¹

In January, the government announced that it would proceed with a forensic audit, and subsequently, opened up the bidding process for the auditing contract.¹⁵² In late-May, it was reported that Britain and Canada would pay for the forensic audit, and that nine other

¹⁴⁴ Ibid.

¹⁴⁵ Ibid.

¹⁴⁶ Ibid.

¹⁴⁷ Paul Tait, “[Britain Delays Afghan Aid Over Lack of IMF Deal](#),” Reuters, March 9, 2011. The money was designated for the ARTF discussed later.

¹⁴⁸ Ibid.

¹⁴⁹ Agence France-Presse, “[Norway Freezes Aid to Afghanistan Over Corruption](#),” Dawn, September 6, 2011. Note that 280 million Norwegian Kroners equal about \$49 million, not \$36 million as stated in the article.

¹⁵⁰ Joshua Partlow and Andrew Higgins, “[U.S. and Afghans at Odds over Kabul Bank Reform](#),” Washington Post, October 7, 2010.

¹⁵¹ Matthew Rosenberg, “[Afghanistan Rejects U.S. Aid for Bank Audits](#),” Wall Street Journal, November 26, 2010; Alissa J. Rubin and Rod Nordland, “[Officials in Afghanistan Begin Investigation into Possible Fraud at Troubled Bank](#),” New York Times, January 14, 2011.

¹⁵² Joshua Partlow and Andrew Higgins, “[Kabul Bank Employees Flee to Pakistan Amid Investigation into Lending. Officials Say](#),” Washington Post, January 31, 2011.

privately owned Afghan banks, including Azizi Bank, would be audited as well.¹⁵³ As already mentioned, Afghanistan's other private banks are suspected of mismanagement and corruption. The actual work of the audit started in the first week of June, or nine months after the Kabul Bank scandal began.¹⁵⁴

The Karzai administration also moved slowly to prosecute those responsible for the Kabul Bank fraud. Going after those who stole from Kabul Bank is something that the Afghan government should have been doing from the beginning because it is mandated to pursue those who commit crime. Afghan criminal law places particular responsibility on the police and the attorney general:

Police are duty bound to report within 24 hours to the Primary Saranwal (attorney general) all the crimes that they happen to know. ... The Primary Saranwal has the obligation to introduce the penal action for prosecution of all crimes, known by him or reported to him. ... The Saranwal shall not dismiss or stay a case except as otherwise provided by the law.¹⁵⁵

In the first week of January, or a stunning four months after the Kabul Bank scandal began, the Attorney General's Office (AGO), which prosecutes criminal cases on behalf of the government, finally began its investigation of Kabul Bank.¹⁵⁶ However, by the end of the month, it was reported that the AGO's investigation was stalled by "a lack of technical capacity to understand the transactions" and "by political pressure from President Karzai's office."¹⁵⁷ Moreover, the investigation did not appear to have the goal of prosecuting the shareholders. It was looking for scapegoats.¹⁵⁸

The Karzai government seemed desperate to pin the blame for the Kabul Bank fraud on anyone but the shareholders. Managers from other Kabul Bank branches, who may have participated in the fraud, were called in for questioning and some were detained, but not

¹⁵³ Ben Farmer, "[Britain to pay £7 for Afghan Bank Probe](#)," Daily Telegraph, May 24, 2011. Seven million pounds is about \$11.3 million. For Canada's assistance, see: "[KB Audit to Start Next Week: Fitrat](#)," Pajhwok Afghan News, Outlook Afghanistan, May 31, 2011.

¹⁵⁴ Ibid.

¹⁵⁵ "Interim Criminal Procedure Code for Courts," Articles 21-22. Words in parenthesis added. Saranwal means "prosecutor."

¹⁵⁶ Alissa J. Rubin and Rod Nordland, "[Officials in Afghanistan Begin Investigation into Possible Fraud at Troubled Bank](#)," New York Times, January 14, 2011.

¹⁵⁷ Joshua Partlow and Andrew Higgins, "[Kabul Bank Employees Flee to Pakistan Amid Investigation into Lending, Officials Say](#)," Washington Post, January 31, 2011.

¹⁵⁸ Ibid; Alissa J. Rubin and Rod Nordland, "[Officials in Afghanistan Begin Investigation into Possible Fraud at Troubled Bank](#)," New York Times, January 14, 2011.

the shareholders.¹⁵⁹ At the end of January, it was reported that a group of Pakistani employees from Kabul Bank fled to Pakistan for fear of being arrested or worse.¹⁶⁰

It was evident that the AGO investigation was set up to placate international donors by making it look like the Afghan government was going after the bad guys.¹⁶¹ In February, a frustrated Western diplomat remarked, “This has been going on for five months, and I am astonished the Afghan government has not dealt with this.”¹⁶² A U.S. official quipped, “If this were America, fifty people would have been arrested by now.”¹⁶³

Chairman Farnood’s post-scandal freedom perhaps best illustrated the Afghan government’s “do nothing” attitude to resolving the bank crisis. He allegedly was under house arrest, but at the same time was given office space at Kabul Bank to help “find the bank’s missing money.”¹⁶⁴ Farnood’s stunning level of freedom enabled him to land a \$1.3 million transfer from Kabul Bank’s Lashkar Gah branch in Helmand Province.¹⁶⁵

Notably, in January as well, the Cabinet failed to meet the IMF’s demand of reforming the banking sector to prevent a similar banking scandal. It rejected a new banking law that would have prevented bank shareholders from holding the positions of either Chairman of the Board of Supervisors or Chief Executive Officer, the positions held by Farnood and Ferozi.¹⁶⁶ The law would have made it difficult for shareholders to influence lending decisions. The Cabinet backed down after certain commercial bank shareholders complained.¹⁶⁷

In early-February, the IMF increased its demands on the Afghan government before it would renew the ECF program. Now it wanted Kabul Bank placed into receivership and the perpetrators of the fraud prosecuted.¹⁶⁸ Receivership is a central bank action that

¹⁵⁹ Joshua Partlow and Andrew Higgins, “[Kabul Bank Employees Flee to Pakistan Amid Investigation into Lending, Officials Say](#),” Washington Post, January 31, 2011. USAID notes that Farnood and Ferozi were “aided and abetted by other senior managers and board members.” See: USAID, Office of the Inspector General, “[Review of USAID/Afghanistan’s Bank Supervision Assistance Activities and the Kabul Bank Crisis](#),” Report No. F-306-11-003-S, March 16, 2011, p. 14. During the Kabul Bank run, the central bank “forced out about 10 top managers at Kabul Bank and replaced them with executives from the central bank.” See: Alissa J. Rubin and Adam B. Ellick, “[More Problems Foreseen for Troubled Kabul Bank](#),” New York Times, September 15, 2010.

¹⁶⁰ Joshua Partlow and Andrew Higgins, “[Kabul Bank Employees Flee to Pakistan Amid Investigation into Lending, Officials Say](#),” Washington Post, January 31, 2011. One of these employees was Rana Tayyab Tahir, referred to here as an executive with the finance department.

¹⁶¹ Greg Miller and Ernesto Londono, “[U.S. Officials Say Karzai Aides are Derailing Corruption Cases Involving Elite](#),” Washington Post, June 28, 2010.

¹⁶² Alissa J. Rubin, “[I.M.F. Said to Have Harsh Assessment of Troubled Kabul Bank](#),” New York Times, February 15, 2011.

¹⁶³ Dexter Filkins, “[Letter From Kabul: The Great Afghan Bank Heist](#),” The New Yorker, February 14, 2011.

¹⁶⁴ Alissa J. Rubin and James Risen, “[Losses at Afghan Bank Could be \\$900 Million](#),” New York Times, January 30, 2011.

¹⁶⁵ Ibid. It is not clear whether this was Farnood’s money or if he was stealing it from Kabul Bank. In any case, the transfer to Farnood by bank employees appears to have been illegal under Afghan banking law, Articles 55.4 and 76.7.2, unless the conservator (Masood Ghazi) had approved the transfer. The Lashkar Gah branch was shut down for a week as a consequence of the transfer.

¹⁶⁶ Eltaf Najafzada and James Rupert, “[Afghanistan to Sell Kabul Bank as Cabinet Halts Law on Shareholder Loans](#),” Bloomberg, April 20, 2011.

¹⁶⁷ Ibid. Justice Minister Habibullah Ghalib refused to name the individuals who complained to the Cabinet.

¹⁶⁸ Matthew Green, “[Afghans Resist IMF Pressure to Sell off Bank](#),” Financial Times, February 3, 2011; “[Statement by an IMF Staff Visit to the Islamic Republic of Afghanistan](#),” Press Release No. 11/46, imf.org, February 15, 2011; Alissa J. Rubin, “[I.M.F. Said to Have Harsh Assessment of Troubled Kabul Bank](#),” New York Times, February 15, 2011. In mid-

would close down Kabul Bank permanently and permit the central bank to collect as much money as possible from the bad, or non-performing, loans.¹⁶⁹ In contrast, the Karzai administration still wanted to save Kabul Bank, but could not secure the private investment needed to recapitalize it.¹⁷⁰ The central bank released a statement saying that Kabul Bank “had a bright future” and likely would become “one of the most successful [banks] in the country within three years.”¹⁷¹

The new IMF demands, five months after the Kabul Bank scandal began, would later prompt Finance Minister Zakhilwal to accuse the IMF of playing politics by moving the proverbial goal post.¹⁷² The IMF declined to discuss its new Kabul Bank demands with this paper’s author; however, the timing of the new demands likely revealed the IMF’s motive for issuing them.¹⁷³

To be sure, it was an embarrassment to the Afghan government that the IMF even had to press it to prosecute those who stole from Kabul Bank. It was like telling a doctor to help a sick person or a teacher to instruct his or her students. The IMF demanded prosecutions for the Kabul Bank fraud only after it was learned that so many members of the Cabinet and the Parliament played a role in the fraud.¹⁷⁴ Perhaps the IMF (and the other FSWG members) concluded that prosecutions were necessary to send a message to the Afghan elite that such corruption would not go unpunished. The IMF’s prosecution demand also may have been a reaction to the late-January revelation that Kabul Bank’s losses were closer to \$900 million, or triple the original \$300 million estimate.¹⁷⁵

Afghanistan’s banking law mandates receivership when banks are insolvent, and Kabul Bank was still insolvent five months after the scandal started.¹⁷⁶ The money collected in receivership would be used to reimburse the Afghan government for its \$820 million bailout of Kabul Bank.¹⁷⁷ However, receivership triggered yet another IMF demand: the Afghan government needed to propose a plan for how to recapitalize the government’s reserves in the event that receivership failed to fully reimburse the \$820 million.¹⁷⁸

January, the IMF’s position was that Kabul Bank needed recapitalization although it was unclear “where the money to do so would come from.” See: Alissa J. Rubin and Rod Nordland, “[Officials in Afghanistan Begin Investigation into Possible Fraud at Troubled Bank](#),” New York Times, January 14, 2011.

¹⁶⁹ For the receivership of banks, see “Law of Banking,” Articles 64 through 96.

¹⁷⁰ President Karzai failed to find new private investors to recapitalize Kabul Bank. See: Matthew Rosenberg and Maria Abi-Habib, “[Afghan Officials Probed Over Bank](#),” Wall Street Journal, February 1, 2011.

¹⁷¹ Word in bracket added. Alissa J. Rubin, “[Lender Disputes Kabul Bank’s Losses](#),” New York Times, January 31, 2011.

¹⁷² Paul Tait, “[Afghan Bank Crisis Talks ‘a Waste of Time’ –Minister](#),” Reuters, June 20, 2011.

¹⁷³ This paper’s research did not turn up evidence that the IMF sought receivership or seriously pushed for prosecutions prior to February. The IMF declined to discuss the issue with this paper’s author in a July 20, 2011 email.

¹⁷⁴ Matthew Rosenberg, “[Afghan Officials Shielded Bank from Scrutiny](#),” Wall Street Journal, February 1, 2011; Matthew Rosenberg and Maria Abi-Habib, “[Afghan Officials Probed Over Bank](#),” Wall Street Journal, February 1, 2011.

¹⁷⁵ Alissa J. Rubin and James Risen, “[Losses at Afghan Bank Could be \\$900 Million](#),” New York Times, January 30, 2011.

¹⁷⁶ Joshua Partlow, “[IMF Wants Afghanistan’s Troubled Kabul Bank Sold Off](#),” Washington Post, February 16, 2011.

¹⁷⁷ “Law of Banking,” Article 86 (priority of payments). Afghan banking law states that in receivership the depositors get paid first. However, in Kabul Bank’s case, the depositors got paid through the bailout, so any collected money in receivership would go first to the Afghan government.

¹⁷⁸ “[Statement by an IMF Staff Visit to the Islamic Republic of Afghanistan](#),” Press Release No. 11/46, imf.org, February 15, 2011. The IMF statement refers to the central bank being recapitalized “with government resources as needed.”

In Kabul Bank's case, receivership also meant salvaging the good part of the bank by letting it continue under a new name, or "New Kabul Bank," and grouping the bad loans in another entity that would get shut down after as much money as possible were recouped from the bad loans.¹⁷⁹ The Kabul Bank shareholders would have no association with the new bank.¹⁸⁰ New Kabul Bank began as a legal entity on April 18, 2011.¹⁸¹

In mid-February, following a 10-day visit to Afghanistan, the IMF issued a "harsh" review of the Karzai administration's handling of Kabul Bank.¹⁸² An IMF press release stated that the Afghan government needed to prosecute those who committed the fraud, to put the bank under receivership, and to take measures to increase "accountability and transparency in the banking system."¹⁸³ The approval of a new ECF program was linked to the Afghan government taking these steps.¹⁸⁴

A few days after the IMF rebuke, Zakhilwal tried to deflect the IMF's criticism by searching for scapegoats. The finance minister stated that "Afghan and U.S. officials agreed" that part of the blame for the Kabul Bank scandal rested on "an 'erroneous' audit and inadequate help from international banking advisors" that compounded the Kabul Bank scandal.¹⁸⁵ Privately, a U.S. official disagreed, saying that the Afghan government was responsible for supervising its own banks.¹⁸⁶ Significantly, the Ministry of Finance did not blame the central bank, Afghanistan's primary banking regulatory body.

A.F. Ferguson, Kabul Bank's independent auditor, gave the bank a clean audit only three months before the scandal began.¹⁸⁷ Western officials suspect that Kabul Bank's executives bribed A.F. Ferguson's auditors.¹⁸⁸ In contrast, the Deloitte advisors worked at the central bank under a USAID contract called the Economic Growth and Governance Initiative (EGGI). More is known about Deloitte's performance than A.F. Ferguson's work because USAID reviewed Deloitte's contract after the Kabul Bank scandal.

The March 2011 USAID report investigated whether USAID or Deloitte "were negligent in failing to report the Kabul Bank fraud."¹⁸⁹ The report states that Deloitte's contract mandate was not "to supervise private banks," but "to provide trainers and technical experts to build the capacity of the Bank Supervision unit within the Central Bank...."¹⁹⁰ However, in the course of their work, Deloitte advisors discovered "fraud indicators" at

¹⁷⁹ Alissa J. Rubin, "[Afghanistan Outlines Plan for Scandal-Plagued Bank](#)," New York Times, April 20, 2011.

¹⁸⁰ Ibid.

¹⁸¹ The date is courtesy of Thomas Ruttig of the [Afghanistan Analysts Network](#) in an August 7, 2011, email.

¹⁸² Alissa J. Rubin, "[I.M.F. Said to Have Harsh Assessment of Troubled Kabul Bank](#)," New York Times, February 15, 2011.

¹⁸³ "[Statement by an IMF Staff Visit to the Islamic Republic of Afghanistan](#)," Press Release No. 11/46, imf.org, February 15, 2011.

¹⁸⁴ Ibid.

¹⁸⁵ Alissa J. Rubin, "[I.M.F. Said to Have Harsh Assessment of Troubled Kabul Bank](#)," New York Times, February 15, 2011; Associated Press, "[Afghanistan: Ministry Says Clean Audit Compounded Kabul Bank's Troubles](#)," New York Times, February 18, 2011.

¹⁸⁶ Ibid.

¹⁸⁷ Ibid.

¹⁸⁸ Alissa J. Rubin, "[Karzai Blames Western Firms for Kabul Bank's Troubles](#)," New York Times, April 11, 2011.

¹⁸⁹ USAID, Office of the Inspector General, "[Review of USAID/Afghanistan's Bank Supervision Assistance Activities and the Kabul Bank Crisis](#)," Report No. F-306-11-003-S, March 16, 2011, p. 1.

¹⁹⁰ Ibid, pp. 13-14.

Kabul Bank, but did not report them to USAID.¹⁹¹ In March, USAID suspended Deloitte's contract with the central bank.¹⁹²

The lead Deloitte advisor defended his actions by stating that there was a "confidentiality" issue in his advisory role with the central bank that prohibited him from revealing the fraud.¹⁹³ The confidentiality issue likely is a reference to the confidentiality agreement that "most U.S.-paid advisors sign" that is "meant to assure Afghan officials that they are not being spied on."¹⁹⁴

The USAID report also criticized Deloitte's advisors for aloofness: "...Deloitte advisors remained detached, providing only theoretical advice instead of lending hands-on assistance to find evidence of the fraud that seemingly everyone believed exists."¹⁹⁵ However, as if to justify Deloitte's hands-off approach, the report also noted that insecurity hampered Deloitte's work and endangered the lives of its staff.

The Deloitte staff at the central bank had previously worked for BearingPoint on the same contract, and back in November 2008, when one of BearingPoint's advisors conducted an onsite examination of Kabul Bank, the advisor received "two death threats."¹⁹⁶ In a stunning confession, the USAID report admits that as a consequence of the death threats: "With USAID's concurrence, BearingPoint discontinued participation in onsite bank examinations, and limited its technical assistance to classroom training, coaching, and reviewing information obtained by bank examiners."¹⁹⁷ Consequently, Deloitte's opinion on Kabul Bank, restricted as it now was, could only show a healthy bank since its opinion was based on Kabul Bank's audits, which used the "fake" books, and the information that central bank examiners obtained from Kabul Bank.

How good were the central bank examiners? Were they any better at obtaining evidence of fraud from Kabul Bank? No, because the examiners confronted the same political interference that U.S. advisors encountered. As previously noted, the central bank's examiners were threatened too, when they looked for evidence of insider trading following a regular inspection of Kabul Bank in January 2010.

The USAID report highlighted the central bank examiners' fear of Kabul Bank's management in a chilling incident that occurred in the summer of 2009. BearingPoint advisors were conducting a training course for central bank examiners. The examiners looked in disbelief after a BearingPoint advisor asserted that the central bank "had the

¹⁹¹ Ibid, pp. 7-8. USAID also discovered problems with its contract oversight of Deloitte. USAID's oversight team had a tiny staff that lacked technical banking expertise.

¹⁹² Ernesto Londono and Rajiv Chandrasekaran, "[U.S. Advisors Saw Early Signs of Trouble at Afghan Bank](#)," Washington Post, March 15, 2011.

¹⁹³ USAID, Office of the Inspector General, "[Review of USAID/Afghanistan's Bank Supervision Assistance Activities and the Kabul Bank Crisis](#)," Report No. F-306-11-003-S, March 16, 2011, p. 7.

¹⁹⁴ Ernesto Londono and Rajiv Chandrasekaran, "[U.S. Advisors Saw Early Signs of Trouble at Afghan Bank](#)," Washington Post, March 15, 2011.

¹⁹⁵ USAID, Office of the Inspector General, "[Review of USAID/Afghanistan's Bank Supervision Assistance Activities and the Kabul Bank Crisis](#)," Report No. F-306-11-003-S, March 16, 2011, p. 6.

¹⁹⁶ Ibid, pp. 1, 5.

¹⁹⁷ Ibid, p. 5. Deloitte kept BearingPoint's hands-off policy because USAID faulted Deloitte for it.

power to remove” Kabul Bank’s management. The BearingPoint advisor pressed the examiners: “You do not think the DAB [Da Afghanistan Bank, or the central bank] can remove the chief executive officer [Khalilullah Ferozi] of Kabul Bank?”¹⁹⁸ The examiners responded, ‘He can remove us.’”

The USAID report suggests that fraud detection training may have helped the central bank examiners “uncover at least some of the abuses.”¹⁹⁹ While this recommendation might have worked under different conditions, at Kabul Bank the problem was not incompetence or ignorance that prevented the central bank from regulating Kabul Bank, it was politics.²⁰⁰ Both U.S. advisors and Afghan examiners feared for their lives because of Kabul Bank’s ties to the Karzai administration, which empowered Kabul Bank’s management to resist the central bank’s regulatory authority.

Although the auditors failed to identify and the advisors failed to report the fraud at Kabul Bank, these failures do not confer criminality on the auditors and advisors unless they took bribes. Blaming the advisors, in particular, for the Kabul Bank fraud is like condemning Western trainers for the corruption in the Afghan National Police or the Afghan judiciary. The onus is on the police and the judges to apply what they have learned, and the trainers cannot be blamed if government officials choose corruption or if they are unable to do the right thing because of political pressure.

On April 11, a defiant President Karzai conducted a fiery press conference. He announced that Kabul Bank would be placed under receivership, one of the IMF’s key demands.²⁰¹ He also indicated that he would permit Kabul Bank management, presumably Farnood and Ferozi, to face prosecution, but the rest of the shareholders who took Kabul Bank money illegally were offered amnesty. They would be excused so long as within one month they repaid what they took.²⁰² Karzai said, “If they [the loans] are paid back within one month, excellent. If not, they’ll be legally pursued by the government of Afghanistan.”²⁰³

Karzai’s amnesty for the shareholders violated Afghan criminal law. As already noted, Afghan criminal law states that those who embezzle “shall be sentenced to long

¹⁹⁸ Ibid. Words in brackets added.

¹⁹⁹ Ibid, p. 7. The lead Deloitte advisor recommended this.

²⁰⁰ USAID’s Inspector General, Timothy Cox, is emphatic that the advisors could not have prevented the Kabul Bank fraud, which was criminal in nature and deliberately concealed. See: USAID, Office of the Inspector General, “[Review of USAID/Afghanistan’s Bank Supervision Assistance Activities and the Kabul Bank Crisis](#),” Report No. F-306-11-003-S, March 16, 2011, pp. 13-14.

²⁰¹ Maria Abi-Habib, “[Kabul Bank to be Dissolved](#),” Wall Street Journal, April 11, 2011. A central bank leadership body reportedly voted for receivership about two weeks prior to Karzai’s announcement. See: Ernesto Londono, “[Afghan Officials Agree to Dissolve Kabul Bank, Under Pressure from U.S. and IMF](#),” Washington Post, March 26, 2011.

²⁰² “[Hamid Karzai Warns of Penalties for Kabul Bank Troubles](#),” British Broadcasting Corporation, April 11, 2011; Alissa J. Rubin, “[Karzai Blames Western Firms for Kabul Bank’s Troubles](#),” New York Times, April 11, 2011; Maria Abi-Habib, “[Kabul Bank to be Dissolved](#),” Wall Street Journal, April 11, 2011. The one-month time limit was extended in June to three years. See: Maria Abi-Habib, “[IMF Said to Raise Flags Over Two Afghan Banks](#),” Wall Street Journal, June 30, 2011.

²⁰³ Words in brackets added. “[Hamid Karzai Warns of Penalties for Kabul Bank Troubles](#),” British Broadcasting Corporation, April 11, 2011.

imprisonment of not more than ten years.”²⁰⁴ It does not say that embezzlers, if caught, should merely pay back what they took and then case closed.

Reminiscent of the Ministry of Finance’s criticism two months earlier, President Karzai also blasted the foreign banking advisors and auditors; however, Karzai took the criticism a step further by calling for their prosecution. Karzai declared that the advisors, “...provided the Central Bank with inaccurate information, they deceived Afghanistan’s government and its economic and financial regulatory bodies.”²⁰⁵ Karzai identified three firms: Pricewaterhouse Coopers, Deloitte, and BearingPoint.

Significantly, like the Ministry of Finance, President Karzai did not assign any blame to the central bank, although he suggested that its staff was inexperienced in regulatory matters.²⁰⁶ He lamented that the central bank was “deceived” with false information given to it by auditing firms. Since it was deceived that meant that the central bank was not at fault for failing to regulate Kabul Bank. According to Karzai, it was the foreign advisors who were to blame because they failed to do their job and gave the central bank bad information, which led the central bank to believe that Kabul Bank was financially healthy.

Karzai’s analysis of the Kabul Bank fraud was notable for its omissions. Karzai did not acknowledge that Kabul Bank’s political connections to his administration shielded it from the central bank’s regulatory authority. Neither did he affirm that auditors and central bank examiners were relying on fake books to evaluate Kabul Bank. Nor did he state that the central bank alone was responsible for supervising Afghan banks, or that the international advisors were mandated only to build human capacity, not to supervise.

With the exception of Farnood and Ferozi, President Karzai’s philosophy on prosecution was striking as well. Karzai showed preference to the shareholders. Karzai would grant redemption to the shareholders so long as they paid back what they took illegally. However, non-shareholders, like the auditors, whom Karzai blamed in part for the Kabul Bank fraud, would be punished. There was no redemption for them.

President Karzai’s partiality towards the rich and powerful shareholders violated the Afghan Constitution and the presidential oath of office. One of the goals of the Afghan Constitution is to create a free and fair society. The Preamble to the Constitution refers to the “creation of a civil society free of oppression, atrocity, discrimination, and violence, based on rule of law, social justice, protection of human rights, and dignity, and ensuring fundamental rights and freedoms of the people.”²⁰⁷

²⁰⁴ “The Penal Code of Afghanistan,” Article 268:1.

²⁰⁵ Alissa J. Rubin, “[Karzai Blames Western Firms for Kabul Bank’s Troubles](#),” New York Times, April 11, 2011; Associated Press, “[Afghanistan: Ministry Says Clean Audit Compounded Kabul Bank’s Troubles](#),” New York Times, February 18, 2011.

²⁰⁶ Hamid Shalizi and Emma Graham-Harrison, “[Karzai Says West had Role in Bank Crisis, Wants US Ties Reviewed](#),” Reuters, April 11, 2011.

²⁰⁷ “The Constitution of Afghanistan,” Preamble 8.

Elsewhere, the Constitution states, “The state is obliged to create a prosperous and progressive society based on social justice.... Any kind of discrimination and privilege between the citizens of Afghanistan are prohibited.”²⁰⁸ The president promises in the oath of office “to observe the Constitution and other laws of Afghanistan and supervise their implementation.”²⁰⁹ Instead of following Afghanistan’s laws, President Karzai was shielding the biggest crooks in Afghanistan from prosecution.

In May, the U.S. Treasury Department pulled its advisors from the central bank because of a “hostile” work environment, likely caused by the Ministry of Finance and the president’s attempt to scapegoat them.²¹⁰

Political Theater

Sometime before April 20, Governor Fitrat of the central bank decided to expose the shareholders for the fraud at Kabul Bank. He thought it would bring closure to the Kabul Bank crisis but instead it ended his political career.²¹¹ Fitrat appeared twice before the Parliament in April. On the 20th, he talked tough against the shareholders in what seemed to be an attempt to appease the IMF, since the IMF wanted prosecutions in the Kabul Bank fraud.²¹²

Publically, Fitrat’s message agreed with President Karzai’s position that the shareholders who repaid their loans would not be prosecuted. Fitrat stated, “If somebody doesn’t cooperate, we will take action. We will seize their property by the order of the court. Even we are ready to confiscate their properties if they do not cooperate.”²¹³ The message was that the shareholders needed to work with the Afghan government. If they did not, and refused to pay back the money, they would be “legally prosecuted and severely punished.”²¹⁴

Privately, however, Fitrat challenged the president’s amnesty policy. Significantly, Fitrat told the Parliament that the central bank had referred 19 cases of “fraud and questionable lending” to the AGO and two corruption cases to the HOO.²¹⁵ If Fitrat supported Karzai’s

²⁰⁸ Ibid, Articles 6 and 22.

²⁰⁹ Ibid, Article 63.

²¹⁰ Office of the Inspector General for Afghanistan Reconstruction, [Limited Interagency Coordination and Insufficient Controls Over U.S. Funds in Afghanistan Hamper U.S. Efforts to Develop the Afghan Financial Sector and Safeguard U.S. Cash](#),” SIGAR-Audit-11-13, July 20, 2011, p. 7.

²¹¹ Doug Palmer, “[Afghan Central Banker Resigns, Fears for Life](#),” Reuters, June 27, 2011. The end of Fitrat’s career as a result of challenging high corruption is similar to what happened to former Deputy Attorney General Fazel Ahmed Faqiryar who was fired for his anti-corruption efforts. See: Dexter Filkins and Alissa J. Rubin, “[Graft-Fighting Prosecutor Fired in Afghanistan](#),” New York Times, August 28, 2010.

²¹² Joshua Partlow, “[Kabul Bank to be Split and Sold Off to Protect Afghanistan’s Financial System](#),” Washington Post, April 20, 2011.

²¹³ Deb Riechmann and Rahim Faiez, “[Afghan Banker: 5 Percent of Kabul Bank Loans Paid](#),” Associated Press, ABC News, April 20, 2011.

²¹⁴ Alissa J. Rubin, “[Afghanistan Outlines Plan for Scandal-Plagued Bank](#),” New York Times, April 20, 2011.

²¹⁵ Deb Riechmann and Rahim Faiez, “[Afghan Banker: 5 Percent of Kabul Bank Loans Paid](#),” Associated Press, ABC News, April 20, 2011.

amnesty for the shareholders, he would not have forwarded these criminal cases.²¹⁶ He would have simply encouraged the shareholders to repay their loans and that would be the end of it.

Fitrat also told the Parliament that Mahmoud Karzai and Abdul Fahim had a repayment agreement with the Afghan government to pay back “some” of their loans.²¹⁷ This announcement exposed Karzai and Fahim because President Karzai’s policy was that the shareholders needed to repay all that they received from Kabul Bank; yet, Fitrat told the Parliament that the two men had agreed only to a partial repayment. In February, Mahmoud Karzai had promised to repay all of his Kabul Bank loans: “I’m repaying every penny. No one can say that I am getting special treatment.”²¹⁸

On April 27, Governor Fitrat made a public break with President Karzai on the Kabul Bank crisis. Before the Parliament, Fitrat identified by name eight shareholders and two other prominent businessmen who took money from Kabul Bank illegally, stated the amount of money that each of the men received, and explained that they violated Article 34 of Afghanistan’s banking law.²¹⁹ Fitrat noted that most of the shareholders had confessed to their crimes.²²⁰

Fitrat’s identification of only ten names in the Kabul Bank fraud is subject to interpretation because far more people received Kabul Bank money illegally. Fitrat’s list of 10 names appears to be a “top ten” list of the most egregious offenders, or those who received the most amount of money. Fitrat may have reasoned that it would be impractical or disruptive to target every person involved in the fraud.

Fitrat’s identification of only Article 34 of Afghanistan’s banking laws is curious as well. The crooks behind the Kabul Bank fraud participated in an elaborate scam, and as noted earlier, the central bank’s MLR identified 18 banking law violations.²²¹ Article 34 addresses only one violation that banks will not engage in non-banking businesses. Consequently, accusing the Kabul Bank crooks with an Article 34 violation alone does not bring to justice to the scandal.

²¹⁶ Alternatively, Fitrat’s referral of the cases could be interpreted as a mere game, in conjunction with the Karzai administration, to appease the IMF; however, in a June 28 Aljazeera interview, Fitrat stated that he angered the president when he forwarded the fraud cases. It was one of two actions that turned Karzai against Fitrat. The second was that he tried to freeze the shareholders’ international assets.

²¹⁷ Alissa J. Rubin, “[Afghanistan Outlines Plan for Scandal-Plagued Bank](#),” New York Times, April 20, 2011.

²¹⁸ Matthew Rosenberg and Maria Abi-Habib, “[Afghan Officials Probed Over Bank](#),” Wall Street Journal, February 1, 2011.

²¹⁹ Abasin Zaheer and Abdul Qadir Siddiqui, “[Kabul Bank’s Corrupt Shareholder’s Named](#),” Pajhwok Afghan News, April 27, 2011; Rahim Faiez, “[Afghan Banker Calls for Public Trials in Bank Case](#),” Associated Press, Bloomberg Businessweek, April 27, 2011. Several media sources mistakenly identified all 10 men as Kabul Bank shareholders. See: Martine Van Bijlert, “[The Kabul Bank Investigations: Central Bank Gives Names and Figures](#),” Afghanistan Analysts Network, May 2, 2011. The first half of Article 34, entitled “Prohibited activities,” reads: “No bank shall engage in, as an agent, partner or co-owner, in wholesale or retail trade, manufacturing, transportation, agriculture or fisheries, mining, building, insurance or other business activities except for activities that are authorized by Article 33.”

²²⁰ Abasin Zaheer and Abdul Qadir Siddiqui, “[Kabul Bank’s Corrupt Shareholder’s Named](#),” Pajhwok Afghan News, April 27, 2011.

²²¹ See footnote 85 for the MLR.

Fitrat also told Parliament that he asked the government to confiscate the shareholders' property and to set up a special court to try them.²²² Fitrat said the shareholders' actions "had a very bad effect on the financial system of the country. That's why no one has the right to forgive any of them. They should be sentenced."²²³

Fitrat's request that the government confiscate the shareholders' property was significant because it agreed with Afghan criminal law and the United Nations Convention Against Corruption (UNCAC), to which Afghanistan is a signatory.²²⁴ The Afghan Penal Code states that goods acquired in crime must be returned, or monetarily compensated, and that the court has the power to confiscate:

If a person, who is punished in accordance with the provisions of this law, has acquired a good through crime he shall be adjudged to return the good, and if the good should not be available, to return the same or its price to its owner. A person who inflicts a loss as a result of committing a crime shall be adjudged to compensation of the inflicted loss, too. ...The court can in cases where the law has not anticipated confiscation as a punishment, order confiscation of goods obtained through commitment of crime....²²⁵

Article 31 of the UNCAC requires signatories to freeze, seize, or confiscate property acquired by corruption.²²⁶ Member of Parliament Sher Wali Wardak told Fitrat, "All the parliamentarians are with you and support your bold step of naming the shareholders."²²⁷ A minority of legislatures ridiculed Fitrat and accused him as being part of the problem.²²⁸

Fitrat also exposed members of Karzai's Cabinet and the Parliament, before whom he was testifying. He stated that 103 ministers and members of Parliament also took money from Kabul Bank.²²⁹ Member of Parliament Shukria Barekzai, whose husband, Abdul Ghafaar Dawi, was on Fitrat's top ten list, stated that all 103 names "...should be disclosed, because they have no privilege over other people."²³⁰

Fitrat's April 27 Parliamentary testimony was the final act that turned President Karzai against him. Fitrat and the central bank now became targets of the Karzai administration. In fact, the Karzai administration and the shareholders' opinions of Fitrat and the central

²²² Abasin Zaheer and Abdul Qadir Siddiqui, "[Kabul Bank's Corrupt Shareholder's Named](#)," Pajhwok Afghan News, April 27, 2011.

²²³ Rahim Faiez, "[Afghan Banker Calls for Public Trials in Bank Case](#)," Associated Press, Bloomberg Businessweek, April 27, 2011.

²²⁴ "[United Nations Convention Against Corruption](#)," United Nations Office on Drugs and Crime, unodc.org. Returning what was taken in crime, or its monetary equivalent, is a reoccurring theme in the Afghan Penal Code. See Articles 48:2, 151, 273:1 (in embezzlement), 463 (in larceny), 473 (in fraud), 515:3 (in kidnapping). The court also has the power to confiscate goods associated with crime. See Articles 117, 119, and 132.

²²⁵ "The Penal Code of Afghanistan," Articles 6 and 119:1.

²²⁶ "[United Nations Convention Against Corruption](#)," United Nations Office on Drugs and Crime, unodc.org.

²²⁷ Abasin Zaheer and Abdul Qadir Siddiqui, "[Kabul Bank's Corrupt Shareholder's Named](#)," Pajhwok Afghan News, April 27, 2011.

²²⁸ Ibid.

²²⁹ "[Central Bank Urges Trial of Kabul Bank Shareholders](#)," Tolonews, April 27, 2011.

²³⁰ Ibid.

bank converged. The union of views attested to the “Karzai administration-Kabul Bank shareholder” political alliance.

Mahmoud Karzai summed up the amended narrative in May: “The Afghan people must know the fact that Kabul Bank collapsed due to the illegal activities of Sher Khan Farnood, lack of appropriate oversight, corruption in Da Afghanistan Bank (the central bank) and other international contractors, and negligence by the U.S. Agency for International Development.”²³¹ Likewise, Mr. Dawi declared, “Negligence and inattention by the governor of Da Afghanistan Bank led to the collapse of Kabul Bank and he (Fitrat) is responsible for the current scandal.”²³² Neither man noted his own criminal actions.

The Karzai administration agreed. On May 29, a presidential commission (“Lodin Commission” from here out) that had been set up on April 2 “to assess responsibility” for the Kabul Bank fraud, delivered its report to President Karzai.²³³ The Lodin Commission likely was the Karzai administration’s attempt to satisfy the IMF’s prosecution demand. However, the commission was a shill for the president and his policy of protecting the shareholders because it exonerated them and legitimized the Karzai administration’s search for scapegoats.

The commission, which was led by HOO chairman Azizullah Lodin, placed the lion’s share of the blame for the Kabul Bank scandal on Fitrat and the central bank. Mohammad Yasin Usmani, another commissioner and the former HOO chairman, explained, “The Central Bank we blame because their monitoring was very weak. They didn’t monitor. Even myself two years ago, I wrote a letter to the central bank and sent a delegation for investigation. They rejected it, said, ‘Everything is okay.’”²³⁴ In a telephone interview, Lodin singled out Fitrat: “It is clear the whole problem was the Central Bank of Afghanistan. They knew everything that was going on in Kabul Bank. He (Fitrat) is the root of the problem and he knew everything.”²³⁵

Lodin also mischaracterized Fitrat’s ability and qualifications: “The government of Afghanistan appoints people to key positions who have no knowledge, who are uneducated, with lack of experience, and these kinds of problems happen.”²³⁶ Before leading the central bank, Fitrat served as an advisor to the World Bank and worked in

²³¹ Abdul Ghayoor Waziri, “[Kabul Bank Blame-Game Deepens](#),” The Killid Group, May 14, 2011. Note that Karzai did not name Ferozi, whom he sided with in the Farnood-Ferozi schism. Since the start of the Kabul Bank scandal, Mahmoud Karzai has repeatedly blamed Farnood for the problems at Kabul Bank.

²³² Ibid.

²³³ The commission’s starting date was kindly provided by the [Afghanistan Analysts Network](#) via email with Thomas Ruttig on July 11, 2011. The Lodin report is not available to the public.

²³⁴ Heidi Vogt and Rahim Faiez, “[Afghan Probe: Monitors at Fault in Bank Crisis](#),” Associated Press, Boston Globe, May 29, 2011.

²³⁵ Word in parenthesis added. Rod Nordland, “[Afghan Central Bank Defends Itself After Critical Report](#),” New York Times, May 30, 2011.

²³⁶ Ibid. The New York Times article notes, “Asked if he was referring to Mr. Fitrat, an experienced banker who formerly worked for the World Bank, Mr. Ludin acknowledged he was.”

private banking in the U.S.²³⁷ Prior to that, Fitrat was an economic consultant to the IMF and even served as the Afghan central bank's governor in 1996.²³⁸

It should be noted that the Lodin Commission did not fully consult with the central bank in its investigation.²³⁹ This is extraordinary since the central bank knew more about the Kabul Bank scandal than any other Afghan institution. The Lodin Commission's blunder of not consulting with the central bank in its probe was like investigating a murder without interviewing the witnesses. Fitrat noted that some of the commissioners refused to sign the final report in protest.²⁴⁰

The Lodin Commission exonerated the shareholders, with the exception of Farnood and Ferozi. Speaking about Mahmoud Karzai, Lodin stated, "He is not guilty. He has no problem."²⁴¹ Abdul Fahim was also absolved of any crimes, although he still owes tens of millions of dollars and, reportedly, put up collateral for his loans.²⁴²

Lodin explained that Mahmoud Karzai had paid back \$4.2 million (out of \$22 million), and was no longer responsible for the rest of the money that he received.²⁴³ Of Karzai's remaining loans, \$8 million was for a Dubai villa, which presumably would transfer to the Afghan government, \$6 million was for his Kabul Bank loan shares, and \$4 million for accumulated interest.²⁴⁴ Interestingly, Mahmoud Karzai's partial payment of his total debt obligation to Kabul Bank, without any interest, appears to be the same deal that he worked out with the central bank as recorded in the October 30 MLR.²⁴⁵

The Lodin Commission also announced that, based on its recommendations, President Karzai would decide who to prosecute for the Kabul Bank fraud—not the attorney general who is mandated to make such decisions under Afghan law.²⁴⁶ When asked why the AGO could not make such a decision, Ahmad Big Qaderi, a Lodin Commission member and the head of the AGO's Monitoring of the Law Implementation Department, replied that they would defer to the president.²⁴⁷

Qaderi's admission that President Karzai would decide who gets prosecuted for the Kabul Bank fraud was remarkable. Such a reality was true whether Qaderi voiced it or not, but

²³⁷ Doug Palmer, "[Afghan Central Banker Resigns, Fears for Life](#)," Reuters, June 27, 2011.

²³⁸ Ibid.

²³⁹ Fitrat made this point in his defense. See: Rod Nordland, "[Afghan Central Bank Defends Itself After Critical Report](#)," New York Times, May 30, 2011.

²⁴⁰ Ibid.

²⁴¹ Rod Nordland, "[Afghan Bank Commission Absolves President's Brother in Fraud Case](#)," New York Times, May 29, 2011. The same article describes a bizarre interview with Mahmoud Karzai where he claims that Fitrat apologized to him for telling Parliament on April 27 that he (Karzai) owed \$22 million, and that he (Fitrat) accepted Karzai's accounting. Fitrat's spokesman denied that such a conversation ever took place. The purported Karzai-Fitrat conversation is likely fiction. Had Fitrat not parted with President Karzai on the Kabul Bank scandal then such a conversation would be believable, but Fitrat broke with the president so there was no need to pretend that Mahmoud Karzai was free of his obligation.

²⁴² Ibid.

²⁴³ Ibid. According to Lodin, Karzai had "paid off all his obligations to the bank."

²⁴⁴ Ibid.

²⁴⁵ Allisa J. Rubin and Rod Nordland, "[Afghan Elite Borrowed Freely from Kabul Bank](#)," New York Times, March 28, 2011.

²⁴⁶ Heidi Vogt and Rahim Faiez, "[Afghan Probe: Monitors at Fault in Bank Crisis](#)," Associated Press, Boston Globe, May 29, 2011.

²⁴⁷ Ibid; Qaderi's title at the AGO was kindly provided via email from Pajhwok News Agency on August 16, 2011.

one might have expected a politically formulated answer from Qaderi -that the AGO alone would decide who to prosecute. Qaderi's bold admission implied that the decision on who to prosecute was a political one and that Karzai was the one preventing the shareholders from facing justice.

The Lodin Commission reported that Kabul Bank's loans (good and bad) totaled \$587 million.²⁴⁸ Of that amount, \$538 million, or almost 92% of all Kabul Bank loans, were bad loans.²⁴⁹ The bad loans were comprised of 207 "undocumented" loans, or loans taken under fictitious names and companies, or loans having no paperwork (literally "no files").²⁵⁰ Adding \$338 million for accumulated interest and taxes and the total loss to Kabul Bank was \$925 million.²⁵¹

Another area of agreement between the Karzai administration and the shareholders was their perception of the Kabul Bank scandal. They both downplayed the seriousness of the scandal. For instance, Lodin, who as head of the HOO leads Afghanistan's top anti-corruption institution, called the Kabul Bank scandal a "minor incident."²⁵² Referring to the lack of an IMF program affecting aid to Afghanistan, Lodin said, "The donors should not stop giving aid for this minor incident. They should instead help us get rid of the situation."²⁵³ In fact, the IMF was trying to help the Afghan government "get rid of the situation" through Afghanistan's banking laws, its criminal justice system, and the Parliament -not by sweeping it under the rug.

Commissioner Usmani, in his rational that the central bank was more at fault than the shareholders, explained that the shareholders were just businessmen and inexperienced.²⁵⁴ Similarly, Deputy Attorney General Rahmatullah Nazari downplayed the shareholders' actions. Nazari stated, "To receive a loan from a bank is not a crime. If the money was loaned legally, who is responsible? The giver or the receiver?"²⁵⁵ Nazari's characterization of the fraud omitted the fact that most of the money, according to the Lodin Commission, was loaned illegally. The bad loans were not signed for and were made using fictitious names. Moreover, the borrowers were not repaying these loans.

²⁴⁸ Heidi Vogt and Rahim Faiez, "[Afghan Probe: Monitors at Fault in Bank Crisis](#)," Associated Press, Boston Globe, May 29, 2011.

²⁴⁹ Rod Nordland, "[Afghan Bank Commission Absolves President's Brother in Fraud Case](#)," New York Times, May 29, 2011. Good ("performing") loans are secure loans backed with collateral. They are properly documented and accrue interest. \$538 million is arrived at by subtracting the reported \$49 million in good loans from the total loan portfolio.

²⁵⁰ Ibid. The definition of "undocumented" was kindly provided via email correspondence with the [Afghanistan Analysts Network](#) on July 28, 2011. The undocumented loans were only known through private references in the "seniors' notebooks," which presumably refers to Chairman Farnood's personal records as cited earlier. See: Matthew Rosenberg, "[Afghan Minister Denies Bribery Allegations](#)," Wall Street Journal, February 3, 2011.

²⁵¹ Heidi Vogt and Rahim Faiez, "[Afghan Probe: Monitors at Fault in Bank Crisis](#)," Associated Press, Boston Globe, May 29, 2011.

²⁵² Abdul Qadir Siddiqui, "[Lodin: Kabul Bank Crisis Shouldn't Affect Aid](#)," Pajhwok Afghan News, June 20, 2011.

²⁵³ Ibid.

²⁵⁴ Heidi Vogt and Rahim Faiez, "[Afghan Probe: Monitors at Fault in Bank Crisis](#)," Associated Press, Boston Globe, May 29, 2011. The Afghan Constitution (Article 56) and the Afghan Penal Code (Article 5) both state that ignorance of the law is not an excuse. Of course, this begs the question as to what role inexperience could play in theft.

²⁵⁵ Pamela Constable, "[Afghan Officials Lash Out at Former Central Bank Head Who Fled to U.S.](#)," Washington Post, June 28, 2010.

When Mahmoud Karzai was asked at the beginning of the Kabul Bank run whether anyone should go to jail if it is proven that fraud brought down Kabul Bank, he replied, “I don’t think so because that would create chaos. Maybe there should be fines or something like that.”²⁵⁶ Six months before the bank scandal started, Haseen Fahim justified the loans that he took out at Kabul Bank. He explained that insider borrowing was unavoidable since Afghanistan’s economy is “starting from zero.”²⁵⁷ Fahim omitted the fact that his “loans” were really grants since they were interest-free and did not need to be repaid.

President Karzai himself minimized the shareholders’ fraud. As already noted, he offered amnesty to the shareholders by giving them one month to repay what they took illegally. Karzai said, “If they [the loans] are paid back within one month, excellent. If not, they’ll be legally pursued by the government of Afghanistan.”²⁵⁸ Were Karzai to apply the same lenient standard to other crimes committed in Afghanistan, convictions would freeze across the country.

The Crisis Intensifies

In June, the Kabul Bank crisis took a turn for the worse. An IMF deadline expired on June 11 for the Afghan government to come up with a plan to deal with Kabul Bank that would be acceptable to the IMF. However, the IMF rejected the government’s proposal as inadequate and, consequently, \$70 million from the Afghanistan Reconstruction Trust Fund (ARTF) was withheld from Afghanistan’s budget.²⁵⁹ At the same time, it was also reported that donor countries had not contributed to the ARTF for three months due to the lack of an IMF plan.²⁶⁰ The Afghan government was projected to tap its reserves in August in order to complete the expected budget shortfall.²⁶¹

The Afghan government is dependent on contributions from donor countries to pay for its budget because it does not bring in enough revenue on its own.²⁶² Donor countries contribute money to Afghanistan through three main funds: the Law and Order Trust Fund (LOTFA), the Afghanistan Security Forces Fund (ASFF), and the ARTF.²⁶³ The first two of these funds pay for the police and military respectively, and money going to them did not appear to be at risk from the lack of an IMF plan.

²⁵⁶ Jon Boone, “[Afghan Officials Resist Clean-Up of Kabul Bank as Scandal Engulfs Elite](#),” Guardian, September 3, 2010.

²⁵⁷ Andrew Higgins, “[In Afghanistan, Signs of Crony Capitalism](#),” Washington Post, February 22, 2010.

²⁵⁸ Words in brackets added. “[Hamid Karzai Warns of Penalties for Kabul Bank Troubles](#),” British Broadcasting Corporation, April 11, 2011.

²⁵⁹ Paul Tait, “[Exclusive: Afghan Cash Crunch Looms, Millions Withheld Over Bank](#),” Reuters, June 17, 2011.

²⁶⁰ Ibid.

²⁶¹ Ibid; Ray Rivera, “[World Bank is Withholding \\$70 Million as Afghans Try to Resolve a Scandal](#),” New York Times, June 17, 2011.

²⁶² Afghanistan’s three most recent budgets are located on the World Bank’s website. To view them, use the following permanent link: <http://go.worldbank.org/NKSSH907N0>. SY1390, or solar year 1390, extends from March 21, 2011 to March 20, 2012.

²⁶³ For information on LOTFA, see: “[Law and Order Trust Fund for Afghanistan \(LOTFA\) Phase V](#),” United Nations Development Programme, UNDP.org.af. For information on ASFF, see: “[Afghanistan National Army \(ANA\)](#),” Institute for the Study of War, understandingwar.org.

What was at risk was the funding for the non-security, operational portion of the budget (called the “Recurrent Window”), which the ARTF supplemented.²⁶⁴ Notably, this included the salaries of teachers, medical staff, and all other non-security civil service employees, or over 250,000 people. The ARTF also funds the non-security, development portion of the Afghan budget. Some examples of ARTF-funded development programs include “village block grants for rural infrastructure,” “secondary and tertiary roads,” and access to microfinance for the poor.²⁶⁵ The development portion of the Afghan budget also did not appear to be at risk from the lack of an IMF plan since the World Bank, which manages the ARTF, signed two ARTF-funded development deals with the Afghan government in July and August.²⁶⁶

Commenting on the Afghan government’s lack of progress in resolving the Kabul Bank crisis, a Western diplomat remarked in late-June, “What is discouraging to many countries is that there is no progress on the matter. ... These financial-sector issues have not been tackled well, and the whole economic reforms are not progressing well. The donors are basically saying, ‘What is going on here? Why are there so many problems?’”²⁶⁷

In contrast to this grim characterization, Finance Minister Omer Zakhilwal insisted that the Afghan government had done “95% of what was asked” of it by the IMF and that the remaining details were “inconsequential to Kabul Bank.”²⁶⁸ While Kabul Bank was put in receivership in April and work on Kabul Bank’s forensic audit started finally in early-June, Zakhilwal overstated the Afghan government’s achievements. The Karzai administration still had not prosecuted anyone for the Kabul Bank fraud. In fact, with the exception of Farnood and Ferozi, the Lodin Commission made it harder to prosecute the shareholders because it exonerated them, and President Karzai did the same with his illegal amnesty policy.

In addition, the Afghan government still had not reformed the banking and lending laws to prevent another Kabul Bank-like crisis. While the Afghan government started the Kabul Bank forensic audit, the central bank appeared to be stalling on the Azizi Bank forensic audit, which was of particular concern to the IMF, and outright changed its mind

²⁶⁴ To learn more about the ARTF, see: “Afghanistan Reconstruction Trust Fund,” worldbank.org. From the homepage, go to Countries>Afghanistan>Afghanistan Reconstruction Trust Fund>ARTF Information.

²⁶⁵ Ibid, p. 4; “[Afghanistan: Projects, Programs, and Results](#),” worldbank.org. The first of these, the National Solidarity Program (NSP), is very popular. See: Mohammad Ehsan Zia, “[Afghan Aid That Works](#),” *Christian Science Monitor*, May 16, 2008; Ben Arnoldy, “[Afghanistan War: Successful Foreign Assistance Lets Afghans Pick Their Project](#),” *Christian Science Monitor*, July 28, 2010.

²⁶⁶ The deals were signed on July 24 and August 9. See: “[New ARTF Grant Aims at Further Improving Education Quality and Infrastructure](#),” worldbank.org, July 24, 2011; “[New ARTF Grant Aims to Drive More Donor Funding to National Budget Through Improved Public Financial Management System](#),” worldbank.org, August 9, 2011. During the same months, the World Bank also signed two other development deals with the Afghan government through the International Development Association. See: “[Government of Afghanistan Signs \\$52 Million Grant with the World Bank Aimed at Transparently and Effectively Managing its Untapped Natural Resources](#),” worldbank.org, July 16, 2011; “[Auditing Commercial Banks and Modernizing the National Payment System are Core Focuses of \\$19 Million World Bank Grant](#),” worldbank.org, August 25, 2011.

²⁶⁷ Joshua Partlow, “[Afghan Delays in Addressing Banking Problems Imperil Foreign Aid](#),” *Washington Post*, June 29, 2011.

²⁶⁸ Jon Boone, “[Afghanistan Facing Insolvency Within a Month, Say Officials](#),” *Guardian*, June 17, 2011. Zakhilwal’s comments given to the *Guardian* were actually from May and he repeated the argument in June.

about auditing the other banks claiming that it was too difficult to implement all the audits.²⁶⁹

Zakhilwal argued that bringing Azizi Bank into the IMF dispute over Kabul Bank had nothing to do with the approval of a new IMF plan. He accused the IMF of playing politics and said that another meeting with the IMF was “a waste” of his time.²⁷⁰ Zakhilwal explained, “We are now negotiating with a partner who is not a willing partner to actually conclude this.”²⁷¹ Undoubtedly, the IMF was using its financial leverage to force the Afghan government to address Azizi Bank, but from the IMF’s perspective, it did not want a “Kabul Bank 2.”

Another outstanding issue was that an acceptable plan still was lacking to recapitalize the central bank for its \$820 million bailout of Kabul Bank.²⁷² Zakhilwal argued incorrectly that the recapitalization plan was irrelevant to a new IMF deal.²⁷³ On the contrary, recapitalization was directly connected to Kabul Bank since without the scandal there would not be a recapitalization need. Once Kabul Bank went into receivership, the next financial step was to reimburse the state for the bailout, and the IMF expected this to be achieved through new taxes. The IMF noted: “Regarding the costs of the Kabul Bank insolvency, a budget allocation is a critical measure going forward to ensure that additional tax revenues are used to begin paying for the costs.”²⁷⁴

Afghanistan’s reserves would be paid back in part by whatever the receivership process collected, but by the end of July, the shareholders had paid back only \$70 million.²⁷⁵ Instead of having just one month to repay their loans, as President Karzai ordered on April 11, the Afghan government extended the repayment period to three years.²⁷⁶ However, future repayment promises from Kabul Bank shareholders were not enough to satisfy the IMF’s recapitalization demand. It is unclear how much the Afghan government will be able to recover from Kabul Bank’s bad loans. The Lodin Commission predicted that \$347 million would be repaid.²⁷⁷ It is worth noting that, as of June, the Dubai villas had not yet transferred to the Afghan government.²⁷⁸ If sold, they could bring in tens of millions of dollars or more.

²⁶⁹ Office of the Inspector General for Afghanistan Reconstruction, “[Limited Interagency Coordination and Insufficient Controls Over U.S. Funds in Afghanistan Hamper U.S. Efforts to Develop the Afghan Financial Sector and Safeguard U.S. Cash](#),” SIGAR-Audit-11-13, July 20, 2011, p. 7. The central bank may have reneged on performing the other forensic audits under President Karzai’s orders, since the audits would presumably expose corruption in these banks and pressure the president to do something about it.

²⁷⁰ Paul Tait, “[Afghan Bank Crisis Talks ‘a Waste of Time’ –Minister](#),” Reuters, June 20, 2011.

²⁷¹ Ibid.

²⁷² Jon Boone, “[Afghanistan Facing Insolvency Within a Month, Say Officials](#),” Guardian, June 17, 2011.

²⁷³ Paul Tait, “[Afghan Bank Crisis Talks ‘a Waste of Time’ –Minister](#),” Reuters, June 20, 2011.

²⁷⁴ Sandrine Rastello, “[IMF Seeks to Avoid Repeating Kabul Bank Collapse Before Aid to Afghanistan](#),” Bloomberg, June 20, 2011.

²⁷⁵ Alissa J. Rubin, “[Names of Suspects in Bank Fraud Sent to Afghan Courts](#),” New York Times, July 31, 2011.

²⁷⁶ Maria Abi-Habib, “[IMF Said to Raise Flags Over Two Afghan Banks](#),” Wall Street Journal, June 30, 2011.

²⁷⁷ Rod Nordland, “[Afghan Bank Commission Absolves President’s Brother in Fraud Case](#),” New York Times, May 29, 2011.

²⁷⁸ Jon Boone, “[Afghanistan Facing Insolvency Within a Month, Say Officials](#),” Guardian, June 17, 2011.

At the IMF's insistence, the Karzai administration tried to add a supplemental bill to the current year's fiscal budget that would raise \$73 million in additional revenue to pay back the bailout.²⁷⁹ The new tax increase presumably would continue each year until the reserves were paid back completely.²⁸⁰ However, the Afghan Parliament rejected the tax plan and preferred instead to sell off the shareholders' businesses and other assets.²⁸¹

Compounding the Afghan government's problem to recapitalize its reserves was the fact that the government already was under pressure to raise additional revenue to compensate for the ARTF's decreasing contribution to the operational side of the budget, which was scheduled to be cut by about 50% over the next four years.²⁸² Put simply, the Afghan government's budget was already under enormous strain going forward, even without the recapitalization burden.

On June 27, the Kabul Bank crisis took another startling turn. It was reported that central bank Governor Fitrat fled to the U.S. after being tipped off about an assassination plot against his life.²⁸³ On U.S. soil, Fitrat resigned from the central bank. He explained, "My life has become completely in danger. ... Since I exposed the fraudulent practices on April 27 in parliament I have received information about threats on my life."²⁸⁴

Fitrat's escape from Afghanistan may have been to avoid prosecution. The Lodin Commission had signaled that Fitrat was a prosecutorial target. A U.S. official acknowledged that Fitrat "wasn't sticking around Kabul to take the fall."²⁸⁵ Another Western official said that it was no surprise that Fitrat fled because "he didn't want to be a scapegoat."²⁸⁶

The Karzai administration was critical of Fitrat's flight and, in contrast to its foot dragging in prosecuting the shareholders, promptly issued an arrest warrant for him with Interpol.²⁸⁷ Deputy Attorney General Nazari claimed that Fitrat's assassination story was an "excuse" to flee prosecution. Nazari explained, "The central bank had responsibility to oversee and inspect the Kabul Bank properly. Mr. Fitrat paid no attention and sent reports saying the bank was in good condition. This clearly shows the hand of the central bank in the crisis."²⁸⁸ President Karzai's spokesman, Waheed Omer, called Fitrat's flight

²⁷⁹ The Parliament struggled to pass Afghanistan's current budget (SY1390). The \$73 million supplemental was part of the reason why Parliament rejected the budget on April 25. See: Abasin Zaheer, "[Wolesi Jirga Again Rejects Current Year's Budget](#)," Pajhwok Afghan News, April 25, 2011.

²⁸⁰ Abdul Ghayoor Waziri, "[Kabul Bank Blame-Game Deepens](#)," The Killid Group, May 14, 2011.

²⁸¹ For Parliament's June rejection of the \$73 million supplemental, see: "[Afghan Row with IMF over Failed Bank Threatens Salaries](#)," British Broadcasting Corporation, June 20, 2011; Jon Boone, "[Afghanistan Facing Insolvency Within a Month, Say Officials](#)," Guardian, June 17, 2011. For a blistering editorial on the \$73 million supplemental, see: "[Parliament Rejects Budget Again!](#)," Outlook Afghanistan, April 30, 2011.

²⁸² Islamic Republic of Afghanistan Ministry of Finance, "[1390 National Budget](#)," p. 19.

²⁸³ Doug Palmer, "[Afghan Central Banker Resigns, Fears for Life](#)," Reuters, June 27, 2011.

²⁸⁴ Maria Abi-Habib, "[Afghan Central Bank Chief Flees to U.S. and Quits Post](#)," Wall Street Journal, June 28, 2011.

²⁸⁵ Ibid.

²⁸⁶ Ibid.

²⁸⁷ Sayed Salahuddin and Pamela Constable, "[Ex-Chairman and Ex-CEO of Kabul Bank arrested in Afghanistan](#)," Washington Post, June 30, 2011.

²⁸⁸ Pamela Constable, "[Afghan Officials Lash Out at Former Central Bank Head Who Fleed to U.S.](#)," Washington Post, June 28, 2010.

“treason.”²⁸⁹ Omer confirmed that the AGO was preparing to prosecute Fitrat, which allegedly was for taking millions in bribes to keep quiet about Kabul Bank’s fraud.²⁹⁰

On June 28, Fitrat gave an interview to Aljazeera where he offered additional details about the assassination plot against his life and the Kabul Bank fraud.²⁹¹ Fitrat denied that he played any part in the corruption of Kabul Bank, and defended himself by noting that it was him who was pushing for the prosecution of the shareholders and that the president blocked his efforts. Asked if he played a role “in any way” in the Kabul Bank corruption, Fitrat replied:

“I absolutely deny it –absolutely, categorically not only deny that but I also insisted for creation of a special prosecution, for creation of a special court. I actually requested the government to appoint Major Crimes Task Force, or Sensitive Investigation Unit, or Anti-Corruption Unit in the Attorney General’s Office. These are...some credible sub-organizations within the Government of Afghanistan that were funded by international organizations, but the president himself denied and didn’t allow that. I requested for an open and public prosecution of those who were responsible for the government. This was the government who blocked this request. If I were involved, I [would have] never requested for [these things].”²⁹²

Fitrat alleged that the Afghan government was involved in the plot to kill him because he knew too much about the Kabul Bank scandal. He also stated that Mahmoud Karzai “took millions...illegally under fictitious names” and that “other relatives of other high level authorities of Afghanistan” took “possibly hundreds of millions of dollars.”

It was known already that Mahmoud Karzai took out a number of loans from Kabul Bank and, significantly, that his loans were “undocumented.”²⁹³ According to Fitrat, Karzai’s loans were in fact recorded, but under fictitious names, the inference being that Mr. Karzai knew about the fictitious names. Fitrat’s remark that relatives of the Afghan elite got “possibly hundreds of millions of dollars” suggests that a sizable portion of Kabul Bank money was funneled to the family members of the Afghan elite.

Fitrat also confirmed that President Karzai received \$14 million from Kabul Bank during his 2009 presidential campaign, but added that this money paid for “70 expensive vehicles” and his “entire media campaign.” Fitrat stated that the money for the campaign was given by the shareholders to Karzai’s “closest aids” and that he (Fitrat) had “confessions” from the shareholders “in the presence of several central bank officers.”²⁹⁴ Fitrat noted that the central bank officers also were “afraid of their lives.”

²⁸⁹ Doug Palmer, “[Afghan Central Banker Resigns, Fears for Life](#),” Reuters, June 27, 2011.

²⁹⁰ Ibid; Rod Nordland, “[Afghans Arrest Two Officials Over Kabul Bank Collapse](#),” New York Times, June 30, 2011.

²⁹¹ “[Afghan Banker: I Have Evidence of Death Plot](#),” Aljazeera, June 29, 2011. Retrieved June 29, 2011. The video of the Fitrat interview is attached to the article.

²⁹² Ibid. Words in brackets added.

²⁹³ Andrew Higgins, “[In Afghanistan, Signs of Crony Capitalism](#),” Washington Post, February 22, 2010.

²⁹⁴ News reports indicate that Ferozi was the one who was bribing on behalf of Kabul Bank. Ferozi’s initial offer to President Karzai’s re-election campaign as well as money passed in briefcases was reported before. See: Dexter Filkins, “[Letter From Kabul: The Great Afghan Bank Heist](#),” The New Yorker, February 14, 2011.

According to Fitrat, two of his acts turned the president against him. The first was when he called for the prosecution of the shareholders, which he did before Parliament on April 27. The second was when he asked international banks and other central banks “to freeze” the assets “of those involved in Kabul Bank’s fraud” including “the president’s brother.”²⁹⁵

The IMF Capitulates

The first arrests in the Kabul Bank scandal came on June 30, two days after Fitrat’s Aljazeera interview and ten months after the Kabul Bank scandal began.²⁹⁶ Kabul Bank’s two top executives, Chairman Sherkhan Farnood and Chief Executive Officer Khalilullah Ferozi, were arrested and taken to the prosecutor’s headquarters in Kabul where they would stay “for interrogation” as they awaited trial.²⁹⁷ Attorney General Aloko stated that the evidence against Farnood and Ferozi was “quite clear.”²⁹⁸ He added, “They were involved in corruption, fraud and misusing people’s money.”²⁹⁹ Deputy Attorney General Nazari noted that the men were arrested for fear that they would leave the country as Fitrat did.³⁰⁰

A New York Times reporter visited Farnood and Ferozi at the prosecutor’s headquarters shortly after their incarceration. The two men had their cell phones with them and were playing a game of chess in the presence of 15 visitors.³⁰¹ Ferozi said to the reporter, “You destroyed the bank, now you want to destroy the detainees. Please leave me alone. Talk to the attorney general’s office, they’re the ones who did this.”³⁰² Several other arrests were made in July but none were shareholders. They were Kabul Bank and central bank employees.³⁰³

Afghan criminal procedure law states that after the arrest of a “suspect,” the attorney general has a maximum of 30 days either to issue an indictment (a formal charge by the state for a crime or crimes) or to release the suspect.³⁰⁴ During the 30 days, while the accused is in a provisional detention center, the attorney general investigates to determine

²⁹⁵ [Afghan Banker: I Have Evidence of Death Plot](#),” Aljazeera, June 29, 2011.

²⁹⁶ Sayed Salahuddin and Pamela Constable, “[Ex-Chairman and Ex-CEO of Kabul Bank arrested in Afghanistan](#),” Washington Post, June 30, 2011.

²⁹⁷ Ibid.

²⁹⁸ Ibid.

²⁹⁹ Ibid.

³⁰⁰ Ibid.

³⁰¹ Rod Nordland and Alissa J. Rubin, “[2 Ex-Officials Held in Kabul Bank Collapse](#),” New York Times, June 30, 2010.

³⁰² Ibid.

³⁰³ Reuters, “[Eight More Arrested in Inquiry Over Insider-Loan Scandal at Kabul Bank](#),” The Independent, July 4, 2011. The eight are described as three Indian nationals and five Afghans. See also: Alissa J. Rubin, “[Names of Suspects in Bank Fraud Sent to Afghan Courts](#),” New York Times, July 31, 2011.

³⁰⁴ “Interim Criminal Procedure Code for Courts,” Articles 6 and 36. The attorney general is the “Primary Saranwal.” The 30-day rule begins when the suspect is in the attorney general’s custody. For instance, if the judicial police or another police body make the arrest, and not the AGO, the police by law may interrogate the suspect before handing him or her over to the prosecutor. See Articles 30 and 31. The same principal applies in counter narcotics. See: “Counter Narcotics Drug Law,” Article 37.

if there is sufficient evidence to charge the suspect with a crime.³⁰⁵ If so, the indictment is issued and the suspect's legal status is changed to the "accused."³⁰⁶ The indictment gets sent to the court, which must set a trial date "immediately" after the indictment has been issued.³⁰⁷

Since Farnood and Ferozi were arrested on June 30, by law they were required to be indicted or released by July 30. The indictment appears to have been issued at the end of July. It was reported that Attorney General Mohammad Ishaq Aloko sent the names of 15 people, including Farnood and Ferozi, to the courts to stand trial.³⁰⁸ Deputy Attorney General Nazari noted that about 30-40 people in all were involved in the Kabul Bank fraud.³⁰⁹ This figure probably tallies central bank and Kabul Bank employees rather than the shareholders and the other recipients of Kabul Bank money.

A month and a half later, on September 13, Tolo TV, a local Afghan television network, reported that Farnood and Ferozi were released from detention.³¹⁰ The announcement was a shock. Was the Karzai administration reversing its decision to prosecute the two masterminds of the Kabul Bank fraud?

This paper's research has been unable to determine the legal grounds in which Farnood and Ferozi were released. Afghanistan has a bail system so, if an indictment was in fact issued, a judge could have ordered the men released on bail while they awaited their trials. However, since the men were considered a flight risk as just noted, bail should not have been an option.

If bail was not issued then President Karzai might have arbitrarily –and illegally- ordered Attorney General Aloko to release Farnood and Ferozi.³¹¹ It is telling that the government's official reason for releasing Farnood and Ferozi was so that they could help find Kabul Bank's missing money.³¹² If the men were released on bail, then the government should not have felt the need to justify their release, other than saying that bail was posted.

A spokesman for the receivership office explained, "They know the people they distributed the loans to, and they can identify them. In these type of meetings, everyone is

³⁰⁵ "Interim Criminal Procedure Code for Courts," Articles 23, 37-39.

³⁰⁶ Ibid, Article 5.

³⁰⁷ Ibid, Article 42.

³⁰⁸ "The Afghan attorney general has sent the names of several people accused in the scheme to defraud Kabul Bank of hundreds of millions of dollars to the Afghan courts for trial, including the bank's former executive director and its board chairman." See: Alissa J. Rubin, "[Names of Suspects in Bank Fraud Sent to Afghan Courts](#)," New York Times, July 31, 2011. See also: Ben Farmer, "[40 People Involved in Ruin of Kabul Bank](#)," Daily Telegraph, August 1, 2011.

³⁰⁹ Ibid.

³¹⁰ "[Today's Afghan Headlines](#)," unama.unmissions.org, September 13, 2011. This paper's research was unable to determine the fate of the other banking staff that were arrested. They should have been either released or indicted 30 days after their arrests.

³¹¹ Karzai's interference at the AGO is well documented. See: Greg Miller and Ernesto Londono, "[U.S. Officials Say Karzai Aides are Derailing Corruption Cases Involving Elite](#)," Washington Post, June 28, 2010; Dexter Filkins and Allissa J. Rubin, "[Graft-Fighting Prosecutor Fired in Afghanistan](#)," New York Times, August 28, 2010.

³¹² Ernesto Londono, "[In Kabul Bank Scandal, Little Money Recovered](#)," Washington Post, October 2, 2011.

face to face and no one can deny anything.”³¹³ To accomplish their work, Farnood and Ferozi would at times need to visit “fancy restaurants and hotels” for “work meetings.”³¹⁴ Assuring the public, the Deputy Attorney General noted, “A crime has happened. They will go to the court whether they manage to secure the money or not.”³¹⁵

Releasing Farnood and Ferozi to help find the bank’s missing money defied common sense. As mentioned earlier, Farnood scored a \$1.3 million transfer from Kabul Bank’s Lashkar Gah branch the last time he was tasked with helping find Kabul Bank’s missing money.³¹⁶ Beyond that, it was unclear why there was still a need for Kabul Bank borrowers to be identified. They were identified already.

The central bank, the AGO, and the Lodin Commission each investigated the Kabul Bank fraud. The latter had reported the number of undocumented loans and the recipients of that money should have been identified through Farnood’s “personal records.”³¹⁷ Former central bank Governor Fitrat testified before Parliament that 103 ministers and members of Parliament also received Kabul Bank money, although he refused to read out the names, but he did identify by name eight shareholders and two other prominent businessmen.³¹⁸ Clearly, the Afghan government knew already the identities of those who received Kabul Bank’s money.

The releasing of Farnood and Ferozi was alarming and suggested that President Karzai would not allow them to be prosecuted after all. Whether or not a conviction in court would be obtained was secondary. If Farnood and Ferozi were believed to be responsible for the fraud at Kabul Bank, then the men needed to stand trial. As noted earlier, the attorney general “has the obligation to introduce the penal action for the prosecution of all crimes, known directly by him or reported to him” and he “shall not dismiss or stay a case except as otherwise provided by the law.”³¹⁹ Afghan law does not say that the President of the Republic, whenever he so desires, shall intervene into the attorney general’s duties and prevent prosecutions.

The reason that Afghan law gives the attorney general the authority to prosecute is so that other government bodies, including the president, do not get that authority. It is called the separation of powers and it is essential to the rule of law. If a society does not separate state powers among different government bodies then all that is left is favoritism, cronyism, and corruption.

On October 6, the IMF announced a major breakthrough that signaled the nearing to the end of the Kabul Bank crisis in what concerned the freezing of international aid to the

³¹³ Ibid.

³¹⁴ Ibid.

³¹⁵ Ibid.

³¹⁶ Alissa J. Rubin and James Risen, “[Losses at Afghan Bank Could be \\$900 Million](#),” New York Times, January 30, 2011.

³¹⁷ Heidi Vogt and Rahim Faiez, “[Afghan Probe: Monitors at Fault in Bank Crisis](#),” Associated Press, Boston Globe, May 29, 2011; Matthew Rosenberg, “[Afghan Minister Denies Bribery Allegations](#),” Wall Street Journal, February 3, 2011.

³¹⁸ [Central Bank Urges Trial of Kabul Bank Shareholders](#),” Tolonews, April 27, 2011.

³¹⁹ “Interim Criminal Procedure Code for Courts,” Article 22.

Afghan budget. A staff-level agreement was reached between an IMF team visiting Kabul and the Afghan government to renew the ECF program.³²⁰ Final approval rested in the hands of the IMF's Executive Board, which was scheduled to meet in November. An IMF press release the same day explained on what basis the IMF team was able to support the renewal of the ECF program.³²¹ The press release was remarkable for its omissions: the IMF capitulated on several of its demands.

The press release noted that the Afghan government had placed Kabul Bank into receivership, which President Karzai begrudgingly agreed to in April, and that efforts were underway to get back the "embezzled assets" from the former shareholders. The statement poked fun at the Karzai administration: the shareholders embezzled Kabul Bank's assets and were getting away with it.

On the forensic audit, prosecution, and recapitalization demands, the press release was silent, although separately it was reported on October 2 that Finance Minister Zakhilwal was confident that Parliament was going to agree to recapitalize the central bank.³²² The forensic audit demand for Kabul Bank, in particular, dated back to October 2010.³²³

The press release also made vague references to the Afghan government "stepping up" supervision, "outlining further steps to strengthen and develop Afghanistan's financial sector," and initiating "measures to safeguard fiscal sustainability." These steps apparently did not include substantively reforming Afghan banking law to prevent bank shareholders from influencing lending decisions, which was what had occurred at Kabul Bank. As noted earlier, in January the Cabinet had rejected a law that would have prevented bank shareholders from holding the positions of either Chairman of the Board of Supervisors or Chief Executive Officer, the positions held by Farnood and Ferozi.³²⁴

On October 15, the Afghan Parliament approved an eight-year, \$825 million recapitalization measure.³²⁵ Tax revenue would be raised each year to pay back the central bank for the Kabul Bank bailout, beginning with a \$51 million budget supplemental to the current fiscal year's budget.

On November 15, 2011, the IMF's Executive Board approved the new ECF program.³²⁶ U.S. State Department spokesman, Mark Toner, stated, "We believe that this shows that

³²⁰ Alissa J. Rubin, "[Afghan Deal with I.M.F. will Revive Flow of Aid](#)," New York Times, October 6, 2011.

³²¹ "[IMF Reaches Staff Level Agreement with the Islamic Republic of Afghanistan on a US\\$129 Million Extended Facility Arrangement, and Concludes the 2011 Article IV Consultations Staff Mission](#)," Press Release No. 11/358, imf.org, October 6, 2011.

³²² Ernesto Londono, "[In Kabul Bank Scandal, Little Money Recovered](#)," Washington Post, October 2, 2011.

³²³ Joshua Partlow and Andrew Higgins, "[U.S. and Afghans at Odds over Kabul Bank Reform](#)," Washington Post, October 7, 2010.

³²⁴ Eltaf Najafizada and James Rupert, "[Afghanistan to Sell Kabul Bank as Cabinet Halts Law on Shareholder Loans](#)," Bloomberg, April 20, 2011.

³²⁵ Hamid Shalizi, "[Afghanistan Passes Key Hurdle to Release Aid Funds](#)," Reuters, October 15, 2011; Joshua Partlow, "[Afghan Parliament Clears Hurdle to IMF Aid](#)," Washington Post, October 15, 2011.

³²⁶ The new ECF program was for \$133.6 million. Deb Riechmann, "[IMF Approves New Credit Program for Afghanistan](#)," Boston Globe, November 15, 2011; "[UPDATE 2-IMF Renews Afghan Ties, Approves Loan Deal](#)," Reuters, November 15, 2011.

the Afghan government is able to address serious reform issues.”³²⁷ Toner added, “More steps are needed and we’re going to continue to urge the Afghan government to implement reforms that are necessary for meeting all the IMF’s recommendations.”³²⁸ The IMF’s outstanding demands were no longer demands but “recommendations.”

Conclusion

The Kabul Bank scandal and ensuing crisis speaks to the endemic corruption problem in the highest levels of the Afghan government. President Karzai aggressively protects the corruption committed by senior officials and other elite private citizens, such as the Kabul Bank shareholders, who support his administration.

The Kabul Bank crisis also speaks to the limits of American power in Afghanistan. Some think that the U.S. has unfettered power to shape Afghanistan since it has in Afghanistan almost 100,000 troops, a large civilian force, and an ongoing multi-billion dollar investment. However, it is the very fact that the U.S. is so heavily invested in Afghanistan that President Karzai and his government have leverage in the relationship. Consequently, the U.S. is in a “Catch 22.” It cannot directly intervene and arrest corrupt Afghan officials, neither can it pullout from Afghanistan suddenly because it has a dubious partner to work with. The political repercussions of the latter are unacceptable.

So what should the U.S. do? It is obliged to work with the Afghan government that is in place. However, by choosing to work with the government, the U.S. places itself in a difficult position in relation to the Afghan people. What kind of a message is sent to Afghans, who know their government is thoroughly corrupt, but observe the U.S. government supporting and defending it?

The best that the U.S. can do under these challenging circumstances is to apply pressure on Karzai when it can; however, the U.S. must be forewarned. To the degree that it pressures Karzai, to the same degree he will destabilize U.S.-Afghan relations by taking actions that are counter to U.S. interests.

A case in point is Karzai’s April 11 press conference, mentioned in the paper, when he criticized foreign banking advisors for allegedly “deceiving” the central bank. Karzai’s actions revealed a “tit for tat” mentality. He yielded on some issues but wanted compensation for doing so. He was making a deal with the U.S., since he likely believed that the U.S. was behind the IMF’s pressure to force a resolution of Kabul Bank.³²⁹

Karzai’s deal, if it may be called that, was that in exchange for allowing Farnood and Ferozi’s prosecution (which he later reneged on), Karzai wanted the foreign advisors prosecuted. There was not a moral equivalence between the two, but Karzai’s deal was a

³²⁷ [“U.S. Urges Afghanistan Take More Steps for IMF,”](#) Reuters, November 15, 2011.

³²⁸ Ibid.

³²⁹ Martine Van Bijlert, [“The IMF, Kabul Bank, Government Salaries and Transition \(Updated\),”](#) Afghanistan Analysts Network, June 20, 2011. Bijlert notes that most think that the US is behind the IMF’s pressure to get the Karzai administration to act on Kabul Bank. The existence of the FSWG probably confirms it. See footnote 139.

political one. In exchange for agreeing to put Kabul Bank under receivership, Karzai wanted the U.S. to give up something so he called for a loya jirga, or a gathering of Afghan leaders, to review strategic ties with the U.S., which it did in mid-November 2011.³³⁰ The jirga resulted in a list of Afghan demands, which must be met before a strategic U.S.-Afghan alliance can be reached.³³¹

The IMF's capitulation in the Kabul Bank crisis is best understood as political expediency. It was likely under pressure to bring the crisis to a close since the Afghan government was on the verge of tapping its reserves to pay for its budget. There was also the issue of the mid-November loya jirga, which the U.S. wanted to end favorably.³³² In late-July, Ryan Crocker, the new U.S. ambassador to Afghanistan, signaled that it was time to reset U.S. relations with President Karzai and a lingering Kabul Bank crisis would not help that goal. Describing Karzai, Crocker stated, "I continue to have very, very high regard for him. He has had arguably the toughest job in the world for the last 9 and a half years, and one of the most dangerous. He has stuck with it, I think he deserves our support; he has our support."³³³

Sherkhan Farnood, Khalilullah Ferozi, and the other shareholders will probably never go to trial. Nothing has changed structurally to force Karzai to permit it. If Karzai protected the shareholders when the IMF had leverage, then there is little hope for him changing his mind today. With the Kabul Bank crisis off Karzai's back, he is in a better position to protect his interests without pretense. In fact, we may speculate that since the IMF has signed a new ECF agreement with Afghanistan, it is unlikely that the Karzai administration will pursue the shareholders' assets –including their Dubai villas– or force them to repay beyond what they have already, regardless of official statements to the contrary.

In late November 2011, Noorullah Delawari, the new central bank governor, predicted that more than 80% of the bailout might be recovered.³³⁴ However, this amount or anywhere near it will have to be seen to be believed because its attainment is dependent on the shareholders' (and the others who took Kabul Bank money illegally) willingness to repay, and if they refuse, no one will be able to do anything about it since they enjoy President Karzai's support.

The reality is that only the Afghan people can clean up the corruption in the Karzai administration.

³³⁰ Hamid Shalizi and Emma Graham-Harrison, "[Karzai Says West had Role in Bank Crisis, Wants US Ties Reviewed](#)," Reuters, April 11, 2011.

³³¹ Two important Karzai demands were an end to the night raids and no more secret U.S.-Taliban negotiations. Karzai also wanted assurance that the U.S. would not abandon him beyond 2014. See: Hamid Shalizi, "End Night Raids Before Afghan Deal: Karzai," Reuters, November 16, 2011; "[Afghan President Backs US Pact in Tribal Elders Talks](#)," BBC, November 16, 2011; Nick Paton Walsh and Masoud Popalzai, "[Afghan Leader Pleased with Elders' Demands](#)," CNN, November 20, 2011.

³³² "[Talks on New U.S.-Afghan Pact Strain Relations](#)," Associated Press, Fox News, August 30, 2011.

³³³ Emma Graham-Harrison, "[U.S. Envoy Praises Karzai, Signals Reset in Afghan Ties](#)," Reuters, July 27, 2011.

³³⁴ "[KB Bailout Cost to be Recouped: Delawari](#)," Outlook Afghanistan, November 26, 2011.

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