

**MINORITY STAFF REPORT
FOR
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
PRIVATE BANKING AND MONEY LAUNDERING:
A CASE STUDY OF OPPORTUNITIES AND VULNERABILITIES
November 9, 1999**

(Extract)

"These case histories are four of hundreds of public figure accounts at the Citibank private bank. On paper, these public figure accounts were supposed to be subject to the highest level of scrutiny provided by the Citibank private bank. In practice, the public figure accounts reviewed by the Subcommittee staff were characterized more by customer deference than due diligence.

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2) Asif Ali Zardari Case History

The Facts

The second case history involves Asif Ali Zardari, the husband of Benazir Bhutto, former Prime Minister of Pakistan. Ms. Bhutto was elected Prime Minister in 1988, dismissed by the President of Pakistan in August 1990 for alleged corruption and inability to maintain law and order, elected Prime Minister again in October 1993, and dismissed by the President again in November 1996. At various times, Mr. Zardari served as Senator, Environment Minister and Minister for Investment in the Bhutto government. In between the two Bhutto administrations, he was incarcerated in 1990 and 1991 on charges of corruption; the charges were eventually dropped. During Ms. Bhutto's second term there were increasing allegations of corruption in her government, and a major target of those allegations was Mr. Zardari. It has been reported that the government of Pakistan claims that Ms. Bhutto and Mr. Zardari stole over \$1 billion from the country.

During the period 1994 to 1997, Citibank opened and maintained three private bank accounts in Switzerland and a consumer account in Dubai for three corporations under Mr. Zardari's control. There are allegations that some of these accounts were used to disguise \$10 million in kickbacks for a gold importing contract to Pakistan.

Structure of Private Bank Relationship. Mr. Zardari's relationship with Citibank began in October 1994, through the services of Kamran Amouzegar, a private banker at Citibank private bank in Switzerland, and Jens Schlegelmilch, a Swiss lawyer who was the Bhutto family's attorney in Europe and close personal friend for more than 20

years. According to Citibank, Mr. Schlegelmilch represented to Mr. Amouzegar that he was working for the Dubai royal family and he wanted to open some accounts at the Citibank branch office in Dubai. Mr. Schlegelmilch had a Dubai residency permit and a visa signed by a member of the Dubai royal family. Mr. Amouzegar agreed to introduce Mr. Schlegelmilch to a banker in the Citibank branch office in Dubai.

According to Citicorp, Mr. Schlegelmilch told the Citibank Dubai banker that he wanted to open an account in the name of M.S. Capricorn Trading, a British Virgin Island PIC. The stated purpose of the account was to receive money and transfer it to Switzerland. The account was opened in early October 1994.

According to Citibank, Mr. Schlegelmilch informed the Dubai banker that he would serve as the representative of the account and the signatory on the account. Under Dubai law, a bank is not required to know an account's beneficial owner, only the signatory. Citibank told the Subcommittee staff that Mr. Schlegelmilch did not reveal to the Dubai banker that Mr. Zardari was the beneficial owner of the PIC, and the account manager never asked him the identity of the beneficial owner of the account. Instead, according to Citibank, she assumed the beneficial owner of the account was the member of the royal family who had signed Mr. Schlegelmilch's visa. According to Citibank, the account manager actually performed some due diligence on the royal family member whom she believed to be the beneficial owner of the account.

Shortly after opening the account in Dubai, Mr. Schlegelmilch signed a standard referral agreement with Citibank Switzerland private bank guaranteeing him 20% of the first three years of client net revenues earned by the bank from each client he referred to the private bank.

On February 27, 1995, Mr. Schlegelmilch, working with Mr. Amouzegar, opened three accounts at the Citibank Switzerland private bank. The accounts were opened in the name of M.S. Capricorn Trading, which already had an account at Citibank's Dubai branch, as well as Marvel and Bomer Finance, two other British Virgin Island PICs established by Mr. Schlegelmilch, according to Citibank. Each private bank account listed Mr. Schlegelmilch as the account contact and signatory. Citibank informed the Subcommittee that the Swiss Form A, a government-required beneficial owner identification form, identified Mr. Zardari as the beneficial owner of each PIC.

Lack of Due Diligence. The decision to allow Mr. Schlegelmilch to open the three accounts on behalf of Mr. Zardari, according to Citibank, involved officials at the highest levels of the private bank. The officials were:

- Mr. Amouzegar, the private banker;
- Mr. Deepak Sharma, then head of private bank operations in Pakistan;
- Mr. Phillippe Holderbeke, then head of private bank operations in Switzerland (who became head of the Europe, Middle East, Africa Division in February 1996);
- Mr. Salim Raza, then head of the EMEA Division of the private bank; and
- Mr. Hubertus Rukavina, then head of the Citibank private bank.

Mr. Rukavina told the Subcommittee staff that when he was asked about opening the Zardari accounts, he did not make the decision to open them, but rather directed that the matter be discussed with Mr. Sharma. According to Mr. Rukavina, he never heard whether the accounts were ultimately opened. Mr. Rukavina left the private bank in 1996 and left Citibank in 1999.

Citibank informed the Subcommittee staff that the private bank was aware of the allegations of corruption against Mr. Zardari at the time it opened the accounts in Switzerland. However, Citibank reasoned that if the charges for which Mr. Zardari had been incarcerated for two years had any merit, they would not have been dropped. Bank officials also believed that the family wealth of Ms. Bhutto and Mr. Zardari was large enough to support a large private bank account, even though Citibank was not able to specify what actions were taken to verify the amount and source of their wealth. Citibank said that bank officials were also aware of the M.S. Capricorn Trading account in Dubai, and they were comforted by the fact that there had been no problems with that account. According to Citibank, Mr. Amouzegar informed his superiors that Mr. Zardari was the beneficial owner of the Capricorn account in Dubai when they were considering the request to open the accounts in Switzerland. Inexplicably, however, the Dubai account manager was apparently still operating under the assumption that the beneficial owner of the Dubai Capricorn account was a member of the Dubai royal family. Subcommittee staff has been unable to determine whether Citibank officials were unaware of or inattentive to the serious inconsistency between Citibank Switzerland and Citibank Dubai with respect to the Capricorn Trading account. Citibank also informed the Subcommittee staff that bank officials had some concerns that if they turned down the accounts, their actions may have implications for the corporation's operations in Pakistan; however, they said they never received any threats on that issue.

Citibank told the Subcommittee staff the private bank decided to allow Mr. Schlegelmilch to open the three accounts for Mr. Zardari on the condition that the private bank would not be the primary accounts for Mr. Zardari's assets and the accounts would function as passive investment accounts. Citibank told the Subcommittee staff that Mr. Holderbeke signed a memo delineating the restrictions placed on the accounts, including a \$40 million aggregate limit on the size of the three accounts, and transaction restrictions requiring the accounts to function as passive, stable investments, without multiple transactions or funding pass-throughs. None of the Citibank personnel interviewed by Subcommittee staff could identify any other private bank account with these types of restrictions. Other private banks interviewed by the Subcommittee staff were asked if they had ever accepted a client on the condition that certain restrictions be imposed on the account. The banks all said they had not. One bank representative explained that if the bank felt that it needed to place restrictions on the client's account, it didn't want that type of client. The existence of the restrictions are in themselves proof of the private bank's awareness of Mr. Zardari's poor reputation and concerns regarding the sources of his wealth.

Movement of Funds. Citibank told the Subcommittee staff that, once opened, only three deposits were made into the M.S. Capricorn Trading account in Dubai. Two deposits, totaling \$10 million were made into the account almost immediately after it was opened. Citibank records show that one \$5 million deposit was made on October 5, 1994, and another was made on October 6, 1994. The source of both deposits was

A.R.Y. International Exchange, a company owned by Abdul Razzak Yaqub, a Pakistani gold bullion trader living in Dubai.

According to the New York Times, in December 1994, the Bhutto government awarded Mr. Razzak an exclusive gold import license. In an interview with the New York Times, Mr. Razzak acknowledged that he had used the exclusive license to import more than \$500 million worth of gold into Pakistan. Mr. Razzak denies, however, making any payments to Mr. Zardari. Citibank could not explain the two \$5 million payments. Ms. Bhutto told the Subcommittee staff that since A.R.Y. International Exchange is a foreign exchange business, the payments did not necessarily come from Mr. Razzak, but could have come from a third party who was merely making use of A.R.Y.'s exchange services. The staff invited Ms. Bhutto to provide additional information on the M.S. Capricorn Trading accounts, but she has not yet done so.

On February 25, 1995, a third deposit of \$8 million was made into the Dubai M.S. Capricorn Trading account. Records show that the payment was made through American Express, with the originator of the account listed as "Morgan NYC." Citibank indicated it does not know who Morgan NYC is, nor does it know the source of the \$8 million.

All of the funds in the Dubai account of M.S. Capricorn Trading were moved to the Swiss accounts in the Spring of 1995. On March 6, 1995, \$8.1 million was transferred; and on May 5, 1995, another \$10.2 million was transferred. Both transfers involved U.S. dollars and were routed through Citibank's New York offices. Citibank informed the Subcommittee staff that M.S. Capricorn Trading closed its Dubai account shortly after the last transfer was completed.

Citibank has indicated that significant amounts of other funds were also deposited into the Swiss accounts. As described below, the \$40 million cap was reached, and millions of additional dollars also passed through those accounts. However, Swiss bank secrecy law has prevented the Subcommittee from obtaining the details on the transactions in the Zardari accounts.

Account Monitoring. Citibank told the Subcommittee staff that, in 1996, the Swiss office of the private bank conducted a number of reviews of the Zardari Swiss accounts, finally deciding in October to close them.

The first review was allegedly in early 1996, triggered by increasing publicity about allegations of corruption against Mr. Zardari. Citibank told the Subcommittee staff that Messrs. Holderbeke, Raza, Sharma and Amouzegar participated in the review, and apparently concluded that the allegations were politically motivated and that the accounts should remain open. The Subcommittee staff was told that the review did not include looking at the accounts' transaction activity.

In March or April, 1996, Mr. Amouzegar asked that the overall limit on the Zardari accounts be increased from \$40 million to \$60 million, apparently because the accounts had reached the previously imposed limit of \$40 million. Citibank told the Subcommittee staff that Mr. Holderbeke considered the request, but declined to increase the \$40 million limit.

In June, press reports in the United Kingdom that Mr. Zardari had purchased real estate in London triggered still another review of the Zardari accounts. Citibank private bank told the Subcommittee staff that its Swiss office internally discussed the source of the funds for the property purchase. Mr. Amouzegar and Mr. Raza then met with Mr. Schlegelmilch, who allegedly informed them that funds had been deposited into the Citibank accounts, transferred to another PIC account outside of Citibank and used to purchase the property. Mr. Schlegelmilch allegedly indicated the funds had come from the sale of some sugar mills and were legitimate. Citibank told the Subcommittee staff it is not sure if anyone at the private bank attempted to validate the information about the sale of the sugar mills. In addition, even though this account activity violated the condition imposed by Citibank that the accounts were not to be used as a pass through for funds, the accounts were kept open.

Closing the Accounts. In July 1996, after Mr. Amouzegar left the private bank to open his own company, another private banker, Cedric Grant, took over management of the Zardari accounts. Citibank told the Subcommittee staff that Mr. Grant began to review the Zardari accounts about one month later to familiarize himself with them. He also reviewed the transactions that had taken place within the accounts.

In September and October 1996, press accounts in Pakistan repeatedly raised questions about corruption by Mr. Zardari and Ms. Bhutto, as Ms. Bhutto's re-election campaign increased its activities prior to a February election date. In September, Ms. Bhutto's only surviving brother, Murtaza Bhutto, was assassinated, and Ms. Bhutto's mother accused Ms. Bhutto and Mr. Zardari of masterminding the murder, because the brother had been leading opposition to Ms. Bhutto.

In October, Mr. Grant completed his review of the Zardari accounts and provided a written analysis to Messrs. Holderbeke, Sharma and Raza, according to Citibank. Mr. Grant had found numerous violations of the account restrictions imposed by Citibank, including multiple transactions and funding pass-throughs. Citibank told the Subcommittee staff that the accounts had functioned more as checking accounts than passive investment accounts, directly contrary to the private bank's restrictions. Apparently, well over \$40 million had flowed through the accounts, though Subcommittee staff was unable to ascertain the actual amount because Swiss bank secrecy law prohibits Citibank from sharing that information with the Subcommittee. Citibank indicated that Mr. Amouzegar had either ignored or did not pay attention to the account activity. Mr. Grant recommended closing the accounts, and they were closed by January 1997.

Legal Proceedings. On September 8, 1997, the Swiss government issued orders freezing the Zardari and Bhutto accounts at Citibank and three other banks in Switzerland at the request of the Pakistani government. Since Citibank had closed its Zardari accounts in January 1997, it took no action nor did it make any effort to inform U.S. authorities of the accounts until late November 1997. Citibank contacted the Federal Reserve and OCC about the Zardari accounts in late November, in anticipation of a New York Times article that eventually ran in January 1998, alleging that Mr. Zardari had accepted bribes, and that he held Citibank accounts in Dubai and Switzerland. On December 8 and 11, 1997, Citibank briefed the OCC and the Federal Reserve, respectively, about the accounts and the steps it had taken as a result of the Zardari matter. These steps included: closing all of the accounts that had been referred

by Mr. Schlegelmilch to the private bank and terminating his referral agreement; reviewing all of the accounts opened in the Dubai office; and tightening up account opening procedures in Dubai, including requiring the Dubai office to identify the beneficial owner of all Dubai accounts. Citibank did not identify any changes made or planned for the Swiss office, even though the majority of the activity with respect to the Zardari accounts had taken place in Switzerland.

On December 5, 1997, Citibank prepared a Suspicious Activity Report on the Zardari accounts and filed it with the Financial Crimes Enforcement Network at the U.S. Department of Treasury. The filing was made fourteen months after its decision to close the Zardari accounts; thirteen months after Mr. Zardari was arrested a second time for corruption in November 1996; and nearly two months after the Swiss government had ordered four Swiss banks (including Citibank Switzerland) to freeze all Zardari accounts.

In June 1998, Switzerland indicted Mr. Schlegelmilch and two Swiss businessmen, the former senior executive vice president of SGS and the managing director of Cotecna, for money laundering in connection with kickbacks paid by the Swiss companies for the award of a government contract by Pakistan. In July 1998, Mr. Zardari was indicted for violation of Swiss money laundering law in connection with the same incident. Ms. Bhutto was indicted in Switzerland for the same offence in August 1998. A trial on the charges is expected.

In October 1998, Pakistan indicted Mr. Zardari and Ms. Bhutto for accepting kickbacks from the two Swiss companies in exchange for the award of a government contract. On April 15, 1999, after an 18-month trial, Pakistan's Lahore High Court convicted Ms. Bhutto and Mr. Zardari of accepting the kickbacks and sentenced them to 5 years in prison, fined them \$8.6 million and disqualified them from holding public office. Ms. Bhutto, who now lives in London, denounced the decision. Mr. Zardari remains in jail. Additional criminal charges are pending against both in Pakistani courts.

On December 11, 1997, Citicorp's Chairman John Reed wrote the following to the Board of Directors:

"We have another issue with the husband of Ex-Prime Minister Bhutto of Pakistan. I do not yet understand the facts but I am inclined to think that we made a mistake. More reason than ever to rework our Private Bank."

Mr. Reed told the Subcommittee staff that it was the combination of the Salinas and Zardari accounts that made him charge Mr. Shaukat Aziz, the new private bank head, with taking a hard look at the bank's public figure policy and public figure accounts.

The Issues

The Zardari case history raises issues involving due diligence, secrecy and public figure accounts. The Zardari case history begins with the Citibank Dubai branch's failure to identify the true beneficial owner of the M.S. Capricorn Trading account. As a result, the account officer in Dubai performed due diligence on an individual who

had no relationship to the account being opened. In Switzerland, Citibank officials opened three private bank accounts despite evidence of impropriety on the part of Mr. Zardari. In an interview with Subcommittee staff, Citigroup Co- Chair John Reed informed the Subcommittee staff that he had been advised by Citibank officials in preparation for a trip to Pakistan in February 1994, that there were troubling accusations concerning corruption surrounding Mr. Zardari, that he should stay away from him, and that he was not a man with whom the bank wanted to be associated. Yet one year later, the private bank opened three accounts for Mr. Zardari in Switzerland. Mr. Reed told the Subcommittee staff that when he learned of the Zardari accounts he thought the account officer must have been "an idiot."

Citibank has been unable to confirm that bank employees verified that Mr. Zardari had a level of wealth sufficient to support the size of the accounts that he was opening. In addition, the Swiss private banker took no action to validate the legitimacy of the source of the funds that were deposited into the account. For example, there was no effort made to verify the claims that some of the funds derived from the sale of sugar mills.

Citibank also performed no due diligence on the client owned and managed PICs that were the named accountholders. Because the PICs were client-created, the bank's failure to perform due diligence on the PICs meant that it had no knowledge of the activities, assets or entities involved with the corporations. One of the PICs, Bomer Finance, has been determined to have been a repository for kickbacks paid to Mr. Zardari, and those kickbacks tainted funds deposited at the Geneva branch of Union Bank of Switzerland. Documentation has not been made available to determine whether Bomer Finance also used its Citibank account for illicit funds.

Another due diligence lapse was the private bank's failure to monitor the Zardari accounts to ensure that the account restrictions imposed on them were being followed. When officials were presented with evidence in 1996 that the restrictions were being violated, they nevertheless allowed the accounts to continue.

The Zardari accounts in Switzerland were opened one day before Raul Salinas was arrested. The account was repeatedly reviewed in 1996, after the Salinas scandal became public. Yet there is no evidence that anyone in the private bank had been sensitized to the problems associated with handling an account of a person suspected of corruption.

The Zardari example also demonstrates the practical consequences of secrecy in private banking. Citibank claims that its decision making in the Zardari matter cannot be fully explained or documented, since all Citibank officials are subject to Swiss secrecy laws prohibiting discussion of client-specific information. In light of the fact that U.S. banks are supposed to oversee their foreign branches and enforce U.S. law, including anti-money laundering requirements, this inability to produce documentation related to a troubling case again highlights the problems with U.S. banks choosing to operate in secrecy jurisdictions.

Pattern of Poor Account Management. The Zardari case history took place during a series of critical internal and federal audits between 1992 and 1997 of the Swiss office which, during most of that time, served as the headquarters of the private bank. The

shortcomings identified in the audits included policies, procedures, and problems that affected the management of the Zardari accounts. They included:

- failure of the "corporate culture" in the Swiss office to foster "a climate of integrity, ethical conduct and prudent risk taking' by U.S. standards";
- inadequate due diligence;
- "less than acceptable internal controls";
- lack of oversight and control of third party referral agents such as Schlegelmilch; and
- inadequate monitoring of accounts;

All of the above resulted in "unacceptable" internal audit ratings. In December 1995, the Swiss office received the lowest audit score received by any office in the private bank during the 1990s. These audit scores indicate the office's poor handling of the Zardari accounts was part of an ongoing pattern of poor account management.