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The Bank Bumiputra Scandal:
More Trouble Ahead for Malaysia's Mahathir?

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Summary

The release in January of an investigative committee's report on the financial scandal involving Malaysia's government-owned Bank Bumiputra has fueled speculation of high-level government complicity and a coverup. Prime Minister Mahathir's government has already been damaged because of its poor handling of the affair. We believe incriminating disclosures against his administration or his party would be a serious blow and possibly bring about his ouster. If nothing else, we believe Mahathir is factoring the scandal into his calculations on whether to hold early elections, possibly late this year.

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The Bank Bumi Scandal Unfolds

The reputation of Bank Bumiputra (Bank Bumi), the second largest bank in Southeast Asia, was tarnished in 1983 by the questionable operations of its Hong Kong subsidiary, Bumiputra Malaysia Finance (BMF). BMF was heavily involved in lending to three Hong Kong Chinese property speculators during Hong Kong's property boom in the late 1970s. When the property market began to weaken, BMF--unlike other banks in the colony--continued to extend credit to these real estate concerns. Following the 1981-82 collapse in the property market, BMF lost nearly \$1 billion in loans that had been made to these concerns. (See Appendix)

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Hong Kong businessman George Tan figured heavily in BMF's lending operations.¹ Based on BMF documents seized by Hong Kong police during their investigation of a BMF official's murder, Tan and his associate were charged with fraud and conspiracy for making "false and misleading statements about their debt-ridden empire."² Testimony during the murder trial disclosed, moreover, that BMF continued to authorize loans to Tan long after his conglomerate admitted it could not pay its debts. [redacted]

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Circumventing Accountability?

Until recently Kuala Lumpur's response to the BMF loss was surprisingly restrained. Prime Minister Mahathir admitted BMF's lending practices were imprudent and pledged action if management malpractices were uncovered, but he downplayed the bank's culpability, maintaining that the property market collapse had affected all Hong Kong banks. It appeared that the government's strategy was to contain the problem while looking for the best way to bail out Bank Bumi, and last September it announced the takeover of the troubled bank by the cash-rich national oil company, Petronas. [redacted]

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According to the US Embassy, public reaction to the Petronas takeover was generally favorable. Many Malaysians, however, believed that the government was attempting to avoid accountability. Speculation of a government whitewash was fueled by the fact that after nine months of operation none of the findings of the Committee of Inquiry Mahathir had established in early 1984 had been released. Public, press, and political opposition calls for a royal commission to investigate the affair gained strength late last year, especially from Malays who wanted to know why a government-owned bank chartered for their benefit had been so involved in helping Chinese property speculators. [redacted]

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The release of a Committee of Inquiry report early this year marked a sharp change in the government's handling of the BMF affair, and we believe it reflects the government's concern about the political damage it has suffered. We also believe it is the clearest sign to date that the government will pursue

1. Tan headed the Carrion group of companies, one of BMF's three main borrowers in Hong Kong. [redacted]

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2. In July 1983, a Bank Bumi official sent to Hong Kong to conduct an extensive internal audit of BMF's lending operations was strangled. The accused killer linked the incident to Tan. Moreover, on the day of his death, the Bank Bumi official was questioning the authorization of a pending \$4 million loan to Tan. [redacted]

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[Redacted]

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investigations into the scandal in an effort to salvage Bank Bumi's reputation and respond to mounting political pressure to account for the Hong Kong lending. [Redacted]

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Linkages to the Mahathir Administration

Circumstantial evidence suggests that the scandal extends into the Mahathir administration. As a government-owned bank, Bank Bumi is closely monitored by both the Finance Ministry and Central Bank and no important decisions are made without their agreement or knowledge. It is unlikely that the government was unaware of Bank Bumi's increase on lending limits for its overseas branches to allow more funds to be channeled to Hong Kong. This action was taken after word of Tan's difficulties had dried up funds from other sources. [Redacted]

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[Redacted]

Trade and Industry Minister Razaleigh's name is most frequently mentioned in the context of the scandal because several of the BMF officials involved were close associates which he helped appoint.³ Mahathir also had close ties with those implicated, as well as with Nawawi Mat Awin, under whose chairmanship Bank Bumi continued lending to Tan.⁴

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[Redacted]

[Redacted]

The most potentially damaging aspect of the affair is the alleged connection of Tan to officials of the United Malays National Organization (UMNO), headed by Mahathir and the dominant party in the government coalition.

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[Redacted]

[Redacted]

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3. Razaleigh took over the Trade and Industry portfolio in July 1984, after having held the Finance portfolio since 1976. [Redacted]

4. Nawawi served as chairman from April 1982 until December 1984 when Bank Bumi's board of directors was replaced in the wake of the Petronas takeover. Although Nawawi has not been accused of any wrongdoing at the bank, he has been harshly criticized for his failure to act quickly and decisively as facts about BMF's errant operations became known. [Redacted]

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[Redacted]

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[Redacted]

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[Redacted]

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[Redacted]

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Assessing the Political Damage

Thus far no direct links have been established between Mahathir and the corruption at BMF. Nonetheless we believe, the hint of association has damaged the political standing of the Mahathir administration, which was elected in 1981 under a banner of clean government. [Redacted]

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In our view, the government also has been tarnished because the scandal involves the financial arm of the politically-sensitive New Economic Policy. Bank Bumi was founded expressly to help Malaysia's comparatively poor Malay businessmen. The bank's huge losses on loans to Hong Kong Chinese businessmen are, therefore, particularly embarrassing to the ethnic Malay leadership. [Redacted]

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Equally damaging to the administration has been the perception that the government has only half-heartedly pursued the issue. The secrecy of the government's investigation--defended as necessary under Malaysia's Banking Secrecy Laws--and a year's delay after the problems surfaced in effecting any management changes at BMF have made the government suspect. Moreover, despite the vigor the government has shown in pursuing the BMF debacle more recently, many businessmen and bankers believe that the government is using the six accused BMF officials as scapegoats in an effort to avoid implicating senior government officials. [Redacted]

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[Redacted]

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[Redacted]

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Potential Trouble Spots

There are several other problems connected with the Bank Bumi scandal which could further damage the Mahathir government. We would not rule out the possibility, moreover, that if damaging evidence continues to materialize, Mahathir could be forced to step down under pressure from certain elements in UMNO's new guard. [redacted]

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--**The George Tan trial.** Testimony in the ongoing Tan trial in Hong Kong may implicate Malaysian government officials. We believe that the Hong Kong Government, under pressure from Malaysia, may block release of testimony damaging to Kuala Lumpur. Trial proceedings could be leaked, however, and we believe the Hong Kong press would not hesitate to publish such information. [redacted]

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--**The trials of the BMF officials.** We would be surprised if trials of the six BMF officials implicate high-ranking government officials. If the BMF officials are returned to Kuala Lumpur to stand trial, we believe they may be "bought off" to deny any Mahathir administration connections. [redacted]

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[redacted] If the BMF officials cannot be coopted, we believe the extradition effort to return them to Malaysia will conveniently fail. [redacted]

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--**Committee of Inquiry report.** It is unlikely that the Committee of Inquiry's final report (due to the government in April) will implicate high-level government officials. In the event that it does, however, the government holds control over the public release of the report and would be able to expunge incriminating portions. On the other hand, a publicly released abridgement would provoke charges of a government whitewash. [redacted]

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--**More corruption at Bank Bumi.** Following the latest Inquiry report, former Prime Minister Hussein Onn, now an adviser to Petronas, publicly alleged that Bank Bumi "has a domestic loan problem as bad as the BMF loan scandal." He contends that the bank extended large amounts of credit backed by doubtful securities. If Onn's allegations--which some observers believe may be well-founded--are proven, Mahathir will find the affair much more difficult to handle. [redacted]

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--**The Islamic opposition party, PAS.** It is probable that PAS will continue its attempts to capitalize on public speculation of government corruption. Although Mahathir contends that the standard under which the government operates obviates the need for the more Islamic state demanded by the Islamic fundamentalists in PAS, he may find it necessary to make some

[REDACTED]

concessions to deal with PAS' criticisms. These might take the form of stricter enforcement of Islamic law on the Muslim population, such as prohibition of alcoholic beverages, or making gambling illegal. [REDACTED]

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Early Elections?

The public perception of "guilt by association" on the part of the Mahathir administration and the threat of additional damaging disclosures may enter into Mahathir's decision whether to call for elections earlier than April 1987, when his current term expires. Elections could be called as soon as mid-1985. The timing, in our view, would fit conveniently with the schedule of the recently announced criminal investigation by a special police panel. The Attorney General has announced that the panel will take at least a year to complete its work. Presumably this could give Mahathir time to stage elections before any criminal charges could be brought against BMF officials and trials begun. [REDACTED]

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7. Other factors also argue in favor of early elections, namely a currently strong economy, and the political boost given UMNO by its victory over PAS in a recent hotly contested by-election. [REDACTED]

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[REDACTED]

APPENDIX

Bank Bumi/BMF Chronology

October 1982: First sign of trouble at BMF with the news that two of its main borrowers are experiencing financial crises. Bank Bumi characterizes media reports as "speculative, misleading and unfair." Extent of BMF's problem loans estimated in the \$250-300 million range [REDACTED]

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December 1982: Bank Bumi quietly dispatches a team to Hong Kong to conduct an internal audit. Malaysian Central Bank also investigating BMF.

March 1983: Central Bank governor admits BMF officials strayed from usual banking practices and imprudently overexposed the bank. Magnitude of the affair discounted, however, with assurances that Bank Bumi could handle the situation.

June 1983: Bank Bumi's annual report, released three months late, reveals little new information. Outstanding loans of approximately \$700 million shown for BMF, virtually all listed in good standing.

July 1983: Mahathir breaks his silence and admits BMF's heavy lending to a handful of Hong Kong property concerns was imprudent and pledges action if investigations disclose management malpractices.

BMF assistant general manager found strangled in Hong Kong.

September 1983: George Tan and associate arrested in Hong Kong and charged with fraud and conspiracy. Extent of BMF outstanding loans to Carrion also disclosed--a staggering \$530 million.

During a press conference, Mahathir confirms press reports that five senior bank officials accepted approximately \$600,000 in consultancy fees in connection with the costly loan exposure at BMF. Although these fees are technically legal, Mahathir terms them morally wrong and indicates the officials will be asked to leave the bank shortly.

November 1983: First major shake-up in Bank Bumi's boardroom. Ousted are BMF's two-man board of directors, Lorrain Osman and Hashim Shamsuddin, and Rais Saniman, a BMF alternate director and Bank Bumi senior general manager for international lending.

Estimates of BMF's potential losses rises to \$700 million--nearly its entire loan portfolio.

Parliamentary call for the establishment of a royal commission to investigate the BMF affair is denied by Finance Minister Razaleigh. Central Bank investigation deemed sufficient.

[REDACTED]

January 1984: Under political pressure, Mahathir compromises and establishes a three-member Committee of Inquiry. This closed-door commission, however, has no legal power to summon witnesses, subpoena documentary evidence from outside Bank Bumi, or require testimony under oath.

April 1984: Testimony from the murdered BMF official's trial in Hong Kong links the defendant to Razaleigh and other unnamed cabinet officials. Connection vehemently denied by Razaleigh. Extent of BMF's loss now estimated at nearly \$1 billion.

September 1984: Government announces Petronas takeover of Bank Bumi to restore financial solvency.

November 1984: First interim report of Committee of Inquiry released. The 13-page expunged version proves disappointing. It does, however, contain details of lending limit increases by the bank's overseas branches to allow more funds to be channeled to the Hong Kong branch after word of Carrion's difficulties dried up funds from all other sources.

Second and third reports issued later in the month. Reports detailed specific loans which involved irregularities warranting police action and recommends Bank Bumi file criminal complaints against the BMF officials. Committee also discloses it is unable to account for about half of the \$1 billion BMF funds allocated.

December 1984: Government files two complaints with Malaysian police in connection with wrongdoing alleged in the committee's reports. Complaints related to payment of consultancy fees and granting of a \$40 million loan without Bank Bumi approval.

Attorney General announces creation of a special police panel to investigate BMF operations. He states that the government's decision to prosecute will rest solely on this criminal investigation which will take another year or two.

January 1985: Government releases latest Committee report which alleges 10 cases of corruption on the part of six named BMF officials. Police complaints also lodged against those named and court petition to freeze their assets granted. A \$47.5 million civil suit also filed against them for repayment of bad loans made to George Tan in 1983. Extradition efforts begun to return former BMF Chairman Lorrain Osman--who is alleged to have received \$12.5 million in bribes--to Malaysia from the UK.

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SUBJECT: The Bank Bumiputra Scandal: More Trouble Ahead for Malaysia's Mahathir?

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