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The Rise of Kleptocracy

MALAYSIA'S MISSING BILLIONS

Cynthia Gabriel

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Over the last two years, a pair of civil asset-forfeiture filings by the U.S. Department of Justice (DOJ) have opened a window into one of history's most outrageous public-corruption scandals.¹ The court papers tell a tale of brazen misdealings and outright theft that have cost the people of Malaysia billions of dollars, spawned large street protests, and roiled the country's political scene. At the heart of the affair is the 1Malaysia Development Berhad (1MDB), a government-owned "strategic development company" that Prime Minister Najib Razak of the long-ruling United Malays National Organization (UMNO) set up soon after taking office in 2009. The stated purpose was to promote growth and investment on a nationwide scale, particularly through the formation of "global partnerships" in the real estate, tourism, and energy sectors.

In fact, 1MDB was used to raise funds that insiders then stole in a massive "pump and loot" scheme. Vast sums were borrowed via government-backed bonds, then siphoned abroad: The Justice Department says that more than US\$4.5 billion was pilfered from 2009 through 2015. As the filings describe in detail, the money went to buy luxury real estate in Manhattan and Beverly Hills; paintings by Monet and Van Gogh; a chunk of one of the world's biggest music-publishing companies; a \$35 million Bombardier Global 5000 business jet; a \$260 million superyacht called *Equanimity*; and \$8 million in jewels bestowed as gifts upon Australian supermodel Miranda Kerr (and since turned over by her to authorities). In addition, an estimated \$85 million went to pay for Las Vegas gambling debts, while tens of millions more were sunk into a movie-production company co-owned by the prime minister's stepson, Riza Aziz. In an

ironic twist, he used the money to make *The Wolf of Wall Street*, the 2013 hit film about financial criminality.

The conduits for the diversion of funds included regional financial centers such as Singapore; secretive shell companies in the British Virgin Islands, the Caymans, Curaçao, and the Seychelles; and large international banks such as RBS, Deutsche Bank, Citibank, JP Morgan Chase, Standard Chartered Bank, and UBS, among others. The 1MDB scam, by no means unique although especially grotesque in its mammoth scale, underlines in bright red the continued complicity of the global financial system in helping kleptocratic developing-world regimes to turn ill-gotten gains into assets held abroad.

The swindle reflects the blatant cover-up of criminality within Malaysia, with domestic investigators compromised by intimidation, manipulative personnel moves, and a conspicuous lack of official curiosity about tons of missing money.² Over a period of years, the state-backed 1MDB was allowed to pile up billions of dollars' worth of debt through bond mispricing, overpayment for assets, the creation of phony "strategic partnerships" with shady foreign concerns such as PetroSaudi International (PSI), and plain fraud. Meanwhile official inquiries in Malaysia were hampered and went nowhere.

As much as a billion dollars reportedly ended up in the personal accounts of the prime minister, whom a January 2016 official inquiry nonetheless held blameless of legal wrongdoing.³ Almost three-quarters of the misappropriated money went into the accounts of Low Taek Jho (better known as Jho Low), the ambitious, jet-setting thirty-something financier—a product of Harrow and the University of Pennsylvania's Wharton Business School—who served as the scheme's prime operative. Although he has not as of this writing in December 2017 been charged with any crime and his lawyers continue to deny that he has committed any offense, he now seems to be on the run. There is speculation that he has gone to China or Thailand.⁴ The most recent reported sighting of his yacht came in October 2017, when it was seen at a diving resort on a small Indonesian island just off the northern tip of Sumatra.⁵

Almost from the outset in July 2009, 1MDB was under the direct control of Najib Razak, who was not only prime minister but Malaysia's finance minister as well. He chaired the fund's advisory board. In September 2009, not long after the first billion dollars went into 1MDB's coffers, the free-for-all began. The mismanagement and failures of basic corporate governance were so glaring that they point to criminal complicity, with losses mounting to the level at which the fund lost the ability to keep up payments on its towering debts.

A web of transactions linking Jho Low to 1MDB and a host of questionable practices became public in early 2015 when a former PetroSaudi staffer leaked a trove of the company's emails. The publishers of the

leaks—a website known as Sarawak Report (*sarawakreport.org*) and the Malaysian financial newspaper *The Edge Malaysia*—were hit with suspensions under Malaysia’s tough media-licensing laws, but the story could not be suppressed. Major media outlets such as the *Wall Street Journal* were soon reporting aggressively on it, carrying articles about money passing from 1MDB to the prime minister personally.⁶

The Uncertain Fallout

This tale of massive corruption has shaken Malaysia to its core. There is intense public anger. Those seeking change are groping their way toward an awkward alliance. The Najib government’s critics include former UMNO leader and prime minister Mahathir Mohamed, who has created his own reformist party. The leading opposition figure, Anwar Ibrahim, remains in jail on the same trumped-up sodomy charge that the UMNO regime has long used to keep him on ice. Najib, having led UMNO to its weakest-ever electoral showing in 2013—before the scandal broke—now faces a constitutional requirement to hold fresh parliamentary elections by August 2018. In an effort to shield himself from the 1MDB scandal’s fallout, he has purged critics within UMNO and turned to the dangerous but familiar game of stressing his Malay ethnicity and Muslim religious identity in order to paint himself as a man of virtue and keep his voter base on board. He has used material inducements as well, offering tax cuts designed to benefit his party’s most loyal supporters.

How will all this turn out? The Najib government has stonewalled domestic inquiries—not only muzzling media outlets, but even going so far as to classify the Malaysian auditor-general’s report on 1MDB as an “official secret” in order to prosecute an official who leaked part of that report. The affair has since become the stuff of world headlines, however, blowing up well beyond the reach of homegrown censorship. Voters are irate, and the opposition is mobilizing. Whether it will be able to organize itself well enough to beat the damaged but still imposing and resourceful UMNO machine remains uncertain, to say the least. The prime minister may seek to act before the opposition can coalesce by calling an election well in advance of the August deadline.⁷

The Justice Department civil filings give us what is to date the fullest available account of money flows from 1MDB. The 2016 filing describes three phases of illicit conduct beginning in 2009. The first mainly involved the fraudulent transfer of slightly more than a billion dollars from 1MDB to the Swiss bank account of a concern called “Good Star Limited” that was in fact covertly owned by Jho Low himself.

The second phase revolved around proceeds that 1MDB had raised through 2012 bond offerings worth \$3.5 billion (arranged and underwritten by Goldman Sachs International). More than two-fifths of that

sum wound up in a Swiss bank account belonging to a British Virgin Islands entity known as Aabar-BVI. These funds, claims the Justice Department, were then diverted for the personal benefit of 1MDB officials and their associates. These included Jho Low, who moved money into a Singapore bank account that he owned under the alias of “Eric Tan.”

The third phase of the fraud came in 2013. That year, a group that included 1MDB officials diverted more than \$1.2 billion out of \$3 billion that 1MDB had raised through a third bond offering arranged by Goldman Sachs. The bond offering was supposed to be funding a joint venture between 1MDB and Abu Dhabi, but in reality a big chunk of the money was going into another Singapore bank account held by “Eric Tan,” this time acting as owner of the “Tanore Finance Corporation.” Tanore had no legitimate connection to 1MDB, but the fund’s executive director Casey Tang was an authorized signatory on the account. The money went to pay for more personal spending by Jho Low and other conspirators. Investigators have traced the trail of the laundered billions through a maze of bank accounts not only in Singapore and Switzerland, but also in Luxembourg and the United States.

It should be noted that Malaysia’s citizens, through their government, are on the hook for the \$6.5 billion in bonds arranged by Goldman Sachs, since the bonds are effectively government-guaranteed. Goldman Sachs, meanwhile, took nearly \$600 million in fees, commissions, and expenses out of the bond sales. That represents close to a tenth of the money raised, which is well above the industry norm and many times the 1 or 2 percent that Goldman Sachs typically charges for arranging such deals.

The DOJ filings detail how money laundering is eased by banks that fail to question suspicious transactions, jurisdictions that allow opaque corporate dealings, and shell companies that are set up in places where regulation is lax.

The banks figuring in the Good Star Phase of the misappropriation include RBS and BSI in Singapore, Deutsche Bank in Malaysia, AmBank, JP Morgan Chase, and Wells Fargo. Jho Low also used an account set up by the Shearman and Sterling law firm to help him transfer his ill-gotten assets.

During the Aabar-BVI phase, Jho Low used not only Swiss and Singaporean bank accounts, but also a roundabout route that involved the Bank of New York (both its home and its London branches) as well as Abu Dhabi’s Falcon Bank (which is owned by same entity that owns Aabar-BVI). Fraudulent wire transfers went through Standard Chartered Bank and Citibank in the United States. In March 2013, \$681 million from the Tanore account was transferred into Najib Razak’s account at AmBank. (Of this, \$620 million was returned to the Tanore account in August 2013.)

Singaporean authorities are looking at a number of other banks, including UBS and DBS Group Holdings, to see if they broke rules while handling transactions linked to 1MDB. In fact, almost \$3.7 billion that was stolen from 1MDB was laundered through various banks in Singapore, which should raise alarms there about vigilance by bankers as well as about Singapore's oversight of its financial institutions.

Making the Banks Care

Big international banks that have in the past paid heavy fines for lapses in this area nonetheless continue to play a huge role in laundering dirty money. If banks and other global financial institutions took care to avoid letting themselves be used, large-scale money laundering of the 1MDB sort would stop. Corrupt politicians and their proxies in the developing world would no longer be able to rinse vast sums stolen from their own countries into assets located in the developed world.

That these famous banks do not in fact "take care" is a sign of the developed world's lack of resolve. Fines are treated as a mere "cost of doing business." But money paid out by one's institution is one thing; going to jail personally is something else altogether. Singapore has tried and convicted several bankers on 1MDB-related charges.⁸ Earlier, the island-state had taken the unusual step of shutting down the local branches of two merchant banks for derelictions connected with 1MDB.⁹ As of this writing, hardly anyone outside Singapore has been criminally indicted for money laundering in a 1MDB case, though it has been reported that the United States intends to bring criminal charges against Jho Low.¹⁰

But he is a suspected grifter, not a respected banker. Until bank officials start ending up behind bars for criminal complicity in hiding ill-gotten gains, global financial institutions will continue to help launder money: There is too much easy cash to be made by simply closing one's eyes.

International efforts to fight money laundering currently revolve around the Financial Action Task Force (FATF), an independent inter-governmental body founded in 1989 to develop and promote policies to protect the global financial system against money laundering and the financing of terrorism and WMD proliferation.

Malaysia is an FATF "observer member country," so it is already supposedly committed to FATF standards and recommendations. These include calls for states to "ensure that financial institution secrecy laws do not inhibit implementation of the FATF Recommendations"; for barring financial institutions from "keeping anonymous accounts or accounts in obviously fictitious names"; and for financial institutions to apply extra scrutiny in certain cases (for instance, when a financial institution has reason to doubt customer-identification data, or with transactions that exceed 15,000 euros).¹¹

The FATF recommends further measures for correspondent banking, and also for checks to determine if “politically exposed persons” (people whose official positions give them control over funds or assets) are involved in a transaction. If the measures recommended by FATF had been followed, 1MDB money could not have been laundered. The FATF is only a recommending body, however, and lacks enforcement powers.

The 1MDB swindle would not have happened had basic principles of public and corporate governance been followed, to include the use of proper checks on how 1MDB’s funds were being handled. Such checks do exist in Malaysia. They govern the dealings of the Khazanah Nasional Berhad, the country’s government-run sovereign wealth fund. But 1MDB was exempted from all such controls, and no corrective measures were taken despite repeated signs of abuse. Although some 1MDB board members tried to instruct management to avoid certain deals, the warnings went unheeded and the board never stepped in forcefully enough to stop the misdeeds. Billions are still at risk.

The fish rotted from the head. All evidence points to 1MDB having been deliberately set up for fraudulent manipulation, with complicity from the very top. Without such complicity, 1MDB’s massive losses could not have happened. The global financial system was an accomplice too. International banks moved and stored stolen funds. It is no secret that big banks have engaged in such practices for a long time. Some have paid heavy fines, but these have obviously not been enough to put a stop to banks’ involvement in money laundering. Meanwhile, individual bank officers are generally not held criminally liable, which may be the problem.

The 1MDB scandal, on its Malaysian side at least, also presents a classic example of a cover-up and the suppression of information through direct interference in the operations of enforcement and policing agencies. The aim was to stop these agencies from taking action against crimes, and the methods included replacing key officials while intimidating others into submission. Malaysia has laws on the books with which to charge those implicated in fraud and financial offenses, but for that to happen, the political pressures that have so far prevented the rule of law from taking its course will have to be lifted. The final say rests with the voters. Najib and UMNO remain formidable, however.

From the international side, if money laundering, especially of ill-gotten gains from developing countries such as Malaysia, is to be stopped, banks and others who accept funds from overseas must be made to do much better due diligence. Now more than ever, the world needs a cross-border legal mechanism to investigate, catch, and try grand swindlers and global kleptocrats.

NOTES

1. The filings took place, respectively, on 20 July 2016 and 15 June 2017. See www.justice.gov/opa/pr/united-states-seeks-recover-more-1-billion-obtained-corruption-involving-malaysian-sovereign; and www.justice.gov/opa/pr/us-seeks-recover-approximately-540-million-obtained-corruption-involving-malaysian-sovereign.

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