

Debt designed to be stolen. A new way to embezzle public money?

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On October 22, 2020, Goldman Sachs entered into a settlement with the U.S. Department of Justice to end the lawsuit against the bank in connection with the Malaysian "1MDB Fund"¹. Two figures in the agreement may seem surprising. Goldman Sachs and its business partners allegedly paid \$1.6 billion in bribes to obtain \$606 million in fees on transactions. Since when have the bribes paid been higher than the expected profit? The answer is elsewhere in the document. The \$600 million in fees were essentially fees for bond issues that totaled \$6.5 billion, the \$1.6 billion bribes were actually taken out of the \$6.5 billion in debt proceeds, and the remaining was also for a large part misused. Goldman Sachs received \$600 million in fees for a bond issue that was intentionally corrupt and intended to be misappropriated by policy makers.

Earlier this year, investigative journalism reports² mentioned that in another debt issue case, the Mozambican tuna bonds, Credit Suisse earned \$24 million in fees for debt issues amounting to \$2 billion. Of the \$2 billion, a tenth, or about \$200 million, was allegedly paid in bribes to public decision-makers. We also know that the rest of the debt proceeds were misused. Again, the disproportion between the fees received and the "bribes" paid is revealing. These were not real bribes, but a misuse of a debt issue designed to be stolen.

These two international cases have drawn public attention to a new form of embezzlement, which is the theft of public money that does not yet exist.

Traditional forms of misappropriation involve stealing public money that already exists in different public accounts and budgets. A public decision-maker is on both sides of the table, both as a buyer in a public tender and behind the seller or beneficiary of a contract. Corruption can take the form of a bribe paid to the decision-maker, a pre-existing conflict of interest if friends or relatives of the decision-maker get the contract, or a conflict of interest created by an investment opportunity offered to the decision-maker who becomes a hidden shareholder in the company to which the contract is awarded. In all of these cases, and unlike Malaysia and Mozambique, the public money that is used already exists.

¹ Frank Vogl, « Goldman Sachs has to deal with unprecedented punishment for bribery », *The Globalist*, 10th November 2020

² <https://www.occrp.org/en/daily/11821-credit-suisse-in-us-crosshairs-over-tuna-bonds-case>

In Malaysia, a development fund was created in 2009 to attract foreign money to finance development projects in Malaysia. Goldman Sachs was the main international bank working with 1MDB. This was probably a good choice on the part of the Malaysian authorities since, as we know, Goldman Sachs enjoys the probably well-deserved reputation of being the most efficient investment bank in the world. However, there is, or should be, an ethical limit to banking efficiency. In just three private placements, Goldman Sachs has raised \$6.5 billion from investors around the world. This \$6.5 billion was added to Malaysia's sovereign debt. More than half of this amount was allegedly stolen by the then Malaysian Prime Minister and his friends.

The Malaysian economy was supposed to grow with 1MDB but the public debt that was raised ended up being largely diverted to private accounts. A similar misadventure occurred in Mozambique. In 2010, one of Africa's biggest gas discoveries was made off the coast of Mozambique, specifically on the Cabo Delgado coast, whose economy is linked to fishing. The bankers then had a brilliant idea: the future revenues from the gas will allow the development of fishing activities. How can future revenues develop a current activity? By issuing debt. Credit Suisse, a competitor of Goldman Sachs, advised Mozambican companies and authorities and partnered with a Russian bank to issue a total of \$2 billion in bank loans and bonds sold to investors.

Some tuna vessels were manufactured in a French shipyard and even sent to Mozambique in the presence of the then President of the French Republic. It is not clear where most of the money went, although there has been mention of the purchase of North Korean spare parts for Soviet-era weapons, a trade of obvious importance for local development³!

The Malaysian and Mozambican scandals led to several legal proceedings in various jurisdictions. As already mentioned, a large part of the Malaysian debt raised went directly to the public decision makers as compensation for granting the debt issue to the bankers, another part of the proceeds was also paid to the Prime Minister and his friends and was used to pay other bribes in the context of 1MDB's activity. In November, Goldman Sachs agreed to pay more than \$2.9 billion to the authorities of the United States, the United Kingdom, Hong Kong, Singapore and Malaysia, in addition to the \$2.5 billion Goldman has already paid to the Malaysian government and the \$1.4 billion guarantee Goldman gave to the Malaysian government to recover the misappropriated funds. The total cost to Goldman Sachs is therefore between \$5.4 billion and \$6.8 billion. Lawsuits are still pending against individual Goldman bankers and Goldman has claimed a portion of the bonuses paid to certain bank executives.

In the Mozambican case, several former employees of Credit Suisse are being criminally prosecuted in various jurisdictions and the bank itself is under investigation.

What the Malaysian and Mozambican cases have in common is that the political leaders were embezzling funds that did not yet exist when the intent to steal them emerged. The asset that these leaders possess that enables them to design the embezzlement is the political power they have to issue or guarantee foreign debt that future generations of their country will have to repay. Political leaders are taking advantage of their right to commit their country's future.

The new forms of embezzlement experienced in Malaysia and Mozambique in recent years pose new challenges to bank governance, fiscal transparency, international cooperation and, more generally, public acceptance of public debt.

The governance of the major international banks has once again been caught off guard. Sovereign debt designed to be stolen poses a specific problem, namely that it is not easily apprehended in the framework commonly known as "KYC" (Know Your Customer). The customer here is nothing more

³ Edson Cortez ed., *Recovery of Assets*, Centro de Integridade Pública, 2019

than a sovereign state or government-guaranteed companies or funds. The risk is low in the context of debt underwriting when you have already identified the interested investors. You buy and sell very quickly and pocket large issuing fees. It is very tempting for the head office of a company not to dig too deeply into the question of how the lucrative business was actually won on the ground and what the money raised will actually be used for. Goldman Sachs' and Credit Suisse's adventurous undertakings should encourage other investment banks to take a closer look at future sovereign debt issues under the auspices of non-transparent governments. They should exercise closer control over transparency or opacity, as well as the controls to which the issuing government is subject. Banks should also analyze the investment case they are expected to sell to investors. Several billions of dollars of issues deserve a more specific description than general development considerations.

Another issue of corporate governance, fairly specific to investment banking, had already been discussed in the aftermath of the 2008 crisis, but in an inconclusive manner. The remuneration of a number of bank executives is clearly excessive. When the monetary unit of salaries is a million dollars, you can hire the best professionals, which is the official justification of the market law applied to bank salaries, but you also have a biased recruitment in which greed is clearly encouraged. This then increases the risk taken on behalf of the bank, as our two banks have only been able to observe. Capping executive compensation is and will remain a very important issue in corporate governance.

Finally on corporate governance, these cases illustrate once again that a bank's star employees are rarely called into question. When you bring tens or hundreds of millions of dollars in fees to the bank, you can easily ignore the concerns of the compliance department, if any. In the case of Goldman Sachs in particular, a \$600 million fee for \$6.5 billion bond issues should have been a red flag to the bank's head office, because a 9% fee is far higher than the less than 1% fee that is common practice for an investment-grade debt such as the Malaysian one.

As far as the management of public resources is concerned, both cases highlighted several problems of transparency. Not only the budget must be transparent, but also the debt, the guarantees given by the government to intermediate structures between the public and private sectors, and the management of the structures whose debt is guaranteed by the government.

International judiciary cooperation has been and still is active in the Malaysian and Mozambican affairs. This cooperation is important and should be supported and encouraged by an exchange of information between civil societies from various countries⁴.

Finally, it is very clear that a debt designed to be stolen will be even less popular than other forms of debt. Rather, it will be an odious debt. The concept of odious debt has been developed by recent research. A debt is "odious" if "the lender knew or should have known that the debt had not received the general consent of the people and the borrowed funds were contracted and spent contrary to their interests⁵." The mobilization of civil society can only increase the price to be paid by bankers and investors interested in a debt designed to be stolen. Such debt is risky, it may not be repaid.

⁴ As early as in 2015, Malaysian civil society and in particular Transparency International Malaysia warned national and international public opinions about the vast ramifications of the 1MDB Case. In Mozambique, the Centro de Integridade Pública called international experts to explore the complexities of the Tuna Bond case and published their detailed conclusions. See Edson Cortez ed., *Recovery of Assets*, op. cit.

⁵ Margot E. Salomon and Robert Howse, "Odious Debt, Adverse Creditors and the Democratic Ideal", in Ilias Bantekas and Cephas Lumina (eds), *Sovereign Debt and Human Rights*, Oxford University Press, 2019. Quoted by Joseph Hanlon, "Linking asset and damage recovery to not paying the \$2 bn odious secret debt", in Edson Cortez ed., *Recovery of Assets*, op. cit.