SOVEREIGN SCANDAL
FOLLOWING THE 1MDB MONEY TRAIL
INTRODUCTION

1MDB scandal could yet bring some critical closure

The 1Malaysia Development Berhad scandal could use some closure. As much as $6 billion was allegedly siphoned from the country’s sovereign fund, in a trail of corruption extending from Kuala Lumpur to Hollywood. As newly elected Prime Minister Mahathir Mohamad reexamines the case, it raises the tantalizing prospect that the ringleaders will be held to account.

A colourful cast of characters play leading roles in the disreputable tale that U.S. Attorney General Jeff Sessions has called "kleptocracy at its worst". Global banks, led by Goldman Sachs, helped the fund raise and move money, pocketing big fees and missing red flags. The U.S. Justice Department says some of the cash ended up financing Leonardo DiCaprio's "The Wolf of Wall Street."

Other sovereign funds were burnt, too. Prominent Abu Dhabi state fund International Petroleum Investment Company got caught up in 1MDB’s questionable dealings and was later folded into a larger, better-run rival. Both wayward outfits were unorthodox by design, overly ambitious, and concentrated too much power in the hands of a few individuals.

Following the surprise election defeat of Najib Razak, the primary architect of the fund, there is fresh scrutiny of the whole affair. He already is being questioned at home over the allegations and the DOJ says it will keep investigating. Reuters Breakingviews was sceptical about facets of 1MDB early on. When the fund tried to list power assets back in 2014, a column noted that while buying coal and gas-fired plants, the then-six-year-old parent had "acquired a poor reputation along the way."

1MDB played a big part in Malaysians turning their back on the man who has denied wrongdoing and used his political power to repress inquiries into the graft accusations. All too often large financial crimes or misdeeds go unpunished. Najib's defeat suggests this case could be different, with a network of anti-corruption fighters around the world working together with re-energised local agencies to seize assets, recover money and pursue criminal charges.

A probe that successfully pins blame on those involved would sharpen the 1MDB lessons for banks, money managers and politicians.

Una Galani
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SIGN OF TROUBLE

Malaysia’s $3 bln sovereign IPO faces many hurdles
By Una Galani

Malaysia faces many hurdles in the upcoming $3 billion initial public offering of its sovereign investment vehicle. 1Malaysia Development Berhad has become a political target for the nation’s opposition after making some poor decisions. Amid the noise, the state fund will have to work hard to interest investors in its energy assets.

The six-year old fund, which counts Prime Minister Najib Razak as an adviser, focuses on strategic investments in property and power. Since 2012, it has spent over 12 billion ringgit ($3.6 billion) acquiring coal and gas-fired power plants in five countries including Bangladesh, Egypt, and Pakistan. Today, 1MDB is Malaysia’s second-largest independent power producer.

The sun rises behind the Petronas Twin Towers in Kuala Lumpur, Malaysia, as the country awaits the swearing in of the new prime minister, Najib Razak, April 2, 2009. REUTERS/David Loh
Aside from a government guarantee for a fifth of its net debt, 1MDB raises and invests its own capital. Net debt stood at 66 percent of total assets at March 2013. A listing of the energy assets – one of the country’s largest initial public offerings – will help pay down debt and fund new growth.

The problem is that 1MDB has acquired a poor reputation along the way. Rapid expansion prompted it to overpay for energy assets, resulting in a $357 million goodwill writedown during the financial year ended in March 2013. That’s equivalent to 11 percent of what it paid for two acquisitions over the same period. It is expected to take further impairments ahead of a listing.

Two bond issues which raised a total of $4.75 billion in 2012 and 2013 have also proved controversial. 1MDB paid Goldman Sachs unusually high fees and commissions ranging between 9 and 11 percent for the funds. In the absence of a proper explanation, the deals look like poor judgment.

Reducing the state’s shareholding in the energy business to around 20 percent may help to insulate it from some of the criticism from the government’s political opponents. The newish senior management team should also ensure the unit begins to act more like a commercial entity. The business plans to double its net power generation capacity, from around 6,000 megawatts today, within a decade.

Nevertheless, investors in the initial public offering will want assurances the energy business will be better managed in the future than its parent has been in the past.

First published Nov. 6, 2014

Malaysia can regain credibility with fund revamp
By Una Galani

The empire-building days of 1Malaysia Development Berhad are over. To reduce its near-$12 billion debt pile, the sovereign vehicle spearheading ambitious government projects has promised not to make any new investments and will bring in equity partners. A well-handled revamp of the energy-to-real estate fund, whose advisory board is led by Prime Minister Najib Razak, could restore investor confidence in the country.

Following a strategic review by new chief Arul Kanda, 1MDB will run its three main units as standalone entities. Money will be raised this year from the energy assets, probably through a flotation which had previously been delayed. Government-linked and private partners will be sought for the firm’s two big real-estate projects, which include the development of a big new financial centre in Kuala Lumpur. Other land may also be sold.

Worries about 1MDB have intensified after it recently postponed the repayment of a 2 billion ringgit loan ($553 million).
Arul Kanda, president and group executive director of 1MDB, poses for photographs at the head office in Kuala Lumpur, Jan. 7, 2015. REUTERS/Olivia Harris

The vehicle said on Feb. 13 that it had finally settled this without providing any details, or explanation for why it took so long.

The opacity has been unnerving: investors had begun to worry that 1MDB had become a contingent liability for the government, even though it is supposed to raise and invest its own capital. Alongside a collapse in the oil price, growing anxiety about the sovereign vehicle has contributed to a 7.3 percent fall of the Malaysian ringgit against the dollar in three months, while the equity market has been one of the worst performers in Southeast Asia.

1MDB hasn’t been an entire failure. It has built a new energy champion for Malaysia and laid the foundations for mega real-estate projects in the capital. However, it has been dogged by controversy, overpaying for assets and forking out high fees on two Goldman Sachs-led bond issues.

The saga has been damaging for the prime minister, who established the vehicle six years ago. It is unclear if he will continue to advise the fund or its units after the restructuring. Either way, if 1MDB can transform itself transparently and effectively, that will be a big boost to Malaysia’s standing.

*First published Feb. 18, 2015*
Twin ghosts haunt Malaysia’s sovereign fund

By Una Galani

One of Southeast Asia’s sovereign funds faces a daunting task. The six-year-old 1Malaysia Development Berhad was set up to finance big national projects but expanded too fast, took on heavy debts and is now at the centre of a growing controversy. An ambitious restructuring brings both political and financial risks.

The fund which counts Prime Minister Najib Razak as chairman of its board of advisors has pledged to dismantle itself following a strategic review led by new chief executive Arul Kanda. It plans to stop making new investments and raise cash through an initial public offering of Malaysia’s second largest independent power producer. Selling unused land and finding equity partners for real estate projects that include a new financial centre in Kuala Lumpur and a development built around the terminus for a planned high-speed rail link with Singapore should bring in additional funds.

1MDB’s most pressing objective is to pay down net debt, which stood at around 38 billion ringgit ($10.3 billion) in March 2014. In the same year it made a net loss of 665.4 million ringgit, despite booking a gain from the revaluation of its property portfolio. Absent similar revaluations, it also made a loss in the previous two years.

In the past year, 1MDB has already redeemed $2.3 billion of investments it held in the Cayman Islands and settled a 2 billion ringgit loan. A public offering of an 80 percent stake in its energy unit – which carries debt of around 18 billion ringgit – was initially expected to raise 11 billion ringgit. However, previous efforts to list the business have been delayed. Meanwhile, potential co-investors may shy away from an entity that appears unable to escape controversy.

Past missteps hardly inspire confidence. 1MDB overpaid for the energy assets it has acquired since 2012 from local tycoon Ananda Krishnan and other conglomerates. It has also attracted scrutiny by paying unusually high fees on bond issues worth $4.8 billion arranged by Goldman Sachs in 2012 and 2013. Around $3 billion was earmarked for a joint venture with state-backed Abu Dhabi investor Aabar. Although the two countries retain a strong relationship, the terms of the venture have still not been finalised and an agreement appears unlikely to materialise.

The fund’s lack of transparency has been a particular concern in recent months. Its failure to repay a 2 billion ringgit loan due at the end of November sparked a broader market sell-off as investors worried that 1MDB’s debts might pose an additional burden for a country already grappling with the plunge in global oil prices.

Kanda said on Feb. 15 that the loan had been settled but provided no explanation of how. Even though Krishnan is widely believed to have played a part in clearing the loan in return for a share of the energy business, 1MDB has remained silent on the issue.

Meanwhile, 1MDB has become a target for Najib’s political opponents. Following reports that
a local tycoon had siphoned money out of the fund, former Malaysian Prime Minister Mahathir Mohamad called for an investigation into its finances. In an attempt to contain the political storm, Najib on March 4 ordered Malaysia’s auditor-general to verify 1MDB’s accounts.

A construction worker walks past a 1MDB billboard at the Tun Razak Exchange development in Kuala Lumpur, Malaysia, Feb. 3, 2016. REUTERS/Olivia Harris

The risk is that the political controversy makes it harder for 1MDB to clean up its finances. If the fund is unable to reduce its debt, the government may be forced to help out, for example by asking state-backed pension funds and companies to support a listing of the energy business or become equity partners in its real estate projects.

Alternatively, the government may have to support 1MDB’s debt directly. The state has explicitly guaranteed 5.8 billion of the fund’s borrowings. Extending this to all of 1MDB’s net debt at the end of March 2014 would increase the state’s contingent liabilities to 18.1 percent of GDP from 15.1 percent at the end of the third quarter. That’s on top of federal government debt that was already at 52.8 percent of GDP at the end of the same period.

What 1MDB’s many critics really want is a frank and simple explanation of how a fund
supported by the Prime Minister ended up in such a financial mess. That would probably draw attention to past mismanagement and costly mistakes. Unless it is able to complete its ambitious clean-up, however, 1MDB’s woes will continue to be a political and financial burden.

First published March 12, 2015

1MDB crisis will weigh on sovereign investors
By Una Galani

The crisis at 1Malaysia Development Berhad may weigh on sovereign investors. The fund has spawned one of the industry’s worst scandals. Allegations of graft involving Prime Minister Najib Razak – which he strenuously denies – have led to a political crisis, a plunging currency, and investigations from Switzerland to Hong Kong. Emirati backer International Petroleum Investment Co could now be on the hook for $7 billion. Though neither is a typical sovereign wealth fund, more traditional peers could suffer in the fallout.

Malaysia's Prime Minister Najib Razak arrives at a presentation for government interns at his office in Putrajaya, Malaysia, July 8, 2015. REUTERS/Olivia Harris

IPIC, chaired by Abu Dhabi royal and Manchester City owner Sheikh Mansour bin Zayed Al Nahyan, aided 1MDB's debt-fuelled expansion. Now that 1MDB is in trouble, IPIC has agreed
to assume responsibility for debt – including bonds, interest payments, and other bits and pieces – equivalent to about 60 percent of the value of 1MDB’s total assets at the end of March 2014. In return, IPIC will receive unspecified assets – most likely real estate.

The diagnosis is not difficult. State ownership combined with powerful patrons enabled all-too-easy access to capital. Both funds have made questionable investment decisions. Similar problems led to the 2009 Dubai debt crisis, which eventually required a $20 billion bailout from Abu Dhabi.

The core problem is that 1MDB and IPIC are more opaque, and have higher risk appetite, than many other sovereign wealth funds. Yet their travails play to the concerns that many governments and financial institutions already have about dealing with sovereign capital more widely.

Leading sovereign funds could also suffer by association with the smaller local mavericks. 1MDB and IPIC operate in the shadows of larger, more established entities: the Abu Dhabi Investment Authority and Malaysia’s Khazanah Nasional Berhad combined manage over $660 billion, according to the Sovereign Wealth Center.

The controversy is bound to make at least some more cautious in dealing with the sector as a whole. That might mean some deals are never offered to funds, or are subject to heightened political scrutiny. To address that, governments will need to reassure themselves that decision-making processes and transparency at their investment vehicles are up to scratch.

*First published Sept. 11, 2015*
ATTEMPTED CLEANUP

Malaysia remains fragile despite China power deal
By Una Galani

Malaysia is getting another sovereign lifeline. State-owned China General Nuclear Power will buy the energy assets of troubled sovereign fund 1Malaysia Development Berhad for 9.83 billion ringgit ($2.3 billion). That is a big step towards solving 1MDB’s debt troubles. But it will do little to ease the pressure on the currency or on embattled Prime Minister Najib Razak, who also chairs 1MDB’s board of advisers.

1MDB is selling the power plants, which stretch from Malaysia to Pakistan, for around 18 percent less than the equity value it paid for them between 2012 and 2013. People familiar with the process say the deal including debt could be worth as much as 18 billion ringgit. So this will help hugely with debt reduction. The fund had 38 billion ringgit of net borrowings in March 2014, the last period for which 1MDB published accounts.

A student activist holds up a placard while sitting behind mock bars near Dataran Merdeka, or Independence Square, during a protest to call for the arrest of “Malaysian Official 1” in Kuala Lumpur, Malaysia, Aug. 27, 2016. REUTERS/Edgar Su
The quid pro quo for China, which paid more than domestic bidders were willing to hand over, could be future power and rail contracts.

The next step financially will be executing on a $5 billion bailout from International Petroleum Investment Co, which is chaired by Abu Dhabi royal and Manchester City owner Sheikh Mansour bin Zayed Al Nahyan. His investment vehicle was forced to help because it had jointly guaranteed some bonds that 1MDB issued to fund its ill-fated spending spree. To conclude the rescue, 1MDB must now hand over assets – which it says will probably be in the form of U.S. dollar cash deposits and fund units – within six months.

Even then, a wider mess remains. The ringgit has slid 23 percent this year against the dollar. The fund is still at the centre of various probes from Malaysia to Switzerland and the United States amid allegations of graft and mismanagement. The scandal is a deterrent to foreign investors, and means increased political risk, as Najib fend off challenges from the opposition and disquiet from within his own ruling party. The slide in the price of crude oil, which Malaysia depends upon to finance its federal budget, adds extra pressure. 1MDB may be moving to fix its debt problems but Malaysia remains fragile.

First published Nov. 24, 2015

Malaysia scrubs out half its sovereign fund stain
By Una Galani

The world’s most troubled sovereign fund is scrubbing itself clean. 1Malaysia Development Berhad has been at the centre of allegations of graft which have sparked investigations from Hong Kong to the United States. Now a $1.7 billion deal with a Malaysian-Chinese group over prime real estate in Kuala Lumpur means 1MDB’s financial woes are close to resolution.

Malaysian politics has been in turmoil since July, when it was revealed that almost $700 million had landed in the personal accounts of Najib Razak, the prime minister. Najib is chairman of 1MDB’s board of advisers. He denies taking any money from the energy-to-real estate portfolio for personal gain. The country’s anti-corruption commission has said the cash came from an unnamed donor. Other officials that have probed the issue have been axed, including the attorney general and deputy prime minister. Opposition politicians have also asked whether 1MDB funds were used to pay for election campaigns.

The mystery has piled pressure onto 1MDB, which already had a poor reputation for mismanagement and overpaying for assets. Gross borrowings were nearly 42 billion ringgit ($9.8 billion) in March 2014, the last period for which the fund has published accounts. That may have risen to 49 billion ringgit after factoring in a 31 percent fall in the ringgit against the dollar, the currency in which more than half the debt was held, a Breakingviews calculation suggests.

Despite a turbulent year, 1MDB President Arul Kanda has made considerable progress. The
former investment banker, who took the helm almost a year ago, has worked Malaysia’s sovereign ties to trim 1MDB’s debts even as institutional investors have cooled on an economy battered by low oil prices.

**Two down, one to go**

Last month, 1MDB agreed to sell its energy assets, which stretch from Malaysia to Pakistan, to state-owned China General Nuclear Power for 17.3 billion ringgit including debt. The transaction should bring closer ties with China, which wants more sway in the region.

In June, 1MDB agreed a debt-for-asset swap with International Petroleum Investment Co, which the fund says will reduce borrowings by around 16 billion ringgit. 1MDB plans to settle the deal with IPIC, which is chaired by Abu Dhabi royal and Manchester City football club owner Sheikh Mansour bin Zayed Al Nahyan, by handing over securities and cash.

Now 1MDB has agreed to sell 60 percent of one of Kuala Lumpur’s biggest real-estate projects, a 486-acre site called Bandar Malaysia that will become a key transport hub, to Iskandar Waterfront Holdings and its partner, state-run China Railway Engineering, for 7.4 billion ringgit.

Beyond that, Kanda has previously said 1MDB will focus on developing its remaining land assets, including a planned 70-acre financial centre. Excluding the leftover Bandar Malaysia stake, these may be worth more than 6 billion ringgit, two sources familiar with 1MDB say. The finance ministry could justify directly owning these, given their strategic value.

Proceeds from the deals could also help address one particularly awkward liability. 1MDB has a $3 billion bond outstanding that does not mature until 2023 but the fund has a strong incentive to pay this back sooner rather than later – even if it means paying bondholders a premium.

**The Goldman problem**

The $3 billion debenture is a glaring reminder of the distrust around the fund. The instrument carries a letter of support from the Malaysian government but trades at just 86 cents on the dollar, indicating financial distress. That stands in stark contrast to two Abu Dhabi-backed 1MDB bonds, which have always traded above par.

Early redemption would also draw a line under the fund’s controversial relationship with Goldman Sachs. The Wall Street bank helped 1MDB to raise a total of $6.5 billion in 2012 and 2013, including the two IPIC bonds. 1MDB paid Goldman roughly $590 million in fees, commissions, and expenses, according to a person familiar with the situation. The fees were more than 9 percent, or almost four times the typical rate for a quasi-sovereign bond at the time.
Pro-democracy group Bersih supporters persuade a protester to back down during a 1MDB protest, calling for Malaysian Prime Minister Najib Razak to resign, in Kuala Lumpur, Malaysia, Nov. 19, 2016. REUTERS/Edgar Su

Goldman charged so much because it put its own balance sheet at risk to raise a large amount of money quickly for a fund that then lacked a credit rating. The bond issue also left the bank exposed to its client’s reputational problems.

1MDB hasn’t decided yet whether to buy back the bonds. Either way, if Kanda succeeds in his ambitious cleanup by completing the deals he has now agreed, 1MDB’s problems will not weigh as heavily directly on the finances of the government as many investors, analysts and politicians had feared.

Najib may never escape the shadow of 1MDB entirely but if the debts can be tamed then his critics will have one less stick with which to beat him.

First published Dec. 31, 2015
Malaysia’s strongman faces a challenge to impress
By Una Galani

Najib Razak’s father feared his son was “too quiet and introverted for the rough and tumble of politics”. The irony of the quip was not lost on those attending an event in Kuala Lumpur last week to commemorate Malaysia’s second prime minister Abdul Razak Hussein, who died 40 years ago.

Just six months ago, it looked as if Najib might be forced out as leader of the predominantly Muslim country of 30 million people. But the grey-haired 62-year old appears to have dispelled his father’s doubts by winning a bitter power struggle with Mahathir Mohamad, the former prime minister who helped him into office almost seven years ago.

Najib’s political days looked numbered when it emerged last year that nearly $700 million had been deposited in his personal bank account in the run-up to the hotly contested 2013 election. Malaysia’s anti-graft agency has said the money was a donation from the Middle East. Mahathir, who remains influential 12 years after leaving office, insisted the funds were connected to 1Malaysia Development Berhad, a sovereign wealth fund that Najib had championed. At the time, 1MDB was struggling with $10 billion of debt that was threatening Malaysia’s sovereign creditworthiness.

Najib denied taking any public money for personal gain and moved quickly to squash internal dissent, firing his deputy and Malaysia’s attorney general. Meanwhile he turned to friendly foreign governments – particularly China – to take on some of 1MDB’s power and property assets and help the fund repay its borrowings.

The result is that Najib now looks like he is here to stay. Though foreign authorities are still probing aspects of the funding furore, last month’s annual assembly of the United Malays National Organisation, the country’s dominant political force since 1957, produced a strong show of support for the prime minister. The introduction of a tough new security law — supposedly to tackle groups like Islamic State — further reinforces the view that Najib has supplanted Mahathir as Malaysia’s strongman.

Yet the prime minister needs to do more than survive. His next task is to shore up popular support ahead of a general election which must be held by 2018. Last time the ruling UMNO-led Barisan Nasional coalition received a minority of the popular vote, only winning a majority of the seats thanks to some creatively drawn electoral boundaries. Najib’s party wants a more legitimate victory next time.

Global conditions will not help endear Najib to voters, however. The falling price of oil is squeezing Malaysia’s exports: the black stuff generated around 30 percent of the country’s federal revenues two years ago. The government is revising this year’s budget, which was drawn up on the assumption that oil prices would average $48 per barrel, well above the current price of $28. A goods and services tax introduced last year has limited the fiscal fallout, but has been extremely unpopular.
Malaysia's Prime Minister Najib Razak attends a presentation for government interns at the prime minister's office in Putrajaya, Malaysia, July 8, 2015. REUTERS/Olivia Harris

Economic policymaking is also in flux. The country's long-serving central bank chief is due to retire in April. Governor Zeti Akhtar Aziz has led Bank Negara Malaysia for almost 16 years, steering the country through multiple crises. While her departure removes another thorn from Najib's side, it comes at a time when the ringgit has lost 21 percent of its value against the dollar in the past twelve months and household debt is amongst the highest in the region.

Worries about further capital flight leave little room to cut interest rates to stimulate growth, which may slow to just 4 percent this year, Capital Economics reckons. The slowdown also undermines Najib's much-publicised goal to make Malaysia a "high income" country by 2020.

Even if foreign capital can be convinced to stay, Malaysians are still leaving. Local businessmen complain of a chronic brain drain due to growing racial divisions. So-called "affirmative action" policies, which favour the majority ethnic Malays over those of Chinese and Indian ethnic origin, are outdated.

Najib has talked often about the need for national reconciliation, and there is still a lingering belief that he is more moderate than many others in his party. He promoted unity under the
slogan “1Malaysia” shortly after he came to power in 2009. Some cabinet ministers in the administrative capital of Putrajaya, rich with Islamic architecture, still hopefully wear an enamel number “1” badge pinned to their jackets.

Yet Najib will struggle to live up to the ideal of racial harmony and the legacy of his father, who brought Malaysians together after race riots in 1969 nearly tore the nation apart.

The ruling coalition has lost many fringe voters to the opposition, whose leader Anwar Ibrahim, another protégé-turned-enemy of Mahathir, was jailed last year on charges of sodomy. That will likely force Najib to court more conservatives and hardline Islamists to prevent another electoral embarrassment. Political observers note that the leader has taken to citing the Koran more than before.

Malaysia’s prime minister may have defied predictions of his demise. But the political and economic cost of his survival is not yet fully clear.

First published Jan. 21, 2016

Royal gift is odd exoneration for Malaysian PM
By Una Galani

Malaysian Prime Minister Najib Razak has won a bizarre exoneration. The country’s attorney general has declared that $681 million transferred into the prime minister’s personal bank account in 2013 was a “gift” from the royal family in Saudi Arabia. Even more astonishingly, he returned $620 million because it was not used. Though the ruling clears Najib of criminal wrongdoing, it won’t draw a line under the funding furore.

While it may be hard for outside observers to grasp, the news is actually a political victory for the 62-year old leader. Najib’s political opponents have failed to oust him using local laws and also failed to link the payments to 1Malaysia Development Berhad, an indebted sovereign fund the prime minister championed. This is not exactly a surprise given that Najib fired the chief prosecutor’s predecessor last July, in the middle of a probe into the fund. It is, however, more evidence that the prime minister has seen off a challenge from inside his own party led by Mahathir Mohamad, the country’s former leader.

Malaysia’s weak political funding rules allow plenty of room for political patronage. The country does not prohibit foreign donations. Past efforts to reform the system have failed, though the government is now revisiting the issue. Besides, Saudi Arabia is well known for liberally dispersing funds from Bahrain to Egypt to help prop up foreign governments that it deems friendly.

Yet even if the explanation gives Najib the legal all-clear, such overt buying of political influence is still embarrassing. It’s unclear what the Saudi royals expected in return, or why the prime minister decided to hand back all but $61 million of the “gift”.
With so much money at his disposal, it also begs the question why his ruling coalition only managed to win a minority of the popular vote in the 2013 general election.

Incontrovertible evidence of direct foreign funding from a fiercely conservative Muslim country will further strain relations between the majority Malay Muslim population and ethnic Chinese and Indian minorities, many of whom are leaving the country in search of more equitable homes. Though Najib may have survived, the circumstances of his exoneration are no less awkward than the details of the scandal that threatened to topple him in the first place.

*First published Jan. 26, 2016*

A Hermes Birkin handbag is pictured on Sept. 22, 2014. Malaysian police seized almost 300 boxes of designer handbags and dozens of bags filled with cash and jewelry from a luxury condominium linked to Najib Razak, Reuters reported on May 18, 2018. REUTERS/Mario Anzuoni
GLOBAL SPILLOVER

Swiss 1MDB probe threatens aftershock for Malaysia
By Una Galani

It’s hard to bury a big scandal. That is the awkward lesson that Najib Razak is learning. The Malaysian prime minister is attempting to draw a line under a multi-pronged financial controversy that almost toppled him. But initial findings from Switzerland’s attorney general that around $4 billion may have been misappropriated from Malaysian state firms is a sharp reminder of the lingering threat posed by foreign investigations.

Beating a retreat
Foreign investors show less enthusiasm for Malaysian government bonds

Even by the standards of Malaysian politics, it has been an extraordinary few days. On Jan. 26, the country’s chief prosecutor concluded that $681 million that was transferred into the Prime Minister’s personal account in 2013 was a donation from the royal family in Saudi Arabia, not money from 1Malaysia Development Berhad, an indebted fund he championed. Najib was cleared of graft. Three days later, however, Swiss authorities published preliminary conclusions from its own probe into 1MDB which found that billions may have been squirreled away between 2009 and 2013.

The Swiss findings implicate former Malaysian officials and current and former ones in the United Arab Emirates. Four companies are in the frame: PetroSaudi, a privately-held Saudi oil company; former 1MDB subsidiary SRC International; Malaysian conglomerate Genting, and...
ADMIC, a joint venture with Aabar Investments – which is ultimately backed by Abu Dhabi royal Sheikh Mansour bin Zayed al-Nahyan. The findings are also uncomfortable for Goldman Sachs as the Wall Street bank, which helped raised $6.5 billion for 1MDB, was closely involved with two of these entities.

Malaysia's prime minister and president of ruling party National Front, Najib Razak, speaks during the launch of its manifesto for the upcoming general elections in Kuala Lumpur, Malaysia, April 7, 2018. REUTERS/Lai Seng Sin

However, Najib himself does not appear to be the focus of the inquiry. It is highly doubtful that any of the four ongoing Malaysian probes into 1MDB will result in any outcome that hurts the prime minister. After all, the present attorney general’s predecessor was axed by Najib at the height of the funding furore.

The happiest outcome for Najib would be for the investigations in Switzerland and elsewhere to also fizzle out. Malaysia says it will cooperate with its Swiss counterparts. Yet foreign investigators’ dependence on domestic help has helped to stymie past inquiries, including a more than decade-long probe into alleged money laundering by former president of Pakistan Asif Ali Zardari and his late wife former Prime Minister Benazir Bhutto – both of whom always denied the charges.
Najib still has the domestic support he needs to stay on top. But the foreign probes into 1MDB are a continued embarrassment at best. At worst, further revelations could threaten aftershocks for the prime minister – and for Malaysia.

First published Feb. 1, 2016

A trader works at the Goldman Sachs booth on the floor of the New York Stock Exchange in New York City, USA, Oct. 14, 2016. REUTERS/Brendan McDermid

Wall Street fingerprints are all over 1MDB scandal

By Una Galani

Wall Street banks played a key role in helping a Malaysian sovereign fund raise and move money, much of which went missing. That is a key takeaway from a damning 106-page report by a bi-partisan parliamentary committee into the goings-on at 1Malaysia Development Berhad. The report, which highlights over $4 billion in suspect payments, shows how Deutsche Bank, JPMorgan, and Goldman Sachs had their fingerprints all over the disgraced fund.

Goldman has long been at the centre of the controversy surrounding 1MDB, where Malaysian Prime Minister Najib Razak remains chairman of the board of advisors. The firm pocketed
eye-popping fees arranging three bond deals between 2012 and 2013 that raised $6.5 billion for the fund. At its client’s highly unusual request, Goldman even arranged to send almost half the proceeds to a small Swiss private bank.

Now the Malaysian report has cast a spotlight on other lenders as well. It shows that 1MDB PetroSaudi, a joint venture of the fund, received $300 million in a JPMorgan account in 2009. Separately, the report suggests that a 1MDB PetroSaudi account was moved to the U.S. bank without the full knowledge of the fund’s board.

The parliamentary committee also found that, even after the controversy around Goldman’s deals, Deutsche went on to arrange two further loans worth a total of $1.23 billion for the already indebted fund in 2014. Deutsche extended the two loans shortly after it hired Yusof Yaacob from Goldman as its chief country officer for Malaysia.

Those deals proved messy too. Creditors subsequently worried about the collateral supporting one of the loans Deutsche arranged. 1MDB repaid it early by borrowing $1 billion from Abu Dhabi’s International Petroleum Investment Company. The Malaysian fund now owes at least $4.5 billion to IPIC and must transfer assets of the same value to its Gulf counterpart by the end of June. Deutsche, Goldman and JPMorgan all declined to comment on the report’s findings.

Crucially, some of the funds that the banks helped raise for 1MDB ended up at an entity incorporated in the British Virgin Islands, which the report says received $3.5 billion. It has a similar name to an IPIC subsidiary called Aabar. IPIC finally admitted on Monday that the vehicle that received the money was not part of the group. 1MDB pointed out that it was “curious” that the Abu Dhabi group waited so long to make that clear, suggesting the relationship between the two sides has soured.

Ultimately, the report paints a picture of banks working side-by-side with 1MDB as it accumulated worrying levels of debt and became the subject of growing controversy which, in the words of the Swiss financial regulator, looks like a case of “blatant and massive corruption”. U.S. authorities have asked the banks to provide details of their dealings with the fund. At the very least, the 1MDB money trail will leave parts of Wall Street red-faced.

First published April 12, 2016

**Abu Dhabi fund woe shows perils of mission creep**

By Una Galani

Abu Dhabi’s sovereign fund woes are a reminder to asset managers of the benefits of staying focused. One of the Gulf state’s investment companies strayed far from its original mandate to invest in oil and gas. A nasty multi-billion dollar tangle with rival state-backed investor 1Malaysia Development Berhad shows how pairing big ambitions with poor governance can backfire.
International Petroleum Investment Company, which was set up more than three decades ago, is chaired by Sheikh Mansour bin Zayed Al Nahyan, a ruling family member and owner of Manchester City football club. It now has assets worth almost $70 billion of which one quarter are “diversified investments” including everything from private banks to space travel.

IPIC’s mission creep has mostly come through Aabar, a company the fund took private in 2010. Over the years, Aabar appears to have racked up big losses from investments including commodities trader Glencore, Malaysian bank RHB Capital and Italian bank UniCredit.

The logo of Swiss Falcon Private Bank, owned by Abu Dhabi’s International Petroleum Investment Co, is seen at its headquarters in Zurich, Switzerland, Sept. 22, 2016. REUTERS/Arnd Wiegmann

Now it has been dragged into the growing scandal surrounding 1MDB. Aabar says it is not the owner of a company called Aabar Investments PJS Limited, which received $3.5 billion from the Malaysian investor. 1MDB says it made the payments based on agreements negotiated with two senior Aabar executives, both of whom have since left the group.

The dispute has scuppered a $4.5 billion debt deal the two agreed last year, and cast a cloud over $3.5 billion of bonds issued by 1MDB and jointly guaranteed by IPIC. Missed interest payments could trigger cross-defaults on both sides.

Aabar’s ties with 1MDB go deeper, though. In 2013, the Malaysian group raised $3 billion to fund a joint venture agreement with Aabar to develop a big real estate project in Kuala...
Lumpur. Meanwhile, Falcon Private Bank, a Swiss lender owned by Aabar, has come under scrutiny for its transactions relating to 1MDB. Falcon says it will cooperate with authorities.

Indeed, the full extent of the Abu Dhabi fund’s troubles are only just becoming clear. Its mistake appears to have been to concentrate too much power in the hands of a few individuals. Either way, the fallout is deeply embarrassing for its sovereign owner. It is hard to imagine that IPIC would have got itself into so much hot water if it had stuck to its core competency.

First published April 25, 2016

1MDB scandal stings Singapore’s banking pillar
By Una Galani

Singapore is finding that being the Switzerland of Asia has its downside. The city-state’s central bank has shut down the local operations of BSI as Swiss authorities opened a criminal probe into the private bank, relating to disgraced sovereign fund 1Malaysia Development Berhad. The battle against illicit money flows is global. But Singapore seems only now to be properly facing up to the risks of its push to court private wealth.

The city-state made an aggressive push to capitalise on Switzerland’s distress following the global financial crisis, when Swiss authorities reined in their secrecy laws and saw their home-grown banking giants UBS and Credit Suisse collectively fined over $3 billion by U.S. authorities for enabling tax evasion. Deloitte reckons that Singapore grew its net new assets in international wealth management by 11 percent compared to a 7 percent decline for Switzerland between 2009 and 2014.

Now that relative success is posing a big threat to Singapore’s reputation as a financial centre. BSI was a correspondent bank for 1MDB, from which Swiss authorities said earlier this year as much as $4 billion appeared to have been misappropriated in a scandal that has engulfed Malaysia’s Prime Minister Najib Razak.

Singapore’s closure order on BSI, a S$13.3 million ($9.61 million) fine, and move to refer current and former executives of the bank to the public prosecutor, appears decisive. But the central bank said it had found policy lapses and problems with internal controls at the Swiss-headquartered bank, which was recently sold to EFG International, as far back as 2011. Swiss regulator Finma, in comparison, clawed back $95 million of BSI’s earnings.

The fallout underscores the tension the city-state faces between the desire to grow as a financial centre and the need to maintain a reputation for robust enforcement. Maintaining this balance is especially difficult given some of the key pillars of Singapore’s financial centre have been struggling in recent years; fees for merger advice are flagging and the country is losing out to its Southeast Asian rivals as a destination for new stock-market listings.
Switzerland is already all too aware of the risks that come with private banking. For Singapore, the Malaysian fund scandal may force a rude awakening.

First published May 24, 2016

An employee enters the reception area of Swiss bank BSI's office in Singapore, May 24, 2016. REUTERS/Edgar Su

Abu Dhabi fund merger papers over Malaysia problem
By Una Galani

Abu Dhabi is papering over its sovereign fund woes by merging two of the emirate’s most prominent investment vehicles. Combining International Petroleum Investment Company (IPIC) with local peer Mubadala should lead to better governance. Creating a new $135 billion fund will also help the Gulf state to scrub out the stain of past missteps – notably a scandal involving IPIC and 1Malaysia Development Berhad.

The two Abu Dhabi funds are similar in size and both arms of the state but are distinct entities. Under Chairman Sheikh Mansour bin Zayed Al Nahyan – owner of Manchester City
football club – IPIC has strayed from its original mandate to invest in oil and gas. It has recently made bets from private banks to space travel, mostly through a subsidiary called Aabar. It also appears to have racked up big losses by investing in commodities trader Glencore, Malaysian bank RHB Capital, and Italian bank UniCredit.

General view of Martyrs Memorial Park opposite Sheikh Zayed Mosque in Abu Dhabi, UAE, May 9, 2018. REUTERS/Satish Kumar

IPIC’s main source of shame, however, is its entanglement in a global money laundering investigation centred on 1MDB. The Malaysian fund made payments worth $3.5 billion to an entity called Aabar Investments PJS Limited. IPIC says it is not the owner of that company. Last year the Abu Dhabi fund replaced two senior executives who 1MDB claims it dealt with when the payments were made.

The dispute has cast a shadow over 1MDB bonds, also worth $3.5 billion, which were jointly guaranteed by IPIC. The Malaysian group has stopped paying interest on the securities, leaving IPIC to pick up the tab. A London court will decide who is ultimately on the hook.

Mubadala’s mandate seems clear by comparison. It has assembled holdings ranging from clean energy to technology and aerospace in an effort to diversify the oil-based economy. It has even recovered the value of a $2 billion preferred equity investment into the holding company of bankrupt Brazilian tycoon Eike Batista by claiming assets including a Colombian
gold mine and a key port. Most significantly, the well-governed fund is highly respected both within the emirate and overseas.

A merger will not save Abu Dhabi from its troubles with 1MDB. But it could be a neat way to erase a fund that has embarrassed the emirate, while placing IPIC’s valuable energy assets in better hands.

First published June 29, 2016

Fat tail U.S. legal risk keeps Malaysian scandal hot
By Una Galani

Malaysia’s sovereign-fund scandal is still hot. The U.S. Department of Justice alleges that more than $3.5 billion was misappropriated from 1Malaysia Development Berhad, known as 1MDB, over the course of several years through a web of fraudulent transactions. The legal details join the dots of the long-running controversy, with plenty of colour and grit. Everyone involved with 1MDB, from Malaysian Prime Minister Najib Razak to bankers at Goldman Sachs, should feel mighty uncomfortable.

A view of the Goldman Sachs stall on the floor of the New York Stock Exchange, July 16, 2013. REUTERS/Brendan McDermid/File Photo

U.S. authorities on Wednesday launched a civil campaign to seize assets worth almost one-third of the total amount allegedly siphoned off. The spoils include a Bombardier jet, artwork
by Monet, an interest in EMI Music Publishing, prime real estate in Beverly Hills, and – rather aptly – the rights to the award-winning movie, “The Wolf of Wall Street”. It’s the largest such effort under the DOJ’s so-called Kleptocracy Asset Recovery Initiative.

Numerous banks are named in the complaint but Goldman Sachs’ dealings with 1MDB come out looking the worst. Of the more than $6 billion the bank raised for the fund through three bond deals in 2012 and 2013, almost half was fraudulently diverted, according to the complaint. In one case, the funds began to disappear days after they were raised. These are the same transactions for which Goldman pocketed huge fees and led one opposition politician to conclude that the Malaysian government had been “royally screwed”.

It’s also bad news for Najib. The complaint doesn’t name him, but it does reference a Malaysian official with responsibilities that match the premier’s.

And his stepson, Riza Aziz, is cited as having benefited from the stolen money. That will put Najib in an awkward position. The prime minister has shored up support at home, winning recent regional elections. But the U.S. legal move is likely to embolden dissenters within the ruling party and the opposition.

U.S. authorities were at pains to emphasise that their investigation remains ongoing – and explain that other individuals and institutions could yet be named and investigated. That will turn up the heat on high-profile individuals and institutions that were entangled in a scandal that fat-tailed overseas legal risks are helping to make impossible to bury.

First published July 20, 2016

**Malaysia fiasco undercuts Goldman’s standards push**

By Una Galani

A sovereign fund scandal has exposed shortcomings in Goldman Sachs’ post-crisis overhaul of its business practices. Five years ago, the Wall Street firm led by Lloyd Blankfein went to great lengths to assure regulators, investors and clients that it was tightening up standards. But its dealings with the now disgraced 1Malaysia Development Berhad cast doubt on the depth of Goldman’s changes.

An attempt by the U.S. Department of Justice to seize assets bought with some of the $3.5 billion it says was stolen from 1MDB offer the clearest account yet of the bank’s deep relationship with the Malaysian fund. Though Goldman has not been accused of any wrongdoing, its name appears frequently in lawsuits that detail a complex web of fraudulent transactions over several years.
Lloyd Blankfein, CEO of Goldman Sachs, pauses while speaking at the Boston College Chief Executives Club luncheon in Boston, MA, U.S., March 22, 2018. REUTERS/Brian Snyder

Back in 2009, Goldman helped set up the fund which counted Malaysian Prime Minister Najib Razak as its top advisor. An excerpt of an email suggests that, from the very start, Goldman executives were concerned about the issue of transparency at the new fund and its reliance on borrowed money. By the time the bank started raising money for 1MDB in earnest three years later, corrupt officials had already sucked around $1 billion from the fund, the legal documents show.

Nevertheless, between 2012 and 2013 Goldman helped 1MDB raise $6.5 billion by issuing three bonds. The Justice Department suggests that around 40 percent of that money was siphoned off, and indicates that $681 million ultimately found its way into Najib’s personal bank account, though the prime minister is not directly named.

Some of the rest of the funds taken from 1MDB ended up in a Bombardier jet, artwork by Monet, an interest in EMI Music Publishing, prime real estate in Beverly Hills, and the movie “The Wolf of Wall Street”.

The relationship with 1MDB was highly lucrative for Goldman. In total, the bank earned roughly $590 million in fees, commissions and expenses, according to the legal filings – far more than a bank would normally expect to earn on bond deals for a quasi-sovereign client.
Goldman was able to charge more because it put its balance sheet at risk by buying the bonds from 1MDB before selling them on to other investors. One of the bond offerings was given the code name “Project Maximus”.

1MDB says that it has not been contacted by the Justice Department or any other foreign agency in relation to their investigations. Najib’s press secretary said in a statement that the law will be enforced without exception if any wrongdoing is proved.

For its part, Goldman says it had no visibility on whether the funds it raised for 1MDB were diverted for other purposes. The bank has previously stressed that its fees were commensurate with the risk it assumed and that it did proper due diligence on 1MDB.

Nonetheless, the transactions may yet drag Goldman into a criminal investigation. U.S. law enforcement officials are probing whether the bank failed to comply with the U.S. Bank Secrecy Act with regards to its fundraising for 1MDB, according to a person familiar with the situation. The Act requires financial institutions to report suspicious transactions to regulators.

Whatever the outcome of the ongoing investigations, however, Goldman’s reputation has already taken a savage beating. This was exactly the kind of mess it was trying to avoid by overhauling its standards following the financial crisis.

Around the time that the bank agreed in 2010 to pay $550 million to settle charges it improperly sold a product linked to subprime mortgages, chairman and Chief Executive Blankfein launched a global review to strengthen the firm’s practices and culture. The following year, Goldman published a 63-page document with 39 recommendations designed to ensure its bankers and traders paid as much attention to reputational risks as financial ones.

Goldman says Blankfein dedicated more time to reinforcing the message about personal accountability, client service and reputational risk management with employees than to any other initiative in 2011 and early 2012.

Moreover, a 28-page assessment of the reforms published by Goldman in 2013 claimed the bank’s approach to transactions was now “fundamentally different”. Committees that approve individual transactions were required to vet deals more vigorously and differentiate “from those we could have done, but should not do, to transactions that we both can and should do”.

It is impossible for outsiders to understand all that transpired inside Goldman while it was vetting the 1MDB deals. But plenty of warning signs were visible. The three most obvious were that a quasi-sovereign client wanted to raise a large amount of money at short notice, was willing to pay hefty fees, and directed the proceeds to a small Swiss private bank.

Goldman’s top bankers doubtless had a vigorous debate about the merits and structure of the various 1MDB bonds. The bank did propose cheaper ways for the sovereign fund to raise cash,
according to a person familiar with the situation. On one occasion, it insisted that 1MDB went to rival banks to seek alternative pricing. Nevertheless, the transactions still went ahead.

The 1MDB saga does not invalidate Goldman’s efforts to reform the way it does business around the world. But the Malaysia mess does raise questions about the depth of these reforms – and serves as a reminder about how hard it is to change a bank’s culture.

First published July 21, 2016

Malaysia’s pivot to China is payback plus
By Una Galani

China has won another enthusiastic friend. Malaysian Prime Minister Najib Razak struck the country’s first major defense deal with China and says relations with its eastern neighbor are “set to reach new highs”. He is the latest Asian leader after Philippine President Rodrigo Duterte to cozy up to Beijing. But his motivations for singing the praise of the People’s Republic, while bashing Western allies, appear unique.

Unlike the Philippines, Malaysia already counts China as its largest trading partner, and the middle-income nation is not desperate for foreign capital to finance basic infrastructure. However, a warm embrace is a good way for Najib to express gratitude for China’s continuing investment support during the ongoing corruption scandal engulfing state fund 1Malaysia Development Berhad.

The carefully cultivated relationship between the leader of the majority-Muslim nation and his former golf buddy President Barack Obama was ruined in July when the U.S. Department of Justice alleged over $3.5 billion was misappropriated from the fund. The agency indirectly linked the corruption to Najib, who denied any wrongdoing.

Ahead of that, Chinese buyers, mostly state-backed, stepped up to buy 1MDB’s energy and real estate assets at generous prices. The $4 billion proceeds helped Malaysia to protect its delicate public finances – and took some pressure off the embattled leader.

Now more Chinese capital is heading for the country, including into a major railway project spanning four states, in what some observers see as quid pro quo. Net foreign direct investment into Malaysia from Hong Kong and China totalled $3.5 billion in the first six months of fiscal 2016, over triple the amount from the United States since 2014.

Chinese investment could help Najib meet his ambitious goal of making Malaysia a “high-income” country by 2020. The tilt east may also be a vote-winner in a nation where anti-U.S. sentiment has always been present; there are signs that Najib is preparing for a general election next year.

But the gamble is not without risks. One reason Malaysia’s economy has proved resilient in a
world of low oil prices is because of robust demand from the West for its higher value manufactured exports, whereas Chinese imports from Malaysia are down nearly 20 percent year to date. If the pivot east jeopardises other valuable trade links, the political payback to China will be costly.

First published Nov.3, 2016

Malaysian Prime Minister Najib Razak and his wife Rosmah Mansor stand with Chinese President Xi Jinping and his wife Peng Liyuan during a welcome ceremony for leaders attending the Belt and Road Forum, in Beijing's Great Hall of the People in Beijing, China, May 14, 2017. REUTERS/Wang Zhao/Pool
NAJIB'S FALL

Malaysia’s throws cheque book at 1MDB problem
By Una Galani

Malaysia will bear most of the burden of its sovereign fund scandal. Abu Dhabi helped the Southeast Asian nation finance 1Malaysia Development Berhad back in 2012. It subsequently looked like the Gulf emirate would share a large part of the multi-billion dollar fallout relating to the fund, now the focus of money-laundering probes around the world. But Malaysia is throwing its chequebook at the problem, paying up to try to repair relations between the two states before Prime Minister Najib Razak seeks re-election.

A debt settlement agreement announced on Monday addresses most of the lingering financial mess. 1MDB will repay a $1.2 billion loan to IPIC by the end of this year. It will also re-assume responsibility for two bonds, which will cost another $4.8 billion including interest.

Malaysia’s former Prime Minister Najib Razak prays before he attends the United Malays National Organisation 72th anniversary celebrations in Kuala Lumpur, Malaysia, May 11, 2018. REUTERS/Athit Perawongmetha

The Malaysian investor had initially played hardball with Abu Dhabi. It stopped paying coupons on the notes last year after the pair fell out over a separate $3.5 billion payment that
went missing. 1MDB paid that amount to an entity with a similar name to a unit of IPIC, which the latter has claimed it never received. Executives from the Abu Dhabi outfit were later named in U.S. lawsuits seeking to seize $1 billion of assets, which prosecutors claim were bought with money stolen from 1MDB. The pair have agreed to enter discussions about this final part of the dispute outside of court. But it is unlikely the funds will be fully recovered.

The entire agreement is backstopped by the Malaysian finance minister – Najib himself. So effectively the outstanding liabilities of 1MDB, now mostly a shell company, sit squarely with the taxpayer. That is, unless one or both sides renege on the deal, as they did with a previous settlement in 2015.

Najib is in a strong position ahead of a general election, which may take place later this year. The opposition is weak and he has few strong internal rivals within the ruling party. But the ongoing global investigations around the vehicle that he helped create could yet throw up nasty surprises – and this deal suggests Najib is uneasy of the threat that poses. Patching up relations with Abu Dhabi removes one potential source of bad news, and is the first step to repairing ties with a key ally, albeit at a high price.

First published April 27, 2017

1MDB poses fresh threat to Najib and Malaysia

By Una Galani

Najib Razak is a marked man. With a shock election defeat as prime minister, his top defence against the multi-billion-dollar scandal at 1Malaysia Development Berhad has gone. Old inquiries into allegations of misappropriated money at the sovereign fund may now reopen at home, and overseas investigators have less reason to go easy on him.

There will be domestic pressure to go after the key architect of the fund. The country’s leader-in-waiting, 92-year-old Mahathir Mohamad, said on Thursday that if Najib has done something wrong he would face the consequences. Indeed, the scandal was core to the campaign waged by Mahathir’s alliance and the opposition benefited from public animosity toward Chinese investments, which flooded into the country as a result of the financial fallout from 1MDB.

Reopening inquiries probably requires a new attorney general. At the height of the scandal in 2015, Najib effectively replaced the chief prosecutor who was investigating the fund. His successor then exonerated the premier, declaring some $700 million that appeared in his bank account was a “gift” from the royal family in Saudi Arabia. Najib has always denied any wrongdoing.

Overseas agencies also have leverage. 1MDB has been probed in six countries, including Switzerland and Singapore. U.S. Attorney General Jeff Sessions called the scandal “kleptocracy at its worst” after his department alleged $4.5 billion went astray. The complaints didn’t name the prime minister but did reference a Malaysian official with
responsibilities that matched the premier’s – and his stepson, Riza Aziz, is cited as having benefited from the stolen money.

Supporters of Mahathir Mohamad are seen outside of the National Palace, a day after general election in Kuala Lumpur, Malaysia, May 10, 2018. REUTERS/Athit Perawongmetha

By not naming him, the United States effectively went easy on Najib, rather than risk pushing him entirely into China’s embrace or destabilising the majority Muslim country. Now they may take their cue from the new government. The Americans could try to nail him as a gift to the new regime, in exchange for a promise to ally with the United States over China.

Yet if chased, Najib could be tempted into the dangerous politics of mutual destruction. Both he and Mahathir have been dogged by scandal. A Najib-led attack on the credibility of the new government could make an unpredictable situation much worse.

*First published May 10, 2018*
Malaysian elections

An alliance of opposition parties spearheaded by Mahathir Mohamad’s Pakatan Harapan (PKR) won Malaysia’s general election, official results showed on Thursday, setting the veteran strongman on course for a return to the prime minister’s office he occupied for 22 years.

PARLIAMENTARY ELECTION RESULTS
Seats taken by party

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STATES WON BY PARTY

Source: Malaysian Election Commission
C. Inton, 10/05/2018
Malaysian political shock may hold sting for banks
By Una Galani

1Malaysia Development Berhad is back to haunt banks. Wall Street fingerprints were all over the scandal in which billions of dollars from the sovereign fund were allegedly laundered overseas. After a shock election defeat for Najib Razak, the former prime minister, a new government led by 92-year-old Mahathir Mohamed could reopen enquiries and come after lenders involved in raising and moving money. That stirs things up the most for Goldman Sachs and Deutsche Bank.

Goldman pocketed eye-popping fees arranging three offshore bond deals in 2012 and 2013 that raised $6.5 billion for the fund. At its client's highly unusual request, Goldman even arranged to send almost half the proceeds to a small Swiss private bank. Even after the fee controversy, Deutsche arranged two further loans worth more than $1 billion for the already-indebted fund in 2014.

New Malaysian Prime Minister Mahathir Mohamad speaks during a news conference in Kuala Lumpur, Malaysia, May 11, 2018. REUTERS/Athit Perawongmetha

Investigative agencies have already done much of the digging. A local parliamentary report, in 2016, detailed suspect payments and the role of banks but stopped short of implicating Najib who denies any wrongdoing. Foreign agencies, led by the U.S. Justice Department, allege as
much as $4.5 billion was misappropriated although they received little support from Malaysian authorities, which cleared Najib after he effectively removed the chief prosecutor investigating the fund.

With help, foreign agencies could turn their focus from seizing assets – including a yacht, jewellery and a Picasso painting – to nailing Najib and the banks. That’s an unwelcome headache for Deutsche, which is struggling to restore profitability and curtailing its global investment banking ambitions. For Goldman, renewed attention on its past dealings comes just as the bank is enjoying a trading revival and expanding its retail banking arm. However, with Gary Cohn, former Goldman president, out of the Trump administration, going after the bank will be less awkward.

The best hope of reprieve rests with Mahathir. He has also been dogged by scandal, and may decide it’s not worth the trouble of reviving the 1MDB affair and inviting a potentially damaging counterattack by Najib. If he does seek to hold people and entities to account, lenders will almost certainly find themselves in the firing line sooner or later.

First published May 10, 2018

Malaysia can push for a healthy China rebalance
By Clara Ferreira Marques

Malaysia has a chance to rebalance its relationship with China. Newly elected Mahathir Mohamad has accused his predecessor of selling out to Beijing, and vows to review investment deals. The country’s strategic position and long-standing ties with the People’s Republic give him leverage to renegotiate. But the Malaysian economy still needs Chinese support, so the haggle will stay polite.

Outgoing Prime Minister Najib Razak bet heavily on cozying up to China. He capitalised on connections made by his father, Premier Abdul Razak Hussein, who established diplomatic ties with Beijing in 1974. When Najib was caught in a scandal around the 1Malaysia Development Berhad sovereign fund, Chinese officials lent a hand, purchasing power assets and real estate connected to 1MDB at generous prices.

Enlightened self-interest, perhaps, given President Xi Jinping was pushing his “Belt and Road” overseas influence initiative, and Malaysia made a perfect regional beachhead. Either way, Beijing’s largesse has been felt in this $300 billion economy. According to DBS research, China contributed roughly 20 percent of the increase in Malaysia’s foreign direct investment between 2013 and 2017. Chinese firms are leading projects like a $14 billion rail link connecting ports on the South China Sea to shipping routes off the west coast, while investing in new shipping terminals too.
Debt burdened

Malaysia’s debt-to-GDP ratio rose 13 pctl points under Prime Minister Najib Razak

![Graph showing Malaysia's debt-to-GDP ratio from 2009 to 2017](image)

Source: Thomson Reuters Datastream, data to 12/31/2017 C. Ferreira Marques | @Breakingviews

Belt and Road money has been less controversial in Malaysia than elsewhere, at least until campaigning ahead of this election. Critics complain of Chinese firms importing workers and crowding out local rivals, as well as murky contract terms. There are grounds for reviewing loan rates, preventing cost overruns, and maybe killing some projects entirely. Indonesia has trimmed its list of investment targets to avoid white elephants, but Malaysia hasn’t quite gotten around to it.

Mahathir can push back. China needs an ally in a region where it has many acquaintances but few friends. The country is already a regional hub for firms like Alibaba. Malaysia is in a key position geographically too, on the Strait of Malacca through which most of China’s oil imports are carried.

But the middle-income country needs a boost to achieve the developed economy status it covets. Chinese cash, properly guided and priced, can help, especially if technological cooperation helps upgrade local manufacturing and exports. The two sides have every reason to wrangle over the details, then agree to get along.

*First published May 11, 2018*
It’s too soon to cash Malaysian election dividend
By Clara Ferreira Marques

It’s too soon to cash a Malaysian election dividend cheque. A muted reaction by investors to the shock election victory of Mahathir Mohamad suggests some optimism over potential reforms. Higher oil prices will help. His past record and some early moves, however, give reason for pause.

Fears of extreme market turbulence after Malaysians voted out the ruling Barisan Nasional alliance last week, ending six decades of rule, have turned out to be exaggerated. In the end, there was a smooth transfer of power. Soothing, if vague, noises from Mahathir on supporting the $300 billion economy played a part, as did the swift appointment of a “Council of Elders” and a core cabinet.

Mahathir Mohamad, former Malaysian prime minister and opposition candidate for Pakatan Harapan (Alliance of Hope) celebrates his victory during a news conference after the Malaysian election, in Petaling Jaya, Malaysia, May 10, 2018. REUTERS/Lai Seng Sin
The appointment of former banker Lim Guan Eng to be finance minister is a good portent. A competent pair of hands who ran a successful state, he is also Malaysia’s first ethnic Chinese finance minister in 44 years, an important gesture from Mahathir, who backed Malay privileges as prime minister until 2003 and can now move away from such destructive policies. And it ends the structure implemented by Najib Razak, the long-time leader ousted by Mahathir, who was his own finance minister, too. Yet Lim also embodies the contradictions and tensions of the new alliance: he was twice jailed by Mahathir, in 1987 and 1998.

It’s far from clear that at 92, the man elected on a wave of discontent has changed into a reformer. Mahathir tolerated no opposition during his last tour of duty and consolidated power. There are already signs of strain in the new coalition, though. Senior figures from one party are suggesting cabinet appointments were made without broad consultation.

Keeping the alliance together is critical to strike the delicate balance between populist promises and the need to retain fiscal discipline, as well as to separate the state and business. Mahathir once backed large-scale projects like the Proton car at the expense of economic logic. Rooting out corruption in the country also requires more than just containing Najib and promising to investigate links to the $4.5 billion 1Malaysia Development Berhad scandal: moving fast to regulate party funding, support whistleblowers and make the anti-corruption commission independent would reassure more.

There are some small signs of scepticism. Shares of Opcom Holdings, a fiber-optic cable company run by Mahathir’s son, are up almost 50 percent. It’ll take considerably more evidence to believe Mahathir 2.0 will be a significant upgrade from version 1.0.

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Malaysia's Prime Minister Najib Razak speaks at the Khazanah Megatrends Forum in Kuala Lumpur, Malaysia, Oct. 6, 2015. REUTERS/Olivia Harris

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Cover: A man holds up a poster as pro-democracy group Bersih stages a 1MDB protest, calling for Malaysian Prime Minister Najib Abdul Razak to resign, in Kuala Lumpur, Malaysia, Nov. 19, 2016. REUTERS/Edgar Su