FINANCIAL HAVENS, BANKING SECRECY AND MONEY LAUNDERING

UNITED NATIONS
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FOREWORD

Ten years ago the United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances placed the issue of the proceeds of crime on the world agenda. Among the Convention's most important and innovative provisions were those which sought to overcome banking and financial secrecy laws where these present impediments to criminal investigations. Over the past decade, many member states have made great efforts to increase the transparency of financial dealings and to make financial and commercial records more accessible for bona fide investigations, with a view to giving effect to the anti-money laundering provisions of the Convention. Today we may look back at that progress, and at the challenges which lie ahead. While there has been a general trend toward enacting money laundering laws which provide for the lifting of financial secrecy in appropriate cases, such secrecy remains a barrier in many jurisdictions, including some of those which have come to be known as "financial havens". In addition, new laundering techniques have been identified, such as the increased use of professionals, corporate registration secrecy and certain types of trusts.

To give a picture of the problem today, at a time when the United Nations General Assembly Special Session on the world drug problem renews its commitment to "take the profit out of crime", I called upon four eminent experts to examine the issues of banking secrecy and financial havens in the context of the fight against money laundering worldwide. This study aims to stimulate discussion on bank secrecy and financial havens, but is not intended to necessarily reflect United Nations policy on the issue. In my view, it will serve as an important contribution to the debate on these issues. I hope that it will also enhance the international community's commitment to find solutions to the problems that continue to hamper the progress of financial investigations worldwide.

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I. Introduction

The major money laundering cases coming to light in recent years share a common feature: criminal organizations are making wide use of the opportunities offered by financial havens and offshore centres to launder criminal assets, thereby creating roadblocks to criminal investigations. Financial havens offer an extensive array of facilities to the foreign investor unwilling to disclose the origin of his assets, from the registration of International Business Corporations (IBCs) or shell companies, to the services of a number of "offshore banks" which are not subject to control by regulatory authorities. The difficulties for law enforcement agents are amplified by the fact that, in many cases, financial havens enforce very strict financial secrecy, effectively shielding foreign investors from investigations and prosecutions from their home country. While bank secrecy and financial havens are distinct issues, they have in common both a legitimate purpose and a commercial justification. At the same time, they can offer unlimited protection to criminals when they are abused for the purpose of "doing business at any cost".

These two issues are analysed in the present study because the recent history of international money laundering control makes it clear that the indiscriminate enforcement of bank secrecy laws, as well as the rapid development of financial havens, constitute serious obstacles to criminal investigations and jeopardise efforts undertaken by the international community since the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, 1988 (the '1988 Convention'), which first required the establishment of money laundering as a criminal offence.

The best example of the opportunities, and immunities, offered to money launderers by these means was BCCI - the Bank for Credit and Commerce International - which collapsed in 1991, uncovering the widest money laundering scheme ever and leading to the seizure of more than US$12 billion. The BCCI case, which is described in more detail in Chapter IV, generated a shock wave in financial markets and among the supervisory authorities of all countries affected by the scandal, forcing them to tighten up regulations to prevent the use of financial markets for money laundering purposes.

However, six years later, another prominent case was revealed following the bankruptcy of the Antigua-based "European Union Bank", demonstrating that the problem had gained a new dimension with the application of modern technologies. The European Union Bank was founded by two Russians, and is alleged to have been used to launder the illicit proceeds of the Russian organized crime. This bank, which was operating on the Internet, offered its clients (according to its advertisements on the net) " the strictest standards of banking privacy in offshore business" and the "financial rewards of offshore banking". Chapter IV further analyses the case of the European Union Bank.

There are important and sobering lessons to be learned from the experience with European Union Bank. Among the more important are the following:

Changes since BCCI have helped, but there are still important gaps in the regulation of offshore banking by bank secrecy jurisdictions that can all too easily be exploited by criminals of various kinds.

The Internet and World Wide Web offers a whole new dimension for encouraging money laundering, fraud and various kinds of scams.

The experience highlighted that the concept of a bank is becoming increasingly elastic, a development vividly encapsulated in the comments of one auditor that some banks are little more than "closets with computers".

The central problem with virtual banks is that there is virtually no oversight, not least because it is not clear who has jurisdiction or where the crime is committed. As one observer noted in testimony before the US Congress, European Union Bank operated on a license from the government of Antigua. "The computer server was in Washington, DC. The man who was operating both the bank and the computer server was in Canada. And under Antiguan law, in effect, the theft of the bank's assets were not illegal. So now the problem is, where is the crime committed, who committed it, who is going to investigate it, and will anyone ever go to jail?"

The willingness of at least some offshore banking jurisdictions to encourage new financial institutions without imposing adequate safeguards or due diligence – a development characterized later in this report as the selling of sovereignty.

In short, bank secrecy and offshore banking offer multiple opportunities for money laundering and various other criminal activities. In the early and mid-1980s the Permanent Investigations Subcommittee of the Committee on Governmental Affairs in the United States Senate held a series of hearings on offshore banking and bank secrecy. The chairman, Senator William Roth, noted that "we have repeatedly heard testimony about major narcotics traffickers and other criminals who use offshore institutions to launder their ill gotten profits or to hide them from the Internal Revenue Service. Haven secrecy laws in an ever increasing number of cases prevent U.S. law enforcement officials from obtaining the evidence they need to convict U.S. criminals and recover illegal funds. It would appear that the use of offshore haven secrecy laws is the glue that holds many U.S. criminal operations together"
. If the immediate reaction to this is that little or nothing has changed in the last decade and a half, a more considered assessment might suggest that, in fact, the situation has deteriorated with a much larger cast of characters now using offshore financial centers for criminal purposes.

Overview

This report examines the world of offshore financial centers and bank secrecy jurisdictions in the context of the control of money laundering and financial crime. It looks at offshore financial centers and bank secrecy jurisdictions as facilitators of money laundering and other forms of crime, elucidates the ways in which they are used by

criminals and identifies a series of remedies or counter-measures that would block or at the very least diminish the attractions of these havens. Section II outlines the various stages of money laundering, warns against using the term in a loose or promiscuous manner, and identifies various kinds of secrecy that facilitate money laundering and other crimes. Section III of the report looks at the legitimate as well as the criminal uses of offshore financial and bank secrecy jurisdictions and explains briefly how bank secrecy and offshore banking evolved. It locates offshore banking and bank secrecy jurisdictions within the global financial system, suggesting that the system is a highly congenial one for both licit businessmen and for those trying to launder and hide the proceeds of crime as well as those who typically exploit loopholes and variations in tax and other laws.

Jurisdictions which offer high levels of secrecy, and a variety of financial mechanisms and institutions providing anonymity for the beneficial owners are highly attractive to criminals for a wide variety of reasons including the potential cover and protection they offer for money laundering and various exercises in financial fraud. Not all offshore financial centers and bank secrecy jurisdictions provide the same services, however, and there are important differences in the schemes they offer to ensure anonymity, the extent of the secrecy they provide, and their willingness to cooperate with international law enforcement investigations. Consequently, this section also provides an overview of what might be termed the geography of offshore banking and bank secrecy. Section IV looks at the way in which offshore financial centers and bank secrecy jurisdictions are used by criminals, highlighting not only the way in which money is often moved to and through offshore banks or bank secrecy jurisdictions as part of money laundering efforts, but also other ways in which offshore jurisdictions are used by criminals. Section V looks at offshore banking and bank secrecy as inhibitors and facilitators for law enforcement investigations, with attention to both de jure and de facto limits to cooperation. Section VI looks at issues for consideration in relation to preventive and control measures that might be taken to enhance compliance with the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, 1988 (the '1988 Convention') and to make it more difficult for money launderers and other criminals to exploit particular banking jurisdictions with the ease and benefits they do at the moment.

II. The Money Laundering Cycle in Action

Introduction

Efforts to curb the laundering of criminally-derived incomes have only recently assumed a prominent position on the priority list of law enforcement agencies; and the very term "money laundering" is of quite recent vintage. Yet it is safe to say that as long as there has been the need, whether for political, commercial, or legal reasons, to hide the nature or the existence of financial transfers, some sort of money laundering has occurred.

In Medieval times when the Catholic Church banned usury, making it not only a crime but (rather like the status achieved by drug trafficking today) a mortal sin, merchants and money-lenders intent on collecting interest on loans engaged in a wide variety of practices that anticipated modern techniques for hiding, moving, and washing criminal money. The central objective was to make interest charges either disappear altogether (hiding their existence) or appear to be something other than what they were (disguising their nature).

This deception could be accomplished in several ways. When merchants negotiated payments over long distances, they would artificially inflate the exchange rates sufficiently to cover interest payments as well. They would claim that interest payments were a special premium to compensate for risk. They would make interest appear to be a penalty for late payment – with lender and borrower agreeing in advance that such a delay would take place. They would pretend that interest payments were really profits by using something similar to today's "shell companies" (companies that have no real operational role). Capital would be lent to the company and then taken back again, supposedly in the form of profits rather than of interest on the loan, even though no profits had really been made. All of these tricks to deceive the Church authorities have their rough equivalents today in the techniques used to launder criminal money flows.

If money laundering can be said to have a long history, so too can the financial havens that are so often a necessary part of it. Among the early users of such havens were the pirates who preyed on European commerce in the Atlantic during the early 17th Century. There were places that openly welcomed the pirates for the money they would spend. And when the time came to retire from the business, pirates often sought safe havens abroad. Mediterranean city states, much like some of today's financial haven jurisdictions, competed to have pirates (and their money) take up residence.

On the other hand, sometimes their loot was used to buy pardons to permit them to return home. In fact, the year 1612 may have witnessed the first modern amnesty to criminal money – England offered pirates who abandoned their profession both a full pardon and the right to keep their proceeds, anticipating by more than three and a half centuries similar deals requested by prominent drug barons from some modern states. Nor are notions of asset-seizure in criminal cases novel. Many of the antecedents of

modern laws facilitating the freezing and confiscating of criminally-derived income and wealth have their roots in Medieval European notions of deodand ('gift to God'), and have come down into modern law in many countries through the English Common Law tradition. Originally most forfeitures were a penalty for political rather than economic offenses. Later, under Common Law, any felony conviction could lead to forfeiture of wealth and estates. While forfeitures are no longer used in such a sweeping way, in one respect there is basic continuity. Early forfeitures were justified in public in much the same terms as modern asset-seizure laws, namely by their deterrent effects; in fact, again like some modern forfeiture laws, it was often more because of their usefulness in raising revenues for the Crown.

Even after the practice of automatically stripping all felons of their wealth died out, forfeitures continued to be applied in peacetime to enforce Customs regulations and in wartime against enemies or enemy sympathizers. It is from those traditions – seizures in contraband cases and the notion of societies at war (drug wars or crime wars now replacing military ones) that most of the rationalization for modern asset forfeiture derives.

While acts of money laundering, use of financial havens, and applications of asset-seizure laws (and even "black money" amnesties) all have historical precedents, not until very recently has the act of attempting to launder criminally-derived income and wealth been made a crime per se. Traditionally the focus was on the underlying offense generating the money. Asset seizures, to the extent they were used in economically motivated crimes, were punishment for that underlying offense. Today there has been a radical change. Started first by the U.S. in 1986 and progressing rapidly around the world, the trend is now to criminalize the very act of laundering money, and to make the act of laundering, completely independently of the underlying offense, grounds for asset-forfeiture. In fact, in some jurisdictions that have taken this path, laundering the proceeds of crime can lead to far more severe penalties than the underlying offenses.

This has not occurred without considerable controversy. The problem has been that there is something quite unique about the crime of money laundering. Unlike the underlying offenses, be they drug trafficking or armed robbery, illegal toxic-waste dumping or extortion, money laundering consists of a set of actions each of which is innocent by itself, but which in total add up to an attempt to hide the proceeds of a criminal act. It is not always immediately obvious to persons outside law enforcement what harm has been done by money laundering, who (leaving aside fiscal considerations) has been injured and therefore why it should be an offense at all. That difficulty of convincingly demonstrating the harmful effects of money laundering goes far to account for the delays and hesitations in making money laundering a crime. In many jurisdictions it still is not.

However, there is no doubt the current trend is in the direction of criminalizing money laundering all over the world. There are several reasons. One is acceptance of the theory that it does little good to attack criminals while leaving the proceeds untouched – the net profits form both the motive, personal enrichment, for the underlying offense, and

they constitute the means, working capital, for further crime. There is also the presumption that in the past those who committed the offenses might be punished, but those, like the willing money managers who facilitated it, went unscathed, a situation that required rectification.

There have also been more immediately practical reasons. Money laundering statutes are seen as a handy tool, not just for widening the enforcement net to include previously exempt categories of participants in criminal acts, but also for creating a means for loading potentially heavier sentences onto those charged with the underlying offense, and for therefore using the threat of such heavier charges for deal-making and securing cooperation. Not least, there is a trend to use asset-forfeiture laws that are so often a part of the anti-money laundering drive as a device for financing police activities.

Money Laundering: Definition and Purpose

Today money laundering attracts the most attention when associated with trafficking in illicit narcotics. However enterprise criminals of every sort – from stock fraudsters to corporate embezzlers to commodity smugglers – must launder the money flow for two reasons. The first is that the money trail itself can become evidence against the perpetrators of the offense; the second is that the money per se can be the target of investigation and action.

Legitimate business corporations, too, might have recourse to the techniques of laundering whenever they need to disguise the payment of a bribe or kickback. In the current climate, where there has been a highly publicized backlash against corporate and public-sector corruption, laundering in bribery cases is likely to attract an increasing amount of attention. In fact even governments make occasional use of the same apparatus – whether to dodge reparations, evade the impact of sanctions or covertly fund political interference in some rival state.

Regardless of who actually puts the apparatus of money laundering to use, or what strange twists and turns it takes, the operational principles are essentially the same. Strictly speaking, money laundering should be construed as a dynamic three-stage process that requires: first, moving the funds from direct association with the crime; second, disguising the trail to foil pursuit; and, third, making the money available to the criminal once again with its occupational and geographic origins hidden from view . In this respect money laundering is more than merely smuggling or hiding tainted funds, though those acts may constitute essential constituents of the process.

Perhaps the most logical way to keep the nature of the process of laundering distinct from some of its constituent parts is to stress the difference between hiding the existence of criminal money and disguising its nature. If criminal money is hidden from the view of the law – for example, if it is spent in the form of anonymous cash or moved to a jurisdiction where there are no sanctions against the use of money of illegal origin – it can scarcely be described as “laundered”. All that has happened is that criminally

derived money has had its existence hidden from the law enforcement authorities of the place where the underlying offense has been perpetrated. However,

Box 1: The money laundering cycle

if the money is given the appearance of legitimate provenance in a place where sanctions against its illegal origins do exist, then and only then can it be said to be truly laundered – it has had its nature disguised.

Money Laundering and Tax Evasion

The nature of the laundering process raises important issues of tax enforcement. By definition, criminal money attempts to evade the scrutiny of the authorities, including the fiscal ones, while it is being earned. However, once it is laundered, that is no longer the case. Although there are several points at which tax evasion and money laundering share techniques and can be mutually supporting, it is important to understand that operationally they are quite distinct processes. In general tax evasion involves taking legally earned income and either hiding its very existence (if, for example, it is skimmed in cash) or disguising its nature (by making it appear to fall into a non-taxable category). In either event it turns legal income into illegal. Money laundering does the opposite. It takes illegally earned income and gives it the appearance of being legally earned. In terms of their impact on the fiscal position of the state, evasion, and laundering also have quite opposite effects.

Earnings of a legal enterprise can be thought of as falling roughly into two categories. Part of the gross proceeds is used to cover expenses, including wages, material costs and interest payments due to those who lent operating funds. Part is left over as profit – which in turn can be either reinvested or distributed to owners who may consume it or save it.

However, when illegal goods and services are sold, the results are different. As before, part of the gross proceeds of illegal activity is used to cover expenses of operation; and part represents profit, some of which may be reinvested and some distributed to owners. But there is a further division. Regardless of whether earnings are used to cover expenses or to reward owners, some remain in the illegal sector and some may be recycled into the legal one. Of that which surfaces in the legal economy, part may be used to meet expenses owed to illegal suppliers; part may be used to meet expenses owed to legal suppliers; and part may become the apparently legitimate property of the owners of the business, who, in turn, may reinvest it in illegal business, reinvest it in legal business, consume it or save it (by acquiring legitimate assets). The actual form the laundering process takes will depend at least to some degree on the intended disposition of the funds.

However, one thing remains true. All of the portion of the criminal earnings that appears in the legal economy potentially attracts the attention of the fiscal authorities. Undoubtedly criminals are as eager as any other entrepreneurs to reduce their fiscal burden, but some such burden is almost inevitable. Tax evaders under report the earnings

of their legal enterprises, thereby paying less tax than they legally should. Criminals, by contrast, over report the earnings of any legal enterprises they use for cover, therefore paying more tax than their legitimate front companies would normally be required.

This is not to suggest that the state would be fiscally better off if legitimate businesses which evade taxes on their legally earned income shifted to explicitly criminal activity on which some taxes got paid! Clearly even though criminals pay some taxes on the portion of their illegal earnings that is laundered, overall they will evade taxes on as much of their overall earnings as possible. The point is that, contrary to the stereotype that sees criminal activity as an off-the-books, unrecorded, and untaxed activity (with its existence hidden from the authorities), once the money is laundered it becomes at least in part on-the-books, recorded and taxed, albeit with its precise nature disguised.

Perhaps the easiest way to understand the distinction is to consider the example of the market for illicit sexual services. A prostitute working the streets might accept cash – the transaction is anonymous, it does not enter the national income accounts of the country and it escapes both formal regulation and taxation. But a prostitute working through the front of a legally-registered escort agency or massage parlor might well be paid through checks or credit cards – the transaction is recorded, but it enters the national economic statistics in a misreported way; and it is subject to at least some degree of taxation. In the second example the earnings are laundered – their nature is disguised rather than their existence hidden.

The Apparatus in Action I: At Home

The term "money laundering" seems to have been coined in the U.S. in the 1920s when street gangs would seek a seemingly legitimate explanation for the origins of the money their rackets were generating. Their reasons for so doing were varied – to hide their material success from corrupt police intent on collecting protection payments, to avoid attracting the (often brutal) attention of envious competitors, or, a little later, to evade the possibility of tax evasion charges, something discovered in the early 1930s to be a powerful weapon against otherwise impregnable criminals.

To accomplish these goals, the street gang might take over cash-based, retail service businesses. The most popular choices were clothes-laundries and car-washes – hence, it seems, the origin of the term. However, other businesses, such as vending-machine service companies, could function almost as well. The point was to mix illegal and legal cash and report the total as the earnings of the cover business. In so doing, all three stages of a classic money laundering cycle were combined in essentially one step – the money was distanced (physically or metaphysically) from the crime, hidden in the accounts of a legitimate business, and then resurfaced as the earnings of a firm with a plausible reason for generating that much cash. Simple though that process appears to be, it has remained the core of most money laundering strategies, no matter how apparently complex.

There are a wide variety of techniques available today by and through which money can be laundered. The choice depends partly upon the following criteria:

The immediate business environment. While in principle there is no limit beyond imagination to the fronts through which and forms in which money can be laundered, in practice, launderers try to make their choices reflect as closely as possible the profile of normal business in the area and jurisdiction in which they are operating.

The orders of magnitude. Small sums laundered periodically will suggest quite different techniques than comparatively large amounts.

The time factor. The technique chosen will likely reflect whether the operation is a once-and-for-all or sporadic event, or something to be conducted on an on-going basis. It will reflect as well the degree to which haste is essential.

The amount of trust that can be accorded to complicit institutions and individuals. This requires a judgement about how much they have at stake in co-operation or betrayal and where, on the fear-greed trade-off curve, they happen to be.

The record of law enforcement. Laundering requires time and money. How much energy and expenditure will be put into the effort to multiply levels of cover and obscure the trail will depend on an assessment of how serious and effective police probes are likely to be in the place or places where the process is conducted.

The planned long-term disposition of the funds. Money may be subjected to differing processes depending on whether it is designed for immediate consumption, for savings in visible or invisible forms or for reinvestment.
The simplest forms of laundering take place strictly within the jurisdiction in which the underlying offense has been committed. If the sums involved are relatively small and/or episodic in nature, there are a number of techniques in which all three stages of the laundering cycle can be neatly combined. Race tracks are classic examples – the launderer simply uses his/her illegal cash to purchase winning tickets, probably paying the true winner a premium, and then presents the ticket for payment. The funds can therefore be accounted for as legitimate earnings from gambling. This is a technique with a long history, and it continues to be used today.

Much the same can occur with state lotteries – there have even been brokerage rings buying winning tickets and reselling them to persons with money to launder. An additional advantage of lottery schemes is that winnings are often tax free.

More sophisticated techniques using the same general principle can be run with the aid of stock or commodity brokers. The person seeking to launder money buys spot and sells forward, or the reverse – one transaction records a capital gain, the other a capital loss. The broker destroys the record of the losing transaction and the launderer exits with the money now appearing as capital gains. The cost is the double commission plus any hush money demanded by the broker.

Similarly with property deals. Someone seeking to wash money will purchase a

piece of property, paying with formal bank instruments and legitimately earned money for a publicly recorded price that is much below the real market value. The rest of the purchase price is paid in cash under-the-table. The property is then resold for the full market value and the money recouped, with the illegal component now appearing to be capital gains on a real estate deal.

Such techniques, while seemingly popular, are usually employed only episodically and for relatively small sums. No one can convincingly appear lucky at the track too often. To handle on-going flows of criminal money, recourse is usually had to a cash-based retail service business – car-washes and laundries, video-game arcades and video-cassette rental stores, bars and restaurants have long been favorites. The principle is simple – the illegal money is mixed with the legal and the entire sum reported as the earnings of the legitimate business.

When the sums become larger and law enforcement in the immediate jurisdiction seen as particularly dangerous, the laundering process will more likely involve an international dimension. At that point the three stages in the cycle become both logically and chronologically distinct.

The Apparatus in Action II: Moving the Money Abroad

The first task is to move the funds from the country of origin. That can be done by either sidestepping or working through the formal banking system. If the decision is made to sidestep the system, the most popular method appears to be shipping money abroad in bulk cash. Sometimes items like diamonds or gold or even precious stamps and other collectibles are also used – the criterion is that they be of high value in relation to bulk making them physically easy to smuggle, as well as relatively easy to reconvert into cash at the point of destination. However, clearly cash is far more important than valuable commodities.

Although an increasing number of countries demand the reporting of the export of all monetary instruments, the record of success is not very encouraging. Bulk cash, particularly in large denomination bills, can still be easily carried out of a country in hand-luggage. While the U.S. $100 bill is the favorite, others exist that could be useful provided the currency is well-known and universally accepted – the largest denomination Deutschmark and the Swiss franc notes would qualify whereas the Singapore dollar, available in $10,000 denominations, would probably be used only rarely and within a limited geographic area. Even if controls on hand luggage are tightened, bulk cash can be easily moved through checked personal luggage, particularly if the passenger travels by ship. And of course the money can be stuffed into bulk commercial containers whose sheer volume defeats any systematic efforts to monitor them. To the extent detection does occur it is the result of either blind luck or informants' tips. Clearly the problem of currency smuggling will increase as world trade grows, borders become more open to both people and goods and currencies become more convertible.

The person whose funds are to be moved does not have to assume the risk by

themselves. There are professional courier networks who will handle the job and guarantee delivery. It is sad to report that among those couriers are sometimes those possessing diplomatic passports – they and their effects are at least partially immune from search and, in any event, they may be subject to little more than deportation if caught. There is an open traffic in diplomatic credentials that should be curbed.

Alternatively recourse could be had to various lateral transfer schemes. These work through the simple principle of compensating balances that has long been used in legitimate trade, particularly when dealing with countries that have exchange controls and/or legally inconvertible currencies.

Consider the example:

Assume Business I in country A owes $X to Business II in country B.
Assume Business II in country B owes $X to Business III in country A.

To settle the debts without compensating balancing:

Business I would ship $X to Business II
Business II would ship $X to Business III

This requires two international transfers and four distinct withdrawal and deposit transactions.

To settle the debts with a compensating balance all that happens is that Business I in country A settles the debt owed by Business II to Business III in country A. There are only two banking transactions, from the account of Business I to the account of Business II and no international transfers.

Obviously in reality the mechanics are much more complex, the sums do not exactly balance and the exchanges are usually multilateral. Still, the principle remains intact. The practice is commonplace, and there are even financial brokers who specialize in arranging such transfers.

However the compensating balance principle is also the basis of operation of the so-called underground banking systems which are becoming more and more popular today as ethnic diasporas grow. Someone in country A seeking to move funds abroad contacts the underground banker and deposits a certain sum. The underground banker sends a coded message to his/her correspondent abroad to credit the equivalent of the deposited sum (less the fee) to a foreign bank account held in the name of the person seeking to move the money out of country A. No actual funds have to move. And the offsetting transaction occurs when someone else abroad attempts to move money back into country A. It is neat and untraceable, particularly when cemented by bonds of extended family trust typical of some ethnic communities living and conducting business abroad.

Nonetheless it cannot be stressed too often that, like so much "informal finance", techniques of underground banking really have benign origins. They were evolved for perfectly legitimate purposes, reflect institutional underdevelopment and/or unfamiliarity with or lack of confidence in the formal banking systems, and have been, in some cases, unfairly targeted by law enforcement officials for criticism. It is impossible to avoid the conclusion that ethnic and cultural misunderstandings, even on occasion prejudice, have played a role in some of the adverse attention focused on these so-called underground banking systems. They can indeed be used for criminal purposes – so too can life insurance companies and nursing homes.

When the decision is made to send criminal money abroad using the formal banking system, additional precautions are required. Any large cash deposit potentially attracts attention. There are also jurisdictions that subject large cash deposits to some form of additional mandatory scrutiny. This can vary from the U.S. model of automatic reporting of sums above a certain threshold to others that rely instead on suspicious transaction reports.

Enormous backlogs of information are generated by cash transaction reporting systems, a problem that will be only partially solved by electronic filings on the Australian model. Ultimately cash deposit reports, whether in paper or in electronic form, are of little use unless there are, not just the resources to process them, but personnel who know what they are looking for. Yet, to date knowledge about the nature, structure and operation of illegal markets remains so rudimentary, there is little logic to piling up raw information until some of those gaps in understanding are addressed.

Equally notorious, in response to the cash transaction reporting systems, are the multiple schemes launderers have devised to get around the reporting rules – prior conversion of cash to checks through formal or informal check-cashing services, breaking cash deposits down to sums below the reporting threshold, securing an exemption from reporting, and even bribing bank staff.

However whichever system of formalized scrutiny, if any, is in operation, one rule remains. Large deposits (whether in cash or in checks) with no apparent justification potentially attract attention. Unlike the situation even a decade ago, so much public attention has been focused on instances when banks accepted huge bundles of cash from unknown parties and either wired it abroad or converted it into bearer instruments, this avenue is likely going to be used less often. Successful money laundering today probably requires working through a front business, one that has a credible explanation for its level of deposits and – something vital when the next stage begins – an equally credible explanation for moving the funds abroad.

Such a company would be one that engages regularly in international trade in goods and/or services. A clever laundering operation would assure that any "payments" it makes to supposed suppliers abroad are in odd rather than round sums, and those sums are not repeated. It might also divide the payments between "suppliers" in several countries, alternate between wire and written forms of remittance and ensure that the nominal recipients appear to have sound business reputations. Although services are the best, for there are no clear rules against which to check the prices being charged to the

domestic company, there is some evidence trade in physical goods can be used as cover for criminal money transfers too. Recent investigations by two university professors in Florida revealed huge discrepancies in the prices at which commodities enter and leave the U.S. when compared both against international norms and even from country to country. Although most such price discrepancies are likely accounted for by tax evasion or capital flight, there is likely to be elements of money laundering as well.
The above actually points to a potentially fatal weakness in money laundering schemes which may not have been sufficiently exploited. The usual presumption of law enforcement is that once the money is inside the banking system, most of the battle is lost. Accordingly much of the regulatory effort is put into building, if not barriers, then at least screening mechanisms against that happening. However money inside the domestic banking system is not yet money inside the international banking system. And there is an asymmetry in the types of front companies needed for these two distinct transactions. If the best cover for placing deposits inside the domestic financial system is a cash-based retail service business, the best cover for sending money abroad is a company that engages in international trade in goods and services. There are serious grounds for questioning why a company engaged in domestic retail services should be sending significant sums abroad, especially if done on a regular basis. And there are serious grounds for wondering why a company engaged in international trade in goods and services (which is, by definition, a wholesale operation) should have large sums of cash deposited in its domestic accounts. Such anomaly can serve as a red flag to alert bank staff that something requires further explanation.

The Machinery in Action III: Seeing the World

Once the money is abroad, it is time for stage two of the laundering cycle, moving it through the international payments system to obscure the trail. Despite a myriad of complications, there is a simple structure that underlies almost all international money laundering activities during this stage of the process.

Contrary to popular stereotypes, only the rankest of amateurs would arrive at the front door of a Swiss bank with a suitcase of high-denomination U.S. bank notes and demand to open a “numbered” account.
That would undoubtedly both begin and end the would-be launderer’s life of crime. To be sure, Switzerland has not lost all of its appeal as a financial haven. It is stable politically; the Swiss franc is strong and well respected; the country plays a major role in the world gold market; and it has a variety of banking institutions ranging from powerful multi-functional institutions well represented all over the world that combine commercial and investment banking with fund management and stock brokerage services to small, discrete private banks specialized in handling the affairs of the “high net-worth individual”.

But, progressively over the last two decades the Swiss authorities have reduced the protection afforded by the country’s famed secrecy laws, signed treaties of cooperation in criminal investigation with other countries, and moved actively and rigorously to freeze suspect accounts in everything from embezzlement to insider trading

to drug trafficking cases. Switzerland also made money laundering a crime per se. Undoubtedly, given the size and historical reputation of the Swiss financial system, much criminal money still seeks refuge there. But, it cannot be said that Switzerland rolls out the welcome mat for drug money (that deriving from tax and exchange control evasion is quite another matter); and most such money that does arrive in Switzerland probably now is subject to a pre-washing elsewhere.

Well before a reasonably sophisticated money launderer will attempt to establish a bank account in any haven jurisdiction there are preliminary steps to be taken. Bank secrecy can often be waived in the event of a criminal investigation. It is for that reason criminal money is normally held not by an individual (even with a "numbered" account) but by a corporation. Prior to the money being sent to Switzerland, Austria, Luxembourg or any other financial haven, the launderer will probably call on one of the many jurisdictions that offer an instant-corporation manufacturing business. Liberia, the Cayman Islands, the British Virgin Islands and Panama are among the favorites, though there are many others that sell "offshore" corporations which are licensed to conduct business only outside the country of incorporation, are free of tax or regulation and are protected by corporate secrecy laws. Preferably for the launderer, such a company will already have a history of actual activity to increase the appearance of legitimacy. Once the corporation is set up in the offshore jurisdiction, a bank deposit is then made in the haven country in the name of that offshore company, particularly one whose owner's identity is protected by corporate secrecy laws. In that way there is between the law enforcement authorities and the launderer, one level of bank secrecy, one level of corporate secrecy, and possibly the additional protection of client-attorney privilege if a lawyer in the corporate secrecy haven has been designated to establish and run the company.

In addition, many laundering schemes devise yet a third layer of cover, that of the offshore trust. There are many perfectly legal reasons for the establishment of offshore trusts, some rather dubious ones (dodging decisions of tax or divorce courts being the most common) and a few that are clearly illegal. The advantage of a trust is that the owner of assets conveys that ownership irrevocably to the trust, and therefore prevents those assets from being seized by creditors. Offshore trusts are usually protected by secrecy laws and may have an additional level of insulation in the form of a "flee clause" that permits, indeed compels, the trustee to shift the domicile of the trust whenever the trust is threatened – by war, civil unrest or even by probes from law enforcement officers. The obvious disadvantage is the nominal loss of control by the owner – in theory a deed of trust is irrevocable; and the former owner can influence, but can not control the actions of the trustee.

In the past Liechtenstein was a favorite place in which to set up such a trust. In fact, it was probably the only jurisdiction that is not part of the English Common Law tradition to have such facilities. The Liechtenstein anstalt, unlike most trusts, is a commercial entity capable of doing business; and it could make the transferor of the assets the ultimate beneficiary, thereby undermining the notion that the conveyance was irrevocable. Today, however, the very term anstalt in a company name can serve as yet another red flag for revenue authorities and law enforcement officers. As serious a

problem are the many former and current British dependencies that offer “asset-protection trusts”. If suitably set up, they can convey all of the advantages of the Liechtenstein model. Typically, assets would first be conveyed to an offshore company; control of the company would be transferred to the offshore asset-protection trust; the person transferring the assets would arrange to be appointed manager of the company; and the trust deed might stipulate that the transferor of the assets had the right to buy them back again for a nominal sum, thereby respecting the letter of the law of trusts while undermining its spirit.

Whatever the exact form it takes, the offshore asset-protection trust creates yet another layer of secrecy and security in a money laundering scheme. And it can be complemented by yet more tricks and devices. Companies can be capitalized with bearer shares so there is no owner of record anywhere – the person who physically possesses the share certificates owns the company. There can be multiple systems of interlocking companies all incorporated in different places, forcing law enforcement officers to proceed from jurisdiction to jurisdiction peeling them away like layers of an onion. There can be multiple bank transfers, again from country to country, where each transfer is protected by secrecy laws that must be breached one at a time. The funds transfer trail can be broken on occasion with the launderer picking up the money in cash from a bank in one place, redepositing it in a bank somewhere else, and then wiring it to yet a third location. The trail can be further complicated if the launderer has purchased his/her own instant-bank in one of several jurisdictions offering such facilities and made sure his/her bank was one of those through which the money passed, then winding up the bank and/or destroying the records
.

Once the funds have been moved through the international financial system sufficiently to make their origins extremely difficult, if not impossible, to trace, it is time to move them home again, to be enjoyed as consumption or employed as capital.

The Apparatus in Action IV: Heading Home

Many techniques can be used for this stage. Ten (among many) possibilities are listed below:

Funds can be repatriated through a debit or credit card issued by an offshore bank. Withdrawals from ATM machines or expenditures using the card can be settled either by automatic deduction from a foreign bank account or by the card-holder periodically transferring the required funds from one foreign bank account to another. Debit cards are superior from the point of view of automaticity and confidentiality. However, even an ordinary credit card can be turned into a debit card by being secured through the deposit of collateral with the issuing bank. Although secured credit cards were initially intended to give persons who were deemed a bad credit risk the advantages of use of a credit card, something that is increasingly essential for many purposes such as reserving hotel rooms or renting cars, it can be very useful to anyone seeking to lower their financial profile.

Bills incurred in the place of residence can be settled by an offshore bank or, even

more discretely by an offshore company. In fact, persons seeking to use at home illegal money held abroad need not even bother to work through their own offshore accounts and shell companies. There are firms who advertise their willingness to handle for clients all of their major payments – utility bills, regular car or mortgage payments etc. The client makes a deposit from his/her offshore account to that firm's offshore account and sends bills or payment instructions to the firm.

One method, so far known to be used only for U.S.-Mexico transactions, is through certain kinds of bank drafts. These are either sold outright by a bank or issued to account holders against the security of their current balances. The Mexican drafts had no payee named on them, yet were guaranteed by the bank, making them virtually as good as cash. They would be redeemed by U.S. banks with a correspondent relationship with the issuing institution even if the individual cashing the draft had no account. Historically they have been used for transactions between people like Mexican farmers who had limited or non-existent credit ratings and U.S. merchants. But they could also be used for more nefarious purposes. Someone might smuggle cash to Mexico, deposit it in a U.S. dollar account, draw out a draft, mail or carry it into the U.S., deposit or cash it in a U.S. bank – with no requirement under U.S. .law for the bank to report the transaction. Once cashed the draft returned to Mexico, and the issuing bank wired payment to the cashing bank, often in a bulk payment to cover a number of drafts at the same time, thus further obscuring the trail. The same kind of transaction could well be occurring in many countries using drafts issued by the banks of many other countries.

Visibility can be reduced through use of a payable-through account. Instead of securing a license to operate in one country, a foreign bank can open a correspondent master account with a bank in the host country and allow its clients to draw checks on the bank's master account. The account remains legally in the name of the foreign bank. The dangers of these accounts have been highlighted in particular by the U.S. authorities.

Money can be brought back disguised as casino winnings. Money would be wired from the criminal's offshore bank account to a casino in some tourist center abroad. The casino pays the money in chips; the chips are then cashed in; and the money is repatriated via bank check, money-order or wire transfer to the criminal's domestic bank account where it can be explained as the result of good luck during a gambling junket. This, of course, is a trick usable only sporadically: "winning" too often will attract attention.

Another option is for the criminal to use international real estate flips. Here the criminal arranges to "sell" a piece of property to a foreign investor – who is, in reality, the same criminal working through one or several offshore companies. The "sale" price is suitably inflated above acquisition cost, and the money repatriated in the form of a capital gain on a smart real estate deal. If the property is a personal dwelling, there is, in some fiscal jurisdictions, an added bonus – the capital gains are tax-free. Like the casino caper and for the same reasons, international real estate sham sales can only be used on an occasional basis.

Preferable in that regard is bogus capital gains on options trading. Unlike with real estate, it is perfectly normal and expected that someone would trade securities

regularly. In fact, frequent securities transactions each “making” modest capital gains are less likely to attract unwanted attention than the occasional major gain. The trick is to "buy" and "sell" a currency, commodity, or stock option back and forth between foreign and domestic companies. The onshore company records a capital gain and the foreign one a capital loss. This works even better if the foreign company is incorporated in a place with secrecy laws. Such a wash trade is perfectly safe since the domestic authorities cannot audit the books of the offshore entity.

For truly regular income flows the criminal might arrange to collect the money in the form of income rather than gambling receipts or capital gains. Personal income is easy to arrange. The criminal simply has one or more of his/her offshore companies hire him/her as an employee or, better, as a consultant. In effect the criminal can pay himself/herself a handsome salary or generous consulting fees out of the offshore nest-egg and perhaps throw in a company car or a condo in some prime living spot on top. Granted this usually attracts the highest personal tax rate – but that can be partially obviated by having as much of the "consulting fees" as seems credible paid to cover "expenses" which are then deducted from the taxable component of the income.

The criminal might also choose to repatriate the money as business income. It is merely a matter of setting up a domestic corporation and having it bill an offshore company for goods sold or services provided. If commodities are the chosen vehicle, it is safer that they actually exist and are overvalued (if on the way out) or undervalued (if on the way in), rather than completely fake. It is easier to argue with Customs inspectors who might check the shipment about the declared value of a good than it is to try to explain a shipment of empty crates. Once abroad the goods can be dumped – on the black market or into the sea. The same can happen with services, in this case without the need to be bothered with physical inventory.

Probably neatest of all, the money can be brought home in the form of a business "loan". The criminal arranges for money held in an offshore account to be "lent" to his/her on-shore entity. Not only is the money returning home in completely non-taxable form, but it can be used in such a way as to reduce taxes due on strictly legal domestic income. For once the "loan" has been incurred, the borrower has the right to repay it, with interest, effectively to himself/herself. In effect, the criminal can legally ship even more money out the country to a foreign safe haven, while deducting the "interest" component as a business expense against domestic taxable income. With the employment of various "loan-back" techniques, the money laundering circle is not merely closed, it can be actually increased in diameter.

The Changing Frontier of Money Laundering

tc "The Changing Frontier of Money Laundering"

The ten fundamental laws of money laundering are summarized in Box 2. In essence, the rule in successful money laundering is always to approximate as closely as possible, legal transactions. As a result the actual devices used are themselves minor variations on methods employed routinely by legitimate businesses. In the hands of criminals transfer-pricing between affiliates of transnational corporations grades into phony invoicing, inter-affiliate real estate transactions become reverse-flip property deals, back-to-back

loans turn into the loan-back scam, hedge or insurance trading in stocks, or options become matched- or cross-trading, and compensating balances develop into so-called underground banking schemes. On the surface it may be impossible to differentiate the legal and illegal variants – the distinction becomes clear only once a particular criminal act has been targeted and the authorities subsequently begun to unravel the money trail.

That trend to institutional commingling is enhanced by three other developments. One of them, which became evident first with drugs, and now is increasingly apparent in other forms of illegal economic activity, is the shift of criminal entrepreneurs from serving a set of essentially unrelated regional markets to catering to an increasingly integrated world-wide market
. There appears to have been a parallel change in money laundering. There seems some evidence to suggest that, in place of the old pattern of the occasional money-laundering institution usually linked directly to one or a few criminal entrepreneurs or groups, there has emerged what is virtually an integrated
underground global financial system whose relations to crimina
l entrepreneurs employing its services tend to occur through a series of arms-length commercial transactions
. Based on the (admittedly spotty) evidence surfacing in actual cases, money launderers are now more often independent contractors who are as comfortable handling drug money as washing payments for a shipment of embargo-busting arms, as skilled in assisting insider trading schemes as in moving corporate bribes.

Incidentally, this suggests that while in the past, taking down a criminal group might well have rolled up the money laundering apparatus along with it, now there are really two quite distinct targets of investigation and enforcement which might require two quite separate methodologies. Pursuing transnational crime requires better exchanges of information on particular offenders and improved facilities for transnational investigation and prosecution of particular cases. It remains therefore fundamentally a matter of criminal law. Combating money laundering, however, may require initiatives that might threaten not this or that institution so much as well-established systems of banking and financial practices which have a long historical pedigree and which are protected by strong vested interest groups. It might require actions which a particular jurisdictions could well interpret as a direct threat to its very sovereignty. As such, demands for action must occur in a context of full awareness of the uniqueness of the economic history and practices of each country affected.

A second complication comes from the fact that, while once it was relatively easy to separate the legal and illegal aspects of economic activity, the two existing in a different social and economic space, today that is not the case. Underground activities – either explicitly criminal or merely "informal" – interact at many levels with legal ones. Sweat-shops in big cities in the industrialized countries hire illegal aliens brought in by smuggling groups that may also deal in banned or restricted commodities; are financed by loan sharks who may be recycling drug money; and make cartel agreements with trucking companies run by organized crime families, all in order to sell their
Box 2: The ten fundamental laws of money launderingThe Ten Fundamental Laws of Money Laundering

Law One: the more successfully a money laundering apparatus is in imitating the patterns and behavior of legitimate transactions, the less the likelihood of it being exposed.

Law Two: the more deeply embedded illegal activities are within the legal economy, the less their institutional and functional separation, the more difficult to detect money laundering.

Law Three: the lower the ratio of illegal to legal financial flows through any given business institution, the more difficult will be the detection of money laundering.

Law Four: the higher the ratio of "services" to physical goods production in any economy, the more easily money laundering can be conducted in that economy.

Law Five: the more the business structure of production and distribution of non-financial goods and services is dominated by small and independent firms or self-employed individuals, the more difficult the job of separating legal from illegal transactions.

Law Six: the greater the facility for using checks, credit cards and other non-cash instruments for effecting illegal financial transactions, the more difficult is the detection of money laundering.

Law Seven: the greater the degree of financial deregulation for legitimate transactions, the more difficult will be the job of tracing and neutralizing criminal money flows.

Law Eight: the lower the ratio of illegally to legally earned income entering any given economy from outside, the harder the job of separating criminal from legal money.

Law Nine: the greater the progress towards the financial services supermarket, the greater the degree to which all manner of financial services can be met within one integrated multidivisional institution, the less the functional and institutional separation of financial activities, the more difficult the job of detecting money laundering

Law Ten: the worse becomes the current contradiction between global operation and national regulation of financial markets, the more difficult the detection of money laundering.

goods cheaply to prestigious and eminently respectable retail outlets that serve the general public. The masses of street peddlers in the big urban centers of developing countries
sell goods that might be smuggled, produced in underground factories using fake brand-name labels or stolen from legitimate enterprises, thereby violating Customs, intellectual property and larceny laws, while paying no sales or income taxes, but making protection payments to drug gangs that control the streets where they operate – the drug gangs might

then use the protection money as operating capital to finance wholesale purchases of drugs or arms.

The result of these and many similar sorts of interfaces is an economic complex that can no longer be divided neatly into black and white – rather it forms a continuum of differing shades of gray.

Such a blurring of traditional frontiers raises new problems of money-laundering control. If economic activity is no longer divisible simply into legal or illegal, if the entire economy is riddled with entrepreneurs who bend this or that rule, to and sometimes beyond the breaking point, then the more accepted it becomes to violate "small" laws, the greater the probability others will decide it is permissible to break slighter larger ones, and so on up the scale
. Moreover the greater the degree to which legal and illegal, formal and informal, underground and overground activities are mixed up, the deeper the confusion over the origins of funds, the more difficult the job of exercising due diligence with respect to crimes deemed especially serious and the greater the problems of effective use of suspicious transaction reporting
.

Third, reinforcing this problem, is something that appears at first glance to be a minor statistical technicality but which really goes to the heart of modern economic development processes and impacts directly on the problem of policing criminal money flows. Although exceptions exist, economic progress is generally associated with a rise in the percentage of economic activity accounted for by the production of "services" as opposed to physical goods. As countries increase in wealth and degree of development, this shift in the composition of Gross National Product, from tangible goods to intangible services opens up new possibilities for the laundering of criminal money.

The best cover for laundering is a business engaged in legitimate retail trade, especially onethatgenerates large amounts of cash on a regular basis. And the higher the service content of the products sold, the greater the potential to use the legitimate retail business to hide the proceeds of crime. It is much easier in services to cloud the audit trail, since there is seldom as clear a relationship between physical inputs and market value of output in a service firm as there is in one supplying physical goods. Tax authorities have long been aware that it is simpler in the services than in the physical goods industries to skim off income and under report earnings. And, it is equally easy to do the opposite, to mix illegally earned with legally earned income and report it all as if it were legal. A simple rule can be enunciated – other things being equal, the higher the ratio of services to physical goods production in a country's Gross National Product, the greater the facility with which its legitimate business firms can be used for laundering money.

This, in turn, has yet another implication that is potentially dangerous from the point of view of money laundering controls. There is a widely-held view that the criminal sector operates overwhelmingly with cash while the legal one uses a mixture of cash and other financial instruments – indeed it is common to use changes in the ratio of

cash to bank instruments as a tool to estimate the size and growth rate of the "underground economy". However, this simple dichotomy may be in the process of becoming obsolete. If the objective is to hide the existence of a criminal money flow or to criminalize legal income after it has been earned (by skimming and hiding) there may be few alternatives to working in cash. But if the objective is to hide the nature of a criminal money flow, an on-going alibi provided by a suitable front company especially in the retail services field becomes more important than anonymity. In this case there is nothing that logically precludes the use of checks or credit cards in conducting retail deals in contraband goods and services.

Although clearly data are spotty and cash still dominates such transactions, there is also no doubt that checks and credit cards figure in a rising proportion. One of the most brilliant laundering schemes in the U.S., a cocaine franchise in Boston that was dismantled back in the early 1980s, worked exclusively by retail customers paying in checks nominally on behalf of a contracting company which deposited the money in its bank accounts, sufficiently so to amortize a revolving line of credit that kept the supply of cocaine replenished. And today in some major cities drugs can be retailed over the counter in bars where the customer has given a credit card to the bartender to "run a tab". The value of the drugs is simply added to the total bill and settled with the credit card; and the books are balanced by the bartender skimming the appropriate amount of cash from bona fide liquor sales. Instances of this can only be expected to accelerate as "smart-cards" and other forms of electronic money become more popular.

This blending of legal and illegal actions, and the mixing of various degrees and sorts of criminality, along with the attendant difficulty of differentiating ordinary financial transactions from laundering and of petty from serious crime, has two important consequences with respect to anti-money laundering measures.

The first is that it calls into question much of the enthusiasm about the potential use of artificial intelligence models and similar devices that are supposed to facilitate the task of wading through great mounds of financial data. Those models can hardly anticipate all the subtle criminal variations on techniques and methods that appear completely innocent by themselves, but have as their intent the hiding of illegally obtained money. Artificial intelligence is no substitute for the old-fashioned kind.

Indeed it simultaneously calls into question the very efficacy of imposing ever more severe general reporting requirements. It may well turn out that all such gross reporting requirements can offer is somewhat better reactive efficiency in following money flows once crimes are already detected using traditional investigatory techniques; and even this will depend on the particular institutional conditions of the country concerned.

Therefore, it may be unwise to shift significant amounts of limited resources out of old-fashioned and less glamorous policing methods and towards reliance on piling up mounds of indigestible raw information and/or dependence on high-tech solutions.

Second, not only does the blurring of the frontiers between legal and illegal economic activities along with the process by which illegal acts get institutionally embedded in legal business firms, make the tracing and unveiling of criminal money much more difficult, but it also raises the cost of doing so. The potential regulatory burden imposed on legitimate business and the degree of disruption of normal transactions flows probably increase more than proportionately. This is especially the case given the rule that the lower the percentage of illegal money running through a particular front, the more respectable that front appears and the more successful that front will be in the long term for laundering.

What this implies is that at some point governments must balance the costs of further regulatory complications against the gains measured in terms of crime control. This is, to be blunt, quite messy. The costs of the extra regulatory burden are, in some cases, relatively easy to approximate in simple quantitative terms. But assessing the gains in terms of crime control is so complex, so mired in definitional and operational complications, as to represent a logical and methodological swamp. Yet it is, alas, one into which everyone concerned with the issue of money laundering will eventually be forced to step.

The Changing Financial Context

tc "The Changing Financial Context" \l 3

Although the essence of money laundering has not changed over the centuries, much less since the term itself was invented, clearly the context within which it occurs has been subject to considerable evolution. In particular there have been a number of developments in the international financial system during recent decades that have made the three F's – finding, freezing, and forfeiting of criminally-derived income and assets – all the more difficult. These are dollarization of black markets, the general trend towards financial deregulation, the progress of the euromarket and the proliferation of financial secrecy havens.

First, along with the apparent spread of world black markets over the last few decades has come their progressive dollarization. Although most illegal transactions at the retail level are conducted in the currency of the country where they occur, around the world there has been a steadily growing appetite for U.S. high-denomination bank notes as a vehicle for conducting covert wholesale transactions, for hiding international financial transfers and for holding underground savings. This applies to the full spectrum of illicit and underground activity, but it has direct implications for the proceeds of serious crimes including drug trafficking. A foreign currency black market exchanging local currency for U.S. $100 bills is going to be equally accommodating to cigarette smugglers and tax evaders, dealers in banned wildlife, or traffickers in heroin. The more popular is the use of the U.S. dollar, the more easily someone can bring U.S. cash to the parallel money markets, convert it to local currency, deposit the local currency in a financial institution, and wire it anywhere else, while attracting considerably less attention than the direct deposit of the U.S. cash would attract. Even better, they can convert the U.S. cash into valuable goods, resell the goods, and deposit the money as the proceeds of legitimate commerce, thereby further obscuring the trail. The steadily

expanding popularity of the U.S. dollar as a physical medium of exchange, means of payment. and store of value is therefore a serious and direct challenge to international crime control.

Second, is the general trend towards financial deregulation, both internal and external. Internally this manifests itself in the emergence of the "financial services supermarket", the integrated, multi-functional financial institution which offers clients at one and the same time deposit, transfer, security and commodity brokerage, investment management and fiduciary services along with departments skilled in creating foreign shell corporations and offshore trusts. Almost all major institutions today also offer private banking services, intruding on a field in which formerly a handful of Geneva banks had the leading reputation. Although such competition usually brings benefits to consumers in the form of lower prices, it can also lead to reduced standards of diligence on the part of the institutions. And the breakdown of the traditional barrier between financial institutions means also the elimination of many of the preliminary checks and balances on the nature, provenance and destination of financial assets that a system of distinct and specialized institutions should have automatically ensured. Once money passes the first barrier to gain entry into the supermarket (which is itself competing vociferously for new business) there are no more layers of scrutiny to pass; while the capacity of the funds to shift from asset to asset and from place to place is greatly enhanced.

Simultaneously international capital markets are also being progressively deregulated. Countries are lowering their barriers to the domestic operation of international affiliates of foreign institutions. Just as more and more of world trade now takes the form of intra-company transfers between branches and subsidiaries of transnational corporations, the same is happening with international money movements. And, in addition, many countries which used to impose some form of border control on inflows and outflows of funds have joined the general trend towards liberalization by making formerly inconvertible currencies legally tradable and by dismantling exchange controls. While many arguments have been advanced against the use of exchange controls and denouncing the distorting effects of currency inconvertibility, nonetheless their existence gave some states at least one potential tool for monitoring and controlling capital movements.

The impact shows up on many levels. Although in reality all currencies, even those formerly deemed legally inconvertible by their countries of issue, could be exchanged on parallel currency markets both at home and in big international financial centers, the rate was usually sufficiently poor as to discourage the practice. And that simultaneously restricted the number of jurisdictions through which criminal money was likely to flow. Furthermore, where capital controls existed, in theory all inflows of foreign currency had to be deposited with or, at a minimum reported to, central exchange authorities, and all outflows of any serious magnitude duly licensed, once more there were limits on the capacity of launderers to use most countries' financial infrastructure. Today, fewer and fewer countries maintain inconvertible currencies and all over the world exchange controls have been at least severely limited if not completely abolished.

When capital movements are free, that freedom applies as much to funds of illegal as of legal origin. And the more jurisdictions through which they can flow, the more currencies through which they can move in and out, the harder the job of tracing.

Furthermore, exchange controls had at least one useful purpose. They limited or at least delayed and smoothed speculative outflows of capital. Without them it is conceivable more countries will be subject to destabilizing waves of capital flight. Drained of foreign exchange, they must offset the impact by attracting compensating inflows. This is one of the reasons some countries have adapted bank secrecy laws protecting foreign currency deposits in their banking system. And it is why some governments have had recourse to the issue foreign exchange-denominated bearer securities. These have been rightfully criticized as presenting a golden opportunity for criminals to hide their money, and obtain handsome interest in the process. But it would seem reasonable to expect the international community, while pressing through the major international lending institutions for measures of financial liberalization, to also come up with a more positive response to countries who attempt to offset some of the short-term consequences of that liberalization than to merely criticize them for aiding and abetting international criminal money flows. It can be safely said that for some countries, the flight of capital poses a greater danger to their social and economic stability than the laundering of criminal money which they may be inclined to accommodate precisely in order to offset that flight.

Presumably there is the basis here for a quid pro quo – certain countries most afflicted by drug trafficking are precisely those to which most of the flight capital is attracted. They could pledge their support for efforts by some developing countries to stop the fiscal and financial damage caused by capital flight in exchange for those developing countries ceasing to issue bearer bonds or attempting to attract "black money" through foreign currency accounts protected by bank secrecy laws.

Third, and reinforcing this trend to liberalization and deregulation – indeed long preceding it – has been the evolution of the eurocurrency market and the general development of an offshore sector of world finance
. This, incidentally, is a concept widely employed but little understood. The offshore banking centers through which the eurocurrency market operates are not the same thing as financial secrecy havens. Both may exist in one and the same place but legally and functionally they are quite distinct. Panama, for example, introduced bank secrecy in 1917, buttressed it with Swiss-style "numbered" accounts in 1959, and only introduced offshore banking legislation in 1971. The biggest "offshore" center is actually the City of London, where bank secrecy laws are no serious impediment to criminal investigations. On the other hand Switzerland, a place which, in the public mind, is synonymous with bank secrecy, has no offshore banks.

More precisely, in popular parlance, "offshore" is taken to mean any bank anywhere in the world that accepts deposits and/or manages assets denominated in foreign currency on behalf of persons legally domiciled elsewhere. But in reality, "offshore" should refer to an institution that, while legally domiciled in one jurisdiction, conducts its business solely with non-residents. What offshore banks are really supposed

to do is handle wholesale transactions, usually denominated in dollars, on a bank-to-bank basis. They do not deal with the general public; nor do they accept cash in suitcases. Their role is to reduce taxes, avoid regulations with respect to capital adequacy and sidestep interest rates restrictions imposed by national authorities, not to hide drug money. It is possible for some banks who have both offshore and on-shore licenses in a particular jurisdiction, to breach the firewall that is supposed to exist between their two types of business. However, that is a violation of their operating principles, not a condemnation of offshore banking per se.

Still, the spread of offshore banking does indeed have implications for money laundering. It means more jurisdictions through which funds can be wired, thereby complicating the chase; and it does so by creating a sector largely or sometimes entirely exempt from the scrutiny of national regulators. And while the initiation came from the large international banks, once offshore centers were up and running, all manner of smaller, more dubious institutions took advantage of the laws to set up shop, protected by the fact that the large institutions had a strong profit incentive to keep the offshore sector insulated from regulation.

Nonetheless, it is not clear that the existence of an offshore sector per se requires any particular form of anti-money laundering initiative since law enforcement has long before concurred that the main point of vulnerability for money laundering occurs when funds enter the banking system on a retail level; and the main point of interest for forfeiture is when the funds come to rest inside or outside the financial system as assets whose beneficial ownership can be fixed. It might suffice to request that countries hosting offshore facilities be diligent in maintaining the firewall and in assuring that banks licensed to do an offshore business are truly legitimate. The problems relating to the fourth recent development, one that is often confused with "offshore" banking, are much more serious.

Fourth, over the last few decades there has been a remarkable proliferation of jurisdictions offering the protection of bank secrecy. The traditional form of protection assured clients of confidentiality and, in the event a banker breaches that confidentiality, clients could have recourse to civil remediation. By contrast, bank secrecy laws impose criminal sanctions on those who release information regarding clients' transactions. There is no doubt bank secrecy can be a useful tool for hiding criminal money. However, before issuing any blanket condemnations or recommendations it is important to note several complicating factors. For a start, it is imperative to understand that bank secrecy can take many different forms, with different origins, functions and degrees of defensibility.

There can be totally anonymous accounts where no one in the bank can possibly know, unless the clients themselves reveal the information, who the beneficial owners of the accounts are. These are the most dangerous. However, at present only Austria offers such accounts; they have some use in hiding criminal money but, because no transfers may be made from them they are of minimal utility in moving and washing it; and there are pressures on Austria to modify or abolish them.

There can be accounts in which a lawyer would interpose him/herself between the bank and the client, thereby protecting the client's identity, first by any bank secrecy laws the country may have, and second by an additional layer of lawyer-client privilege. This was typical, for example, of the old Form B accounts in Switzerland. But these have been abolished. And a strong case can be made for them being banned everywhere else where they might still exist.

There are accounts protected by official bank secrecy acts and additionally by the informal device of nominee ownership in which the nominee and the beneficial owner are connected by civil contract and/or simply a bond of trust (or fear) rather than by a formal attorney-client privilege. These are different from Form B type accounts since the bank has little or no control over the use of nominees. On the other side since there is no client-attorney privilege there is nothing to prevent the nominee from revealing information about the beneficial owner of the account.

There are owner-held accounts that are coded so that only the top management of the bank knows who the beneficial owner is, and in which secrecy laws prevent the management from revealing. These are especially effective if the country's bank secrecy law also forbids the bank to reveal information even if the client requests lifting of bank secrecy. The public rationale of such rules is that they protect clients against harassment and blackmail by outlaw states and secret police forces. On the surface that seems a reasonable argument. However it is difficult not to get the impression that the real purpose is to give a competitive advantage to the particular haven's banks in the bidding for international hot money flows. In other words, it is the welfare of the banks not of the clients that is really at issue. In any event it should be possible for the authorities in the jurisdiction to make a judgement as to whether or not the client making the request for lifting bank secrecy is being subject to a proper criminal process or is being harassed for purely political reasons before agreeing to waive secrecy.

Then there are coded accounts, protected further by bank secrecy laws, but where the client (perhaps under pressure from law enforcement) can request the bank to lift the protection and divulge the information. By definition these pose less of a threat.

Finally, there are accounts protected by bank secrecy laws without the additional device of a code that permits only the most senior managers to know who the account holder is. These more standard forms of secret accounts have a long history. There are sound arguments for their existence. However, there are equally compelling arguments against them. Those who seek secrecy by definition have something to hide. And in the vast majority of cases it is safe to say what they have to hide is the origin, provenance and destination of their wealth, not their political views or ethnic origins. Nonetheless, rather than pressing for a total abolition of this modest form of bank secrecy, one in which bank employees in general have direct access to the identity of the beneficial owner of the account and where there are no extraordinary cloaking devices, there should instead be efforts made for countries to agree on the general conditions under which secrecy is permissible. There is a huge difference between secrecy to protect a

company's financial position from a commercial competitors' probes and secrecy to protect the origin of the company's bank account from a criminal investigation.

Bank secrecy, then, is a serious concern. In particular the status quo, where one country stiffens its secrecy laws to take advantage of another country having been successfully pressured by an economically and politically more powerful neighbor to weaken their laws is the worst of all possible worlds. At the same time it is important not to exaggerate its significance or lose sight of other barriers to finding, freezing, and forfeiting criminal money. Money laundering can proceed very easily without bank secrecy – in fact it may well be that launderers avoid it precisely because it acts as a red flag. Professional launderers advise their clients that the only really effective form of secrecy is keeping their mouths shut.

In addition, even if actions are taken to lower or knock down completely the barrier to investigation posed by bank secrecy laws, the most important obstacle may well turn out to be corporate secrecy laws in defense of which resistance is going to be much greater. It does little good to discover that the owner of a certain bank account is Get High Trading Corporation of Panama if it is impossible to determine just who really runs Get High Trading.

Box 3: Features of an Ideal Financial Haven
Major Characteristics

no deals for sharing tax information with other countries
the availability of instant corporations
corporate secrecy laws
excellent electronic communications
tight bank secrecy laws
a large tourist trade which can help explain major inflows of cash
use of a major world currency, preferably the US dollar, as the local money
a government that is relatively invulnerable to outside pressure
a high degree of economic dependence on the financial services sector
a geographic location that facilitates business travel to and from rich neighbors

Additional Characteristics
time zone location,
a free-trade zone
the availability of a flag-of-convenience shipping registry

Moreover, bank secrecy is only an obstacle once the trail has already been traced to a particular institution. No jurisdiction will ever approve the unrestricted access by law enforcement officers to lists of depositors and their transactions. But many jurisdictions, even those with bank secrecy laws, will permit law enforcement officers to penetrate bank secrecy if they are engaged in investigating something that is a crime in the particular jurisdiction that hosts the bank. The danger then becomes not bank secrecy blocking information flows so much as it giving time for those affected by the search to move their funds to other jurisdictions. It is the potential delay between targeting the

account and getting permission to investigate that is the problem, not bank secrecy per se. And this can be obviated by a common set of principles to which all member states who have bank secrecy laws would adhere spelling out precisely the conditions under which they will cooperate in the search for criminal money and engage in peremptory freezes.

The discussion about what to do about bank secrecy, of course, raises the fundamental question, why are bank secrecy laws widespread and growing in number? Most modern financial havens are countries with growing populations, limited resources, and a crisis in their traditional sources of livelihood. Their agricultural sectors are cramped by lack of fertile land or the dumping of products on world markets by highly subsidized farming in larger and better located producing areas. Some, particularly in the Caribbean, formerly had large numbers of the economically active population employed in sectors like salt harvesting or merchant shipping – and when those sectors went into decline, they struggled to find others that were independent of their always limited, often non-existent natural resource endowments. Financial services were an obvious potential growth sector
.

This has many implications. It means that the more competitive the business becomes, the lower the standards of diligence any one haven can introduce without losing customers en masse to others. That may be partly because the money that is fleeing has something to hide. It may well be that, since diligence has its costs, the service charges in the more diligent haven may become uncompetitive. It also means that havens are being driven to diversify their services to attract and hold business. An ideal financial secrecy haven today offers a significant portfolio of services. The range of these services are discussed more fully in Section III. The characteristics of an ideal haven are summarized in Box 3. They include secrecy, the availability of services for rapid incorporation, currency exchange freedoms etc.

With a complex and interdependent system of financial services, the havens will defend all the more strongly any one component, for fear that if that one is compromised the overall competitive position of the haven will be adversely affected. It is not that most haven countries seek drug money or any other type of assets derived from serious crimes. Rather they literally cannot afford to cooperate too closely. While, particularly given the growing amount of competition, fees for such services are often low and falling, they may constitute a very large percentage of government revenues and private incomes as well, representing the single fastest growing sector of the haven's job market.

While it is popular to decry the operation of such financial havens, and it is certainly true that they can have a harmful effect, particular in terms of facilitating tax evasion and secondarily as places that foster money laundering, it is necessary to show some understanding of their positions, their economic vulnerability and their lack of alternative resources. In the field of drug control, the major consuming countries are happy to research and finance crop substitution programs for producing countries. Wouldn't it be possible to imagine alternative economic development solutions for such financial havens, in conjunction with the world business community, in a kind of "financial crop substitution" program?

III The global financial system, offshore financial centers, and bank secrecy jurisdictions

In Part II of the report we looked at money laundering as a circular process and identified financial havens and bank secrecy jurisdictions as an important part of the circle. Yet, both bank secrecy and offshore financial centers have legitimate purposes and are integral components of a global financial system with multiple points of access and rapid capital movements, whether in settlement of business and commercial contracts or in search of higher interest rates. Consequently, when identifying ways in which offshore financial centers and bank secrecy jurisdictions facilitate criminal activities it is important also to acknowledge that these centers continue to have respectable functions within the global financial system. Accordingly, the first part of this section identifies important characteristics of the global system. The analysis then focuses on the emergence of the offshore world and the legitimate purposes it serves. Picking up some of the themes identified in Section II, the inter-locking components of offshore banking centers and bank secrecy jurisdictions that are conducive to money laundering and other financial crimes are delineated. Finally, this section offers a brief overview of the geography of these financial havens.

The Global Financial System

The move to what is sometimes characterized as a speculative global economy has been facilitated by new technologies that allow unprecedented speed in the movement of money. Flight capital, the proceeds of crime, money seeking preferential interest rates or foreign exchange arbitrage, combine with contract payments and debt settlements, in a vast melange of movements and transactions that is bewilderingly fast and complex. Indeed, the global financial system provides a crucial underpinning for international commerce and investment in a world characterized by global trade, the prevalence of transnational and multi-national corporations, and the rapid movement of investment capital. The globalization of financial services has become one of the most important dimensions of the overall globalization process. Fueled by developments in technology and communication, the financial infrastructure has developed into "a system that links countries, banks and other financial institutions such as brokerage houses and stock markets, currencies and investment portfolios in a global exchange mechanism that engages in operation 24 hours a day"

At the same time, the development of "megabyte money" i.e. money in the form of symbols on computer screens makes it possible to move funds almost anywhere in the world with speed and ease.

Not surprisingly, an increasing proportion of the world's money moves around through electronic rather than cash transactions. Although many economies in the developing world and states in transition are still cash economies, in advanced industrialized and post-industrialized states, the most important financial transactions (in value as opposed to volume) are no longer cash based. This is certainly the case in the United States as illustrated in figure 1 which highlights the inverse relationship between the number of

transactions that take place in cash, check and electronically, and the value of these transactions.
Box 4: US payment structure (in Solomon, Elinor Harris, Virtual Money: Understanding the Power and Risks of Money's High Speed Journey into Electronic Space (New York: Oxford University Press, 1997)

The massive growth of electronic payments has been made possible by the development of the electronic transfer mechanisms operated by the Society for Worldwide Interbank Financial Telecommunications System (SWIFT), the Federal Reserve (Fedwire) and the Clearing House Interbank Payments System (CHIPS). The volume and value of the transactions that move through these mechanisms are staggering. “Each day, more than 465,000 wire transfers, valued at more than two trillion dollars, are moved by Fedwire and CHIPS, and an estimated 220,000 transfer messages are sent by SWIFT (dollar volume un-known)”.

In many respects this system is a money launderer’s dream, offering considerable scope to imitate the patterns and behavior of legitimate transactions, thereby following one of the most fundamental laws of money laundering identified in Section II. Nor is there any obvious institutional and functional separation between the transfer of licit monies and the transfer of the proceeds of drug trafficking or other forms of crime. Differentiation is virtually impossible, thereby meeting another requirement of effective money laundering – the ability to embed illicit transactions and proceeds within a large volume of legitimate business transfers. Another requirement of effective money laundering is that the ratio of illegal to legal financial flows be relatively low. Once again, the electronic transfer system is ideal. According to a report by the now defunct United States Office of Technology Assessment, a reasonable guess is that 0.05 percent to 0.1 percent of the approximately 700,000 wire transfers a day, contain laundered funds to a value of $300 million.

This is dwarfed by the more than $2 trillion that is transferred by wire on an average day, greatly complicating efforts to identify the laundered funds. Furthermore, although bank-to-bank transfers of aggregate funds for settlement or loans constitute about half of the total volume of wire transfers, with the complicity of corrupted bank employees, these can also contain laundered money.

Although there are hopes that artificial intelligence systems can offer enhanced discrimination techniques that lead to the identification of laundered money, the sheer dynamism of the financial world, “the number of financial institutions, the constantly changing relationships and varying levels of activity make it difficult to identify suspicious activity”.

The problem is compounded by the lack of a “centralized database of wire transfers and limited details about senders and recipients”.

These difficulties are exacerbated by the inclusion in the global financial system of stock exchanges and other financial institutions that allow anonymous trading and thereby make it possible to obscure both origin and ownership of funds. Indeed, an

important characteristic of the financial sector in recent years has been the proliferation of new financial institutions and financial centers, an overlapping in the services that are offered by banks and non-bank financial institutions, and the development of new banking practices and mechanisms. The result of all this has been the emergence of a more complex system offering multiple opportunities to evade regulation, monitoring and control – even though efforts have been made to strengthen oversight. "New banking practices, such as direct access banking which permits customers to process transactions directly through their accounts by computer operating on software provided by the bank" undermine "the ability of the bank to monitor account activity, such as transactions involving joint accounts and pass
through banking schemes which have been a traditional method of layering. Beneficial owners of funds can now manipulate the identity of the ultimate recipient of the funds without a review by bank officers".
Moreover, it is possible "to create accounts within accounts, or even to provide quasi banking services to off
line customers in a kind of bank within a bank".
Such services "limit the utility of systems in place which allow information about both the originator and the recipient to travel with the electronic funds transfer".
Correspondent banking relationships that are global in character place "ever more emphasis on vetoing transactions at the bank of origin".
Yet, many of the banks of origin are in countries where little attention is given to the prevention or control of money laundering and where "know your customer policies" are totally lacking at worst and grossly inadequate at best.

Even when efforts are made in this direction, it is relatively easy to provide a legitimate front that satisfies efforts to check the legitimacy of the customer. Unless banks know not only their customers, but also whom their customers are connected to, directly or indirectly, then due diligence will be far from complete. And in many cases, banks and other financial institutions have no inclination to know their customers – especially if it puts them at a competitive disadvantage. Since, overly vigorous investigation of potential customers – even those who are legitimate – could make them go elsewhere, some bankers will be reluctant to engage in such activities. Although, this is understandable in a highly competitive business environment, it can all too easily result in tacit connivance between some banks and institutions and individuals or groups who are interested in moving, hiding or laundering the proceeds of crime.

Efforts to impose new laws or regulations against money laundering will be resisted strenuously if, directly or indirectly, they also inhibit licit activities and impinge on commercial interests whether at the level of individual firms, a particular industry or economic sector, or a particular nation or group of nations. In extreme cases, of course, connivance can become collusion as the rewards of criminal enterprise are extended to those members of the licit economy who facilitate laundering activities. Money laundering has become so lucrative that bank officials and others with access to the financial system are sometimes corrupted – as will be seen in Section IV. Even where this does not occur, however, some financial centers in some countries are willing to operate in a fairly relaxed manner and refrain from exercising due diligence and ensuring

that they know customers. Inevitably, criminals will seek out and exploit the opportunities offered by such centers. Although it is sometimes contended that criminals threaten the global financial system, this is through a process of erosion of norms and standards rather than through disruption. For the most part, criminals are much more interested in exploiting this system than they are in disrupting it – and offshore financial havens and bank secrecy jurisdictions are all too often willing participants in this process of exploitation. They are also attractive to terrorists and insurgent groups seeking to launder criminal proceeds generated to support their armed struggle, or to acquire weapons that can be used in their continuing campaigns of violence.

In short, the global financial system has increasingly taken on characteristics that are as conducive to money laundering as to any other form of money movement. Easy access and a capacity to move money around the system rapidly, and with a minimum of formality and regulation are perfect for money laundering. There are multiple jurisdictions which can be used as channels through which money rapidly passes, as temporary havens, or as final destinations. Such jurisdictions are a necessary complement to "electronic money laundering" which "often requires the complicity of a foreign bank to serve as the immediate or final destination for illegal funds"
.

Although the use of financial centers which give emphasis to secrecy does not necessarily result from criminal intent or criminal motives, the availability of jurisdictions offering services and mechanisms for asset protection (e.g against civil litigation) is important for those who want to hide their money and ensure that it is beyond the reach of law enforcement. Indeed, as one analyst has observed, "the secrecy haven is one of dirty money's most cherished privileges and also one of its most ardent solicitors".
Indeed, offshore financial centers, tax havens and bank secrecy jurisdictions attract funds partly because they promise both anonymity and the possibility of tax avoidance or evasion. A high level of bank secrecy is almost invariably used as a selling point by offshore financial centers. Many Internet advertisements for banks emphasize the strictness of the jurisdiction's secrecy and assure the prospective customers that neither the bank nor the government will ever give bank data to another government. When the advertising is for private banks, it also stresses the protection from tax collectors.

These centers are attractive to criminal organizations seeking to launder the proceeds from their illicit activities. They offer opportunities for creating byzantine financial trails and secretion of funds in places where they are relatively safe from identification and seizure by law enforcement. Both financial havens themselves and the number of institutions that operate within their jurisdiction have multiplied. Many of the havens also offer facilities for incorporation that are very attractive for individuals or organizations attempting to protect their anonymity and operate with a high degree of impunity and flexibility. In short, offshore financial centers and bank secrecy jurisdictions are characterized by "a minimum of transparency and a maximum of autonomy of private action. The function of the state is to insure that very privacy and secrecy by keeping encumbering regulations to a minimum".

This is not to claim that these centers came into existence simply to provide services to organized criminals, drug traffickers, or those engaged in financial fraud. Their origins are, in fact, more complex.

The Origins of Offshore Financial Centers

The origins of "offshore banking" are shrouded by myth and mystification, in part because of widespread misconception about just what the term actually means. In popular use, "offshore banking" is often taken to mean nothing more than persons resident in one legal jurisdiction holding assets in financial institutions incorporated in another jurisdiction. Hence the frequent expression – he/she has their money "offshore".

In fact offshore financial transactions have a precise meaning. Banks or other financial institutions operating "offshore" are exempt from a wide range of regulations normally imposed on "onshore" institutions – their transactions are tax-exempt, not encumbered by reserve requirements, free of interest-rate restrictions and often, though not always, exempt from regulatory scrutiny with respect to liquidity or capital adequacy. Dealing with non-resident clients, almost always other financial institutions, they usually transact a wholesale banking business denominated in a foreign currency or currencies.

While the "offshore" sector is now very large and well established, it is actually of fairly recent vintage, and it emerged not according to some concerted plan but step by step in response to particular circumstances. There is a frequent claim that the first step in the creation of an offshore banking system came when the USSR, fearing an American-imposed asset freeze, began holding its dollar deposits in British banks. In fact the practice of holding foreign currency deposits long predated the Cold War; and the banks holding the Soviet deposits were not exempt from taxes, interest rate restrictions or reserve requirements. To the extent that the practice of offshore banking can be said to have British roots, it was because countries or institutions or individuals could avoid British exchange controls while still enjoying the world-wide connections of the City of London by holding their money in foreign currency (then almost always dollar) deposits in London.

Much more important in explaining the rise of offshore banking was the balance of payments crises that struck many countries, though especially the US, in the 1960s, leading them to impose capital controls on their banking institutions. That was combined with the fact that the banks were seeking to break down the traditional barriers separating various types of financial activity. Normally confined to collecting money in the form of short-term deposits, in the 1960s major western banks began trying to tap the long term capital market in direct competition with corporations and governments. They therefore began aggressively marketing certificates of deposit which could rival corporate and government bonds in attracting investors. Then, in the 1970s, major western banks began taking money so raised and aggressively lending to sovereign governments who had previously relied largely on the sale of bonds when they needed to borrow money abroad. It was really out of these changes – the urge to avoid taxes and interest rate regulations, the desire to tap longer-term sources of funds (of which the legendary OPEC surpluses

were only one part), and the decision to get into the sovereign lending business that led to the emergence of a modern offshore banking sector.

The headiest period of growth of the offshore banking system was in the late 1970s and early 1980s. Since then there have been significant changes in world finance that have restricted that growth and even put it into reverse. The OPEC surpluses are no more. There has been, since the great debt crisis of the 1980s, a substantial decrease in sovereign syndicated borrowings in favor of more conventional forms of international investment flows (direct investments) and a more hospitable environment for countries who have adopted more conservative financial management techniques to sell their bonds. Furthermore as governments all over the world slash or eliminate reserve requirements, reduce taxes and liberalize financial regulations, the incentive to do business offshore has been considerably reduced. Offshore banking will remain a feature on the world financial scene for some time to come, but its relative importance is likely to continue to decline. The decline, however, will be neither uniform nor rapid. The offshore financial sector continues to attract not only substantial demand but also new suppliers willing to offer what can appropriately be described as international minimum standards.

The Legitimate Uses of Offshore Financial Centers and Bank Secrecy

There are legitimate purposes for both bank secrecy and the use of offshore financial centers and the services they provide. Bank secrecy has its root in common law and is an important dimension of both personal and corporate privacy. "Withholding financial information from competitors, suppliers, creditors and customers, is a right that business people assume from the outset ..., confidentiality and the judicious use of information is generally assumed in business as a critical component of rules of the game in market-oriented economies".

At the same time, personal financial matters that rely on the maintenance of banking confidentiality are a key right of citizens in liberal democracies where bank data is protected by a wide range of laws, both civil and criminal. Indeed, most countries have some legislation on the subject. Even the United States which is often seen as the country seeking the most bank related information has a Bank Secrecy Act. The laws vary from the criminal and draconian to simple civil law remedies. The most important laws covering bank secrecy make the disclosure of customer information to any party outside the bank a crime. In many cases there are exceptions for local bank regulators and auditors. But, in some jurisdictions, the auditors face the same criminal penalties as the banks for disclosure, and must be citizens or permanent residents if they are even to be allowed to examine bank data.

Although global deregulation has made offshore financial centers less distinctive, they retain an important niche that is perhaps tarnished but should not be obscured by their exploitation for dubious purposes. In some cases, small or poor nations, particularly but not exclusively in the Caribbean, have established themselves as offshore financial centers in order to attract funds, provide jobs and facilitate economic development. They

offer low or nonexistent tax rates that are attractive to investors, company owners and ordinary citizens anxious to reduce their tax burdens. Indeed, both bank secrecy jurisdictions and offshore financial centers attract deposits from citizens who want to avoid taxes through legitimate tax loopholes. They also attract those trying to evade taxes through concealing much of their wealth by secreting it in jurisdictions that place a premium on confidentiality and do not regard tax evasion in another country as a crime. In the early 1980s, the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, in the United States Senate conducted a series of hearings which not only highlighted criminal exploitation of offshore financial centers but also the extent of the illegal use of offshore banking "to facilitate tax fraud" by the "man next door". With improved communications and the use of the Internet, this phenomenon is almost certainly more widespread than it was 15 years ago.

Yet the use of offshore financial centers and bank secrecy jurisdictions by criminal organizations and by ordinary citizens for tax evasion should not obscure the legitimate roles that these centers continue to play especially in a world where money moves constantly in search of the best rates of return, where vast sums can be made through arbitrage, and where there has been a move away from an investment economy and the embrace of what many observers call a speculative economy or "casino capitalism".

"Legitimate companies ... make much use of offshore banks ... for a variety of reasons, most related to tax laws and regulatory structures, or what one economist has termed "national friction structures and distortions'".

Offshore financial centers offer what one close observer termed "freedoms and services and opportunities". Among the freedoms are freedom from exchange controls, freedom from reserve assets ratio requirements, freedom from disclosure of information, freedom from a range of taxes; the services include personal and corporate banking services, global custody, offshore fund management, trust and company administration, accountancy and legal services, and stock exchange facilities. Following this notion of "freedoms", but sufficiently important to merit separate discussion, it is clear that on-shore banks themselves use offshore financial centers to avoid what are sometimes seen as onerous regulations. Many banks in the United States, for example, send money to the Cayman Islands and other places to avoid or sidestep a Federal Reserve System (FRS) requirement that a percentage of deposits held in the United States be placed with the regional Federal Reserve Bank (FRB) each night in a reserve account that does not bear interest.

Banks with a high volume of corporate accounts, reluctant to forego interest on this money (or to deprive their customers of interest) even overnight, may establish a branch overseas, "creating profit centers from which profits may be repatriated at the most suitable moment for tax minimization".

Individual investors and transnational corporations sometimes place money

offshore for reasons related to cash management.

Similarly, International Business Companies or Corporations (IBCs) that can be created with a minimum of formality in many offshore financial centers, have a variety of legitimate uses such as the holding of patents, the legitimate exploitation of tax treaties, and the conduct of legitimate foreign trade transactions. IBCs can also be a means of holding U.S. property. The point about these uses, however, is that, for the most part, they do not require secrecy. Jurisdictions can know who owns a company without this in any way impinging on the legitimate uses of the company.

Firms can use offshore financial and bank secrecy jurisdictions as part of a deliberate effort to maintain their privacy and thereby their competitive edge in a business environment in which competitive intelligence has become almost mandatory.

In short, as one economic geographer has noted, "offshore finance is an essential and characteristic element of the contemporary world financial system".
It is also something that will continue to be a part of a vibrant and expanding global economy. The real issue, therefore, is not to issue blanket condemnations or make efforts to eliminate bank secrecy and offshore financial services, but to ensure that the legitimate uses of these facilities remain available while making it much more difficult to use them directly for criminal activities or for laundering the proceeds of drug trafficking and other forms of organized crime. The objective is not to create total transparency; such an objective is simply not realistic. The appropriate focus is on legitimate government inquiry – requests from foreign governments and law enforcement agencies for specific information that will assist in criminal investigations. Unfortunately, too many jurisdictions see such inquiries as a threat to their reputations for secrecy and are reluctant to cooperate because of the impact on potential customers.

The Offshore Financial System

To understand the world of offshore banking and bank secrecy, it is important to see it not only as a legitimate part of the global financial system but also as a system of its own with distinct but complementary and reinforcing components, several of which are readily amenable to manipulation by criminals, whether those engaged in fraud or those concerned with moving or laundering the proceeds of drug trafficking, financial fraud or various other criminal activities. Not all jurisdictions, of course, offer the same level of services that can readily be exploited by criminals. Nevertheless, criminals and their specialist advisers seeking to repatriate their money to their home bases, to move it out of the reach of law enforcement, or to disguise its origins and ownership find in the offshore financial havens a set of characteristics, that in many respects seem to be tailor made for their purposes.

These components include:

Banks that are subsidiaries or branches of banks in well-regulated jurisdictions. While these banks accept the appropriate set of standards in their home base, in haven jurisdictions they sometimes act in a less scrupulous manner, in effect creating a double standard of behavior and performance. This can be a useful device for circumventing regulations. Some Costa Rican banks have opened up subsidiaries on Caribbean islands that are beyond the reach of the bank regulators in Costa Rica itself. Major banking countries and the Bank of International Settlements are gradually addressing this problem, but for the moment important gaps in supervision remain.

Indigenous banks. One of the most striking things about offshore financial centers is the enormous increase that has taken place in the number of banks actually created in offshore financial centers. Banks can be set up with relative speed and ease and a minimum of due diligence investigation – so long as they meet a basic level of funds – which can vary significantly from one jurisdiction to another. This provides enormous opportunities for fraud as shown by the European Union Bank discussed in Section I. It also offers attractive opportunities to create new banks in jurisdictions where regulations are either minimal or, if they are in place, are not always vigorously enforced – either because of the lack of will or desire to implement a serious enforcement regime, or because a monitoring and supervisory capacity is lacking, or because there is neither the desire nor the capability to enforce regulations.

The availability of other mechanisms such as trusts and international business corporations or international business companies (IBCs). These institutions are one of the most attractive means for obtaining privacy in financial matters offering a covering identity with the ability to buy, own and sell property and services and directing any possible liability towards itself and away from the owner. Typical advertisements for IBCs note that they are set up offshore, are beyond the control of one's own government, are protected from government rules, regulations, and taxes, facilitate business under less stringent regulations, and offer a high level of confidentiality. In most cases the corporation will be established in countries that, by law, can not divulge information about directors or owners, in many cases, confidential offshore checking accounts can be established in the corporation's name and used to pay bills and buy assets (such as cars) for the corporation. As noted in Section II, given the attractions of IBCs and the ease of establishing them, they have become widespread. Moreover, as further efforts are made to regulate offshore banks, then IBCs will become an even more favored mechanism for those seeking to hide, move, or launder the proceeds of crime.

The prevalence of bank-like institutions such as trust companies, brokerage houses, money exchange houses. These are essentially unregulated financial players and can move money with ease, speed and virtually no oversight. When these are affiliated with on-shore entities, the availability of money laundering channels within the institution are obvious. In some jurisdictions for some periods, companies were even allowed to use the word bank in their name, confusing regulators and offering opportunities for fraud. Although this is perhaps less prevalent than it was, the ubiquity of

bank-like institutions that do not have bank charters is actually challenging the traditional definition of a bank. In effect, any financial institution with an encrypted switch has a technological capacity to offer services very similar to those found in the Asian underground banking systems, the hawallah and the fie chien. The implication, of course, is that, from a regulatory point of view, any financial institution with an encrypted switch should be regarded as a bank for oversight purposes.

The availability of trust schemes which allow the person who sets up the trust to also be the beneficiary. In Niue, for example, the settlor can make a protective trust in his own favor (something that goes beyond the normal common law rule for trusts). Even where this is not the case, there is usually a high level of secrecy associated with trusts and the trustee (and his representatives or employees) must keep the execution of the trust secret.

Bank laws which offer considerable protection to depositors in terms of confidentiality and secrecy. Although many offshore financial centers do make clear that they will cooperate with requests from foreign law enforcement agencies in cases involving the proceeds of drug trafficking or other criminal money – and both Switzerland and the Bahamas have made enormous strides in this respect – such cooperation is not always forthcoming and even when it is can involve considerable foot dragging. The result is that there is an opportunity for money to be moved to another jurisdiction. Consequently, even when law enforcement succeeds in following the money, it does not always succeed in catching it.

The availability of mobile accounts. In some instances, criminals will open an account in one jurisdiction, but with instructions for any incoming funds to be transferred immediately to another location. Additionally, the bank will be instructed that in the event there are any inquiries, then bank officials in the second location must be informed. When they are so informed these officials themselves have instructions that the money should be transferred elsewhere. These schemes, known in law enforcement circles as "walking accounts" pose serious problems for law enforcement efforts aimed at seizing "dirty money". The first account is simply the initial depository and money moves in to it and then immediately moves out. The function of the account is, essentially, to act as an early warning mechanism to identify any inquires by law enforcement and to set off further counter-measures to protect the money.

The availability of casinos. In many offshore financial centers and bank secrecy havens, there is a symbiotic relationship between banks and casinos.
A good example of this is Aruba, where it is alleged that money is frequently laundered through casinos. One participant acknowledged the ease with which this is done: "You take a big pile of money, you buy some chips, and go to play a bit, winning or losing does not matter. Then you take the chips back and in exchange you get a bearer check from a bank in the United States the amount that is ready for you is called casino winnings. No one ever looks in the books to see where that laundered money comes from let alone the amounts concerned".

The opportunities for laundering are very considerable. Although links between banks and casinos are not always readily discernible, their close proximity, as well as the lack of serious oversight or external scrutiny of the casinos makes them an ideal vehicle for completing the money laundering cycle.

The availability of free trade zones. In many cases, there is a symbiotic relationship between offshore financial centers and free trade zones. The importance of this relationship is that it allows money launderers to combine the use of banks with IBCs and other apparently legitimate trading companies. As a previous United Nations report noted, "The implementation of free trade agreements and regional compacts creating trading and economic zones which transcend national borders could increase the use of international trade as a mechanism for laundering the proceeds of criminal organizations. The impact of the liberalization of border and other customs controls, liberalized banking procedures and freedom of access within those zones creates additional potential risks...". Laundering operations are located within legitimate businesses, with real inventories and substantial sales. Indeed, laundered money can be used to buy legitimate goods that are then resold in the home country, providing a legitimate source of income. Reportedly, among the firms that inadvertently sold goods to Cali front companies were General Electric, Microsoft, Apple Computer, and General Motors. In fact, over 100 American companies unwittingly accepted drug money for their products.

The facilitating role of agents. There is increasing reliance in offshore centers on brokers and agents to generate customers, to act as intermediaries in establishing accounts, trusts, and the like, and to act as an additional layer of insulation and confidentiality. There are several levels of participants here. The first level consists of so-called financial consultants who write books and conduct seminars on the tax benefits of participation in the offshore world. In some instances , the salesmanship is followed up with the provision of specific advice and guidance for individuals who have been convinced that moving all or part of their financial assets offshore is beneficial. A second level involves lawyers, accountants, or brokerage and financial firms who provide a portfolio of services to a wide variety of customers some with legitimate purposes and others concerned with using these services in connection with some form of criminality. There is a third level of financial managers who have chosen a market niche in the provision of specialized services to specific clients who are obviously engaged in criminal activity. Whereas the second level might involve a degree of connivance, the third is based much more clearly on collusion with criminals in hiding and laundering their money. Whatever level these various agents operate on, however, they can be very important in facilitating the use of offshore financial centers. Sometimes lawyers or accountants will

Box 5: The Role of professional Money Launderers"Professional money laundering specialists sell high quality services, contacts, experience and knowledge of money movements, supported by the latest electronic technology, to any trafficker or other criminal willing to pay their lucrative fees. This practice continues to make enforcement more difficult, especially through the commingling of licit and illicit funds from many sources, and the worldwide dispersion of funds, far from the predicate crime scene."

US International Narcotics Control Strategy Report, March 1997
refer a person to a bank and the referral itself will be treated as sufficient evidence of the person's bona fides. In other cases, the agents will ensure that all of the arrangements are taken care of while protecting the identity of the client. Indeed, both accountants and lawyers provide important intermediary services that facilitate the criminal exploitation of offshore financial centers and bank secrecy jurisdictions. What they are doing, even at the second level identified above, is offering financial management services without any kind of due diligence. At the third level, they typically take measures to ensure that even if due diligence is exercised by anyone else, the customer will meet the requirements for depositing funds, opening a bank, creating an IBC, establishing an asset protection trust, or whatever else is desired from the offshore or security jurisdiction. In effect they devise schemes with an appropriately complex mix of corporations, jurisdictions, and institutions to provide maximum protection for their clients and to make any law enforcement investigations as difficult and frustrating as possible.

Dissemination of information about available services. Another important component of the offshore financial system is advertising not only in airline magazines but also, and increasingly, on the World Wide Web. Not surprisingly, a wide range of financial services is advertised online. Detailed guides to the world of off-shore banking and tax havens are accompanied in some cases by offers of a variety of ancillary services such as second or third passports, advice on how to avoid an audit trail, and details of how to ensure the privacy of telephone calls; and numerous opportunities to incorporate companies in particular jurisdictions and do it with ease, speed, and a minimum of investigation. Using the Internet for inquiries and the early stages of registration has several attractive features for both customers and service providers – a relatively high degree of anonymity on both sides, ease of use, and low expense. The crucial point about all these services is that they are designed to circumvent or neutralize due diligence. And while they are sometimes justified and portrayed as legitimate ways of tax avoidance they also explicitly appeal to those engaged in tax evasion or those engaged in lucrative forms of criminal activity, whether financial fraud, drug trafficking or other forms of organized crime. When it is possible to apply online to create a trust or an International Business Corporation, then it is clear that due diligence is not being exercised in a serious way; when it is possible to obtain second and third passports in different names, as well as additional false documentation, then even if some due diligence is exercised it is unlikely to generate red flags.

The willingness to provide false documentation that facilitates money laundering and other crimes. Some offshore financial institutions generate false invoices, bills of lading, end-user certificates and other forms of documentation that give the appearance of legitimacy to a

Box 6: A Former Money Launderer Discusses Offshore Financial Centers
Kenneth Rijock, a former Miami lawyer who was convicted of money laundering and served two years in federal prison, now gives lectures on money laundering and how to combat it. What follows are excerpts from an article in Money laundering Alert which is reprinted here with permission.

I learned that one of the greatest assets money launderers have are offshore

banks.

Located mainly in the so
called "tax
shelter" countries, offshore banks offer the money managers of criminal organizations, including drug traffickers, the opportunity to launder funds with maximum safety and confidentiality at minimum risk. I know that by my own experience.

Money launderers are attracted by a business environment where income, corporate and inheritance taxes do not exist, where there are no exchange control laws, and where bank and corporation secrecy laws prohibit even an inquiry into the ownership of companies and bank accounts.

In a typical visit that I would make to one of the secrecy havens in the Caribbean to launder money, I would pay a call on a cooperating bank institution. When I would arrive with my client, by air or sea, the bank's representative would facilitate our passage through customs. When a client advises that he is arriving with millions in cash, nothing is left to chance.

Some of my trips to offshore banks involved renting a Lear jet owned by a former Air Corps bomber pilot, filling it with clients and cash and flying non
stop to a seldom used World War II vintage airfield, where the runway was barely long enough to handle jet aircraft.

Once out of the port, a short ride follows to a shopping center comprised entirely of banks, trust companies and management firms. At the bank, the funds are quickly counted, checked for counterfeits, and deposited in an account opened in the name of a shelf corporation which has been previously created by our local counsel.

Signature cards are passed out, with my advice that the depositors should not sign their own name. The identification of the depositors and the origin of funds are never discussed. Two former prominent depositors at a certain bank, whom I represented, actually visited a toy store and used rubber stamps with the images of Minnie Mouse and Goofy in place of signatures.

Certificates of deposit would be issued. The originals generally would remain at the bank for security reasons because I did not want them to be in the U.S. subject to subpoena. Bank statements would either be held at the bank, or mailed to the office of our local attorney.

The funds deposited would immediately be couriered by the bank to its correspondent banks in New York or London, for deposit in the bank's own accounts. The depositor would be paid a rate of interest of one percent less than the bank was receiving on the funds. The offshore banks have either an ultra-conservative or non existent lending policy, thus insuring that the funds earn safe returns for the bank's owners at little risk to depositors.

Once those steps were taken, I would be free to transfer the funds to large banks in Europe, Asia or Latin America, having succeeded in completely disguising the criminal origin of the money.

Investments then would be made in the U.S. by wire transfers, by checks drawn on the offshore bank's accounts in correspondent banks in the U.S., or by payments to third parties who facilitate the transfer of goods, services or other assets.

After making the deposits, we would enjoy a lunch of lobster and champagne .... and return from our "business trip" with empty luggage.

As traffickers expand their operations, they may deem it advisable to form their own banks in tax shelter countries, thereby adding an additional layer of secrecy to their operations.

In one of the islands where I laundered substantial sums, there are approximately 300 banks operating with licenses granted by that island's government. Only about 10 actually maintain physical banking offices there. The others are operated by management firms for absentee owners or exist only as accounts in other banks.

Because the offshore banks which attract drug traffickers are generally locally owned by business entrepreneurs with strong political connections, the banks are usually insulated from U.S. judicial or diplomatic inquiry.

Typical tax shelter countries have minimal contacts with the U.S. and enforcement agencies generally receive a cold welcome.

Political considerations aside, until the black holes of laundering havens are closed down, no significant progress will be made in the effort to control money laundering. Local authorities must be convinced to close down the banks that openly cooperate with money launderers.

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variety of illicit transactions ranging from fraud to arms trafficking. Over-invoicing using false documents can be an excellent cover for moving the proceeds of drug trafficking and other crimes, while false invoices, bills, and receipts can be used for a variety of tax frauds. Such services and documents are as available to terrorist groups as they are to criminal organizations and can be used to circumvent obstacles to the acquisition of the weapons necessary to continue campaigns of political terror. Since national laws and international regimes both rest on the use of documentation that is legitimate and correct, the generation of false papers in offshore jurisdictions poses a fundamental, if unspectacular challenge to governance at a variety of levels.

These characteristics of offshore financial centers and bank secrecy jurisdictions are not only mutually reinforcing but also make such havens attractive to criminal money. In effect, the characteristics described above can be understood as a tool kit that can be used not only to launder the proceeds of drug trafficking and other crimes but also to commit certain kinds of financial crime. Not all financial centers are equally inviting, however, and what good money launderers do is mix and match particular tools with certain jurisdictions.

The Geography of Offshore Financial Centers and Bank Secrecy Jurisdictions

In some offshore financial centers and bank secrecy jurisdictions serious efforts have been made to minimize the influx of dirty money through more careful regulation. By the same token, in spite of efforts to regulate the offshore banking world, not all jurisdictions are equally regulated. Even in those that are, there is sometimes a large gap between the legal framework and its implementation. Furthermore, when pressure to

close the gap between law and implementation is effective on some of the offshore banking havens or bank secrecy jurisdictions, those that are not pressured tend to be the major beneficiaries. As Switzerland has responded to external pressure for more transparency and greater cooperation with foreign law enforcement, for example, dubious money has almost certainly migrated elsewhere. As pointed out in Section II, these jurisdictions are highly dynamic and are motivated in part by competition for deposits and other forms of business.

All this poses enormous dilemmas both for international supervision and regulation and for the offshore financial centers themselves. The balancing act at the international level is to impose safeguards against and obstacles to illegal activities without at the same time constraining or obstructing legal transactions. So long as there are difficulties in distinguishing between the licit and the illicit, there are real tradeoffs, however, between an approach which over-regulates and one which under-regulates. The balancing act for the offshore financial centers themselves is to attract customers through the provision of banking confidentiality and other kinds of legitimate services that protect money without also acquiring a reputation for "dirty banking". The competition among offshore financial centers takes place through the provision of sophisticated services, financial mechanisms, and tax concessions. Although some jurisdictions are more innovative than others, for the most part the menu of available options is not particularly divergent. Consequently, if there is overly vigorous implementation of "know your customer" rules in one jurisdiction, then this will put the haven at a disadvantage compared to other havens where the formalities and checks on customers are kept to a minimum. The more stringent and scrupulous one is about due diligence and vetting customers, then it is likely that some customers will take their business to alternative venues that ask fewer questions and present fewer obstacles. On the other hand, if a haven develops too unsavory a reputation as a home for "dirty money" or a haunt of organized crime and drug traffickers, then not only will legitimate money go elsewhere as respectable companies move their businesses to avoid tarnishing their reputations, but so too will more sophisticated criminals who want to avoid any taint by association. The financial center will also become the target of considerable external pressure to clean up its act. Not surprisingly, therefore, the offshore banking and bank secrecy world is in constant flux that reflects differential responses to the complex balancing acts relating to competitiveness and cleanliness. The optimum competitive position is one in which the center is neither too stringent in vetting customers nor too obviously indiscriminate in accepting all custom.

As a result, providing a definitive survey of the world of offshore banking and bank secrecy is virtually impossible. This is a dynamic and ever-changing system in which there are constant developments in rules and regulations, in the opportunities offered by individual jurisdictions, in the relative attraction of particular jurisdictions both for licit money and for the proceeds of crime, and in the pressure placed on offshore financial centers by the international community, and especially by the United States, as part of the continuing effort to combat drug trafficking and transnational organized crime.

Moreover, it is a world over which opinions are sharply divided. Some observers argue that the offshore banking sector is losing its distinctiveness and therefore its

attractiveness. According to Michael Giles, chairman of international private banking at Merrill Lynch, “In market after market, the whole structure of foreign exchange controls, the whole fear of having your savings and your capital confiscated or eroded by runaway local inflation, is decreasing”.

The implication is that there is a diminishing need for the services of offshore financial centers and bank secrecy jurisdictions. It would be a mistake, however, to under-estimate the importance of the offshore financial world. The Cayman Islands, for example, one of the most important offshore jurisdictions is generally judged to be the fifth largest financial center in the world, behind London, New York, Tokyo and Hong Kong. There are over 570 banks licensed in the Cayman Islands, with deposits of over US$500 billion. Mutual funds licensed or registered in the Islands, offshore insurers and non resident and exempted companies are other important dimensions of Cayman financial activities.

Not surprisingly, therefore, the offshore financial world is clearly seen as one in which important opportunities remain. As a result, it is constantly welcoming new members. Some of the more recent additions to the world of offshore finance have been remote islands in the South Pacific. Perhaps even more surprising has been the attempt by the state of Montana in the United States to become an offshore center, a development that seems to have encouraged Hawaii to explore a similar option. This trend has created considerable consternation among some specialists. As one money laundering authority noted, “money gets smuggled out of the United States and goes through various layers of transactions offshore. Then it comes back into the state of Montana, and it looks like it came from the late Mother Teresa's convent. Who in the state of Montana is going to ensure there are safeguards to prevent this?”

Thus, while there is no universal definition of the term, many expert observers point to a number of jurisdictions as having the requisite characteristics of a financial haven. Some of the major ones are set out below (see map infra).

The Caribbean:

Anguilla, Antigua, Aruba, Bahamas, Barbados, Bermuda, British Virgin Islands, Cayman Islands, Netherlands Antilles, St. Kitts and Nevis, St. Lucia, St. Vincent, Turks and Caicos Islands, Panama, Costa Rica and Belize.

Europe:

Ireland (Dublin), Switzerland, Liechtenstein, Andorra, Luxembourg, Campione, Monaco, Gibraltar, Malta, Madeira, and Cyprus as well as the British Islands, Guernsey, Jersey, Sark and the Isle of Man.

Asia-Pacific:

Hong Kong, Vanuatu, Cook Islands, Singapore, Western Samoa, Macau, Marianas, Marshall Islands, Nauru, Niue, and Labuan.

Middle East:

Bahrain, Dubai, and Lebanon,

Africa and Indian Ocean:

Liberia, Mauritius and Seychelles.

Within this world, important and difficult judgements have to be made about how flexible to be. Different jurisdictions have responded in different ways to the dilemmas of competitiveness and cleanliness discussed above.

Bermuda, for example, which hosts about 40 per cent of the world's captive insurance companies, has been extremely cautious and is regarded as one of the more scrupulous jurisdictions that, for the most part, has attracted the right kind of business. Yet even in Bermuda, there are virtually unregulated areas of financial activity such as insurance companies and mutual funds that have the kind of multiple account capabilities that facilitate money laundering. Moreover, the fact that Bermuda is generally more careful and moves more slowly in the incorporation of companies than some of its competitors is frequently seen as a disadvantage. Some members of the Bermuda offshore community for example, have expressed concern that it takes five days to incorporate a Bermuda company – significantly longer than some of Bermuda's competitors. There is also anxiety about Caribbean competitors taking spill over work which is of dubious origin but nevertheless provides them with important advantages.

One of those competitors which has been criticised for showing little discrimination about its customers has been Antigua. U.S. News and World Report commented in 1996 that no one has extended an invitation to dirty money like Antigua which has "a virtually unregulated banking industry, no reporting requirements and secrecy laws that punish violations of bank clients" confidentiality. The number of banks there grew by 75 percent in 1995; anyone with $1 million can open a bank, and many consist of nothing but a brass plate or a room with a fax machine".

Although the European Union Bank fiasco has led to increased pressure on Antigua to "clean up its act" it is not certain that there have been any fundamental changes. The authorities in Antigua have attempted to play down the European Union Bank case while also suggesting that they have taken measures to prevent future occurrence of this kind. What they have not explained adequately, however, is how a country with a population of between 65,000 and 70,000 can develop the capacity for adequate supervision of the myriad and complex financial services and institutions available on the island. Until there is such a capacity, the changes in Antigua will be merely cosmetic.

Another country that apparently wants to develop a rather different image of its offshore activities is Panama. In the past, loose regulations and tight secrecy laws made Panama extremely attractive to those who wanted to hide, or launder the proceeds of crime. In 1998, however, there have been reports that Panama – which still has over 100 banks from 30 countries and a bank sector that accounts for11 per cent of GDP is addressing fears about lack of supervision . The President of the Panamanian Banking Association wants to transform Panama into a major financial center "homogenous with London, Zurich, New York or Miami". Some steps have been taken in this direction and Panama has created a financial analysis unit to track money movements. Yet, as one of the cases in Section IV reveals, millions of dollars suspected of being the proceeds of drug trafficking were channeled back to Colombia via Panama during the mid-1990s. Moreover, because the U.S. dollar is, effectively, the currency of the country, Panama is likely to remain one of the favorite jurisdictions for money launderers attempting to put proceeds of crime into the financial system.

In Europe there is continued controversy over bank secrecy in Switzerland and Luxembourg. Yet in Switzerland bank secrecy is not what it was. Pressure from other countries for greater transparency, concerns about the infiltration of Russian organized crime, the passage of new laws against money laundering, the broadening of criminal laws and thereby the potential scope for the implementation of mutual legal assistance have all placed major dents in bank secrecy. Moreover, Switzerland is taking serious initiatives to combat money laundering. Yet, there is also a sense in some quarters that the change is being exploited by competitors. According to one banking official, "the assertion that Swiss bank secrecy is no longer as watertight as it once was, or even that it has become full of more holes than Emmenthal cheese, is not new. It is being spread about in the mass media with a malicious undertone by competing foreign financial centers. Paradoxically, they are often the same people who criticize Switzerland becauseof its apparently rigid protection of secrecy".
Accompanying this is deep-seated concern that Switzerland's "enormous competitive advantage" in the area of client confidentiality is being eroded, and in the words of one bank official, "the time has come to take a stance and defend in a lucid and resolute manner an asset of which the country may be proud and which it cannot do without". Luxembourg, which has over 220 banks in the city and is seventh in the world in terms of assets in foreign currencies, has also been under siege. It was the country which, in effect, brought BCCI to the world. More recently, it has faced criticism from Germany for its policy on taxes and from Belgium on the grounds that Luxembourg's secrecy laws attract dirty money from African dictators.

For those who are concerned that neither Switzerland nor Luxembourg offer the protection they did in the past, Liechtenstein could be an attractive alternative. It is usually described as one of the world's best tax havens with stricter bank secrecy than Switzerland – and even as the place Swiss citizens go if they want to hide money. Moreover, Liechtenstein offers a wide range of services including the Anstalt discussed in Section II. Liechtenstein is also the only continental European country to have trust regulations which bring with them demand for work in the areas of litigation, intellectual property rights and the licencing of patents.

Other alternatives include Austria which still has the Sparbuch or "bearer savings account book" for Austrian citizens which can be operated without customer identification and the Czech republic which also offers anonymous passbook accounts.

Another area where competition is keen is the Mediterranean. A few years ago Cyprus appeared to be the offshore financial center of choice for Russian organized crime, but has strengthened its regulatory framework and increased its capacity for financial monitoring. Other Mediterranean centers include Malta, and Lebanon is also moving aggressively to re-establish its pre-eminence and has increased the scope of the activities in which offshore companies are permitted to engage and reduced the already low tax rates on profits of holding companies.

In the Asia-Pacific region, the competition, if anything, is even greater. Labuan, Malaysia's offshore jurisdiction is implementing a major campaign to attract business while in Mauritius the number of offshore banks jumped from 10 to 2,500 between 1993 and 1996. Even more striking has been the growth in cross border investment going through Mauritius to India. Other participants in the offshore financial business include Vanuatu, the Cook Islands, and Niue all of whom are vigorously promoting their offshore financial centers. In 1994 the Niue government passed laws covering international business companies and asset protection trusts, as well as banking and insurance. The International Business Companies Law was modeled on that developed by the British Virgin Islands, with some additions that point to the market niche: the name of the company can be registered in Chinese script; directors may keep the company records and share register outside Niue; and agents with businesses elsewhere can act as deputy registrars with the authority to incorporate companies. The willingness of Niue to provide charters in any language desired and the limited population base highlights once again the contrast between the lavish provision of financial services, institutions and mechanisms and the meager resources for supervision and oversight.

While some of the smaller jurisdictions have almost certainly attracted dirty money, perhaps the most brazen attempt to enter the offshore financial world at the bottom end of the market was initiated by the Seychelles, which, in the mid-1990s passed an "economic development" act offering citizenship and no questions asked for those who placed deposits of $10 million or more in the islands. Under pressure from the United States and other members of the international community the Seychelles backed away from the sale of its sovereignty.

None of this is meant to ignore efforts to establish closer supervision, more effective oversight or greater transparency in the world of offshore financial centers. Indeed, there has been a series of measures from the early 1980s when the United States became seized of the issue after a series of Senate hearings illuminated offshore banking and the way it could be exploited by drug traffickers and other criminal organizations. Part of the problem, however, is that the issue of bank secrecy goes well beyond the traditional offshore financial centers and jurisdictions such as Switzerland and Luxembourg. There can perhaps be no definitive listing of jurisdictions which refuse to

lift bank secrecy to accommodate criminal investigations, as the situation in this regard is subject to continual change, and judgments about appropriate levels of cooperation with law enforcement agencies will differ. The United States' review of international anti-money laundering provides some clues as to where bank secrecy is an impediment to criminal investigations. The State Department's International Narcotics Control Strategy Report released in March 1998, gives an assessment of whether or not bank secrecy can be lifted to facilitate criminal investigations at the domestic and international levels. Those countries which are listed as not having laws mandating banks to cooperate with domestic law enforcement investigations into money laundering or are unwilling to lift bank secrecy are Afghanistan, Belarus, Belize, Bolivia, Cuba, El Salvador, Guatemala, Guyana, Haiti, Laos, Lebanon, Morocco, Mozambique, Nauru, South Africa, Thailand, and Vanuatu. All of these countries except Belize also lack laws permitting or requiring banks to cooperate with investigations by third party governments through sharing records and making available financial data. They are joined in this by Albania, Armenia, Azerbaijan Bulgaria, Cote D'Ivoire Estonia, Gibraltar, Kazakhstan, Kuwait, Kyrgyzstan Moldova, Nicaragua, Pakistan, Romania, Slovakia, Sri Lanka, St. Vincent/Grenadine, Ukraine, and Uzbekistan.

If some of these jurisdictions lack the will to impose greater regulation and to seek greater transparency in financial matters, in the smaller offshore financial centers and bank secrecy jurisdictions, the problem is also one of capacity. There are too few regulators to oversee the transactions and the institutions that are involved in them. Although there might have been some improvements recently, for a long time, one bank inspector and one insurance adviser, were responsible for regulating a burgeoning companies sector in the British Virgin Islands where the number of new companies incorporated annually greatly exceeded the size of the population.

If at least some offshore financial centers and bank secrecy jurisdictions remain a magnet for money launderers and various other criminals, there are efforts to clean up the situation and movement towards acceptance of norms, laws and regulations. The more important law enforcement and regulatory milestones include the following developments.

The growing use of Mutual Legal Assistance Treaties to facilitate the sharing among governments of information relevant to criminal investigations and prosecutions.

A 1986 case in which a New York investment banker, Dennis Levine, who was accused of obtaining over $12 million through insider trading had used a bank in the Bahamas to cover his activities. . Records of Levine's transactions were given to United States authorities by the bank in spite of the bank secrecy laws.
(Once again, however, cooperation was obtained largely because U.S. authorities had specific information about the accounts. Where such information is lacking, it is not possible to make a sensible request likely to receive a positive response from an offshore or bank secrecy jurisdiction).

An initiative by Britain in which it closed most of Montserrat's "brass plate"

banks and commissioned Coopers and Lybrand to examine offshore financial services in the dependent territories. The resulting Gallagher Report proposed specific reforms in the major jurisdictions.

The work of the Basle Committee on Banking Supervision. In June 1996, representatives from 140 countries at the International Conference of Banking Supervisors incorporated into a report by the Basle Committee 29 recommendations designed to strengthen the effectiveness of supervision of banks operating outside their national boundaries. The recommendations included provision for on site inspections. Guidelines were issued for determining the effectiveness of home country supervision, for monitoring supervisory standards in host countries, and for dealing with corporate structures which create potential supervisory gaps. The level of compliance that has been achieved is being assessed.

The activities of the Offshore Group of Banking Supervisors (OGBS) which has reached agreement with FATF on ways to evaluate the effectiveness of the money laundering laws and policies of its members. The difficulty is that only about a half of offshore banking centers are members of OGBS

The efforts of the Caribbean Financial Action Task Force (CFATF) which has made progress in regional anti-money laundering initiatives and is seeking compliance not only with the 40 Recommendations proposed by FATF but with an additional 19 Recommendations specific to the region. The CFATF is also heavily engaged in mutual evaluations and a delineation of money laundering typologies in the region.

An announcement by the British government in early 1998 that it is reviewing regulations on Jersey, Guernsey and the Isle of Man, assessing how reports of "suspicious transactions" are handled, and examining the willingness and ability of the authorities to secure prosecutions in financial crime cases. At the same time, Britain emphasized to its crown dependencies in the Caribbean the need to clean up their financial services

Growing but still limited recognition in the legal and financial world that the accountants and lawyers who set up the trusts can also be held responsible for the activities that are engaged in through the trusts. In one case, for example, a private banker in the Bahamas was accused of fronting a brothel. This taught him an important lesson about trust funds. As he put it: "You're getting a tiger by the tail with trusts. Because you legally own the assets, the risk for the trustee is incalculable".
Such admissions and more cautious behavior resulting from a growing sense that lawyers can be held culpable, however, remain the exception rather than the rule.

If serious efforts have been – and continue to be – made to impose more effective supervision on offshore financial centers and to create greater transparency in banking matters, there is clearly still a long way to go. Not only are there jurisdictions which refuse to accept the prevailing norms, but even in those financial centers where the banks are under increasing scrutiny and control, other mechanisms for secrecy provide what appear to more than adequate substitutes. As a result the world of offshore financial

centers and bank secrecy jurisdictions is still an attractive one for money launderers and those engaged in various forms of financial fraud – as the next section reveals even more clearly. The offshore financial world is appropriately described as a “Bermuda triangle” for investigations of money laundering, complex financial fraud and tax evasion. Money trails disappear, connections are obscured, and investigations encounter so many obstacles that they are often abandoned. The next section offers glimpses of this world in operation provided by investigations that, for very specific reasons were able to navigate through the black hole.

IV. Cases Involving Financial Havens and Bank Secrecy Jurisdictions

Introduction

Often described as the white collar crime of the 1990s, money laundering is in fact a crucial accompaniment to many forms of criminal activity ranging from drug trafficking and organized crime to financial fraud. The diversity and sophistication of many money laundering operations are very impressive with major criminal organizations using a wide variety of mechanisms and methods. Italian organized crime groups, for example, have used banks and casinos in Nicaragua to launder their money, while some of the New York mafia families have been linked with laundering schemes in Brazil. For their part, Russian criminal organizations seem to have a highly diverse approach to their profits, with reports that "dirty" money of one kind or another is going to Israel via Antwerp, through Gibraltar and into Spain, into the London real estate market, and into the Caribbean. There have also been reports of an emerging triangular relationship among Russian, Italian and Colombian criminal organizations, in which they provide a variety of services, including money laundering, for one another.

Poland is another country that seems to be afflicted by money laundering both by indigenous criminals and by groups from outside. With 49 million bank accounts for 7.5 million inhabitants, Poland has reportedly been the target of Italian and American mafia organizations who use multiple bank transfers between Polish banks and financial institutions in the Caribbean. Groups within Poland also seem to have become active in money laundering and in several cases examined by prosecutors in Poland there seems to be an important connection with Liechtenstein.
If states in transition, are increasingly infiltrated by organized crime and money laundering, so too is the developing world. According to a report in the mid-1990s for the Department of Foreign Affairs in France, French citizens are implicated in money laundering in Central Africa using horse-racing and casinos. The author of the report expressed concern about the project for a Sao Tome free zone, which, in his view, could allow criminals to use commercial and financial trade for drug trafficking and money laundering in Francophone Africa. The implication is that there is no part of the world which is immune from the laundering of criminal proceeds.

The real difficulty in dealing with money laundering, both analytically and operationally, is that if the "fundamental laws" outlined in Section II are followed then it is virtually impossible to detect.

Consequently, in many of the cases that actually result in convictions, money laundering is only one part of a much more comprehensive indictment. In some instances, poorly conceived attempts to launder money helped to alert law enforcement to the criminal enterprise and activities. In many cases, however, it was the initial criminal activities that brought the individuals or groups to the attention of law enforcement – and the money laundering component only became visible in the course of the subsequent investigation. Nevertheless, by presenting an array of cases (mostly but not exclusively

based on United States reports, which are numerous and well-documented), it should be possible to convey a sense of the diversity of money laundering and the sometimes imaginative and sometimes rather crude ways in which offshore financial centers are used to hide, move and clean the proceeds of crime. To think of offshore financial centers in terms only of money laundering, however, would be a mistake. They are also used as a base to commit certain crimes, and to provide coverage for a variety of dubious and criminal financial transactions. The following case studies of money laundering and financial fraud with an offshore component are intended to highlight this diversity.

Before examining the cases, however, it should be emphasized that these are the law enforcement success stories in an area usually characterized by criminal successes and law enforcement failures. Estimates of the annual turnover from global drug trafficking have been estimated by the UN World Drug Report to be somewhere around $400 billion, while the proceeds of all forms of organized crime have been estimated to be as high as one billion dollars. The proceeds obtained through various forms of financial fraud almost certainly exceed those from drug trafficking, while the money involved in tax evasion is some multiple of the proceeds of crime – although precisely what multiple is uncertain. Indeed, because of the clandestine nature of criminal activity, particularly successful criminal ventures, such estimates are inherently problematic. The point, here, however, is simply that the amount of dirty money that finds its way into offshore financial centers and bank secrecy jurisdictions is enormous. Set against this, the assets that are seized or recovered in cases where law enforcement is successful are negligible.

Case Studies in the Use of Offshore Financial Centers and Bank Secrecy Jurisdictions

The BCCI case

In July 1991, more than $12 billion in assets of the Bank of Credit and Commerce International (BCCI) were seized after regulators discovered evidence of widespread fraud. The collapse of the bank did not come as a complete surprise. Investigations into its conduct had been taking place for several years in the United States and Britain. Nevertheless, the action of the regulators and the abrupt end to the bank's activities sent large shock waves through the global financial system. As more and more revelations about the bank appeared, however, what was most striking was not that it had been forced to cease operating, but that it had operated for so long with such freedom and so little interference from governments and regulators. The bank had claimed to make profits that seem to have been largely fictitious and had been wholly indiscriminate about its customers, providing services for drugs traffickers, dictators, terrorists, fraud merchants, intelligence agencies, arms dealers and the like. The notion of due diligence, of knowing the customer, was not part of the bank's lexicon, let alone its operating procedures. Furthermore, "BCCI was not just built on secrecy and deception, but it also sold them as an essential part of its banking service"
. Created by Agha Hasan Abedi as a bank for the developing world, BCCI, by the time of its demise, had become known in some circles as the Bank of Crooks and Criminals

International.

Post mortems of the BCCI scandal abounded, providing the material for several books and creating the impetus for more careful regulation of the global financial system. One of the most comprehensive investigations was done by the Staff of the Foreign Relations Committee of the United States Senate. The report was scathing in its condemnation of a bank that " ... was from its earliest days made up of multiplying layers of entities, related to one another through an impenetrable series of holding companies, affiliates, subsidiaries, banks within banks, insider dealings and nominee relationships. By fracturing corporate structure, record keeping, regulatory review, and audits, the complex BCCI family of entities ... was able to evade ordinary legal restrictions on the movement of capital and goods as a matter of daily practice and routine".

BCCI was able to commit or facilitate a variety of crimes through a variety of means including the use of shell corporations, the exploitation of offshore financial centers and bank secrecy havens, and the diffusion of its corporate structure. Complexity was accompanied by high level political influence. Although headquartered in Luxembourg, BCCI's global scope meant that it was not accountable to any particular jurisdiction or subject to one set of regulations. If the oversight system was inherently weak, however, this weakness was fully exploited by the Bank, which divided its operations between two auditors, neither of whom looked at the totality of its activities and was, therefore, able to obtain a real sense of its involvement with money laundering and various forms of fraud and corruption. In addition, BCCI used the Cayman Islands and the Netherlands Antilles to create a maze of front companies that provided a wall of secrecy about its depositors and its activities. And even when authorities such as the Bank of England learned of some of BCCI's criminal activities, they did not move to close the Bank for another two years. Perhaps most disturbing of all about BCCI is that, as the Kerry and Brown report to the Foreign Relations Committee made clear, it was "not an isolated phenomenon, but a recurrent problem that has grown along with the growth in the international financial community itself. Given the extraordinary magnitude of international financial transactions ... the opportunities for fraud are huge, the rewards great, and the systems put in place to protect against them, far from adequate.

The European Union Bank of Antigua

In the aftermath of the BCCI scandal, intense efforts were made to improve the regulation and oversight of the global banking system. Yet, in July 1997 – six years after the regulators forced BCCI to cease trading, the European Union Bank (EUB) of Antigua collapsed. In this case the bank officials disappeared along with the deposits. Tiny in comparison with BCCI, the case of European Union Bank shows that regulation and oversight of the global financial system still have many loopholes. Indeed, the story of European Union Bank is a perfect example of the way in which the offshore banking jurisdictions and bank secrecy havens facilitate criminal activity. In many ways, it also appeared to be the prototype bank of the future, soliciting for deposits on the World Wide Web and offering anonymity, avoidance of what was portrayed as burdensome and

expensive accounting requirements, and excellent returns of as much as 9.91 percent on a one year, $1 million certificate of deposit.

The European Union Bank was initially registered as an offshore bank in Antigua on June 8, 1994, as the East European International Bank Ltd. On August 18, 1994, it changed its name to European Union Bank Inc. Its parent company was named as Swiss Investment Association SA, an International Business company registered in the Bahamas. European Union Bank was apparently set up by two Russians, Alexandr Konanykhine and Mikhail Khodorovsky, who seem to have presented themselves as officers of the Menatep Bank of Moscow. Perhaps the best indicator of the bank's uncertain origins, however, is that Konanykhine, one of the founders, was already a highly controversial figure who is alleged to have absconded from Moscow in 1992 after embezzling $8.1 million from the Exchange Bank. Reportedly, on February 27, 1995, the Board of Governors of the U.S. Federal Reserve System, in a restricted memo, said it had been advised by the Bank of England that Konanykhine had visited Antigua in January 1995, and met, "government officials to request their cooperation in keeping Menatep's ownership of European Union Bank confidential", something that Konanykhine denied . Khodorovsky, who was, in fact, a top official at Menatep Bank not only denied that Menatep was involved with EUB but also dismissed the allegations regarding Menatep's ties to organized crime.

The Bank, in September 1995 launched its Web site and claimed to be the first Internet bank with customers able to create and manage accounts on-line via any Internet connection. In July 1996, it was announced by Lord Mancroft, then the bank's chairman and a member of the British House of Lords, that the European Union Bank would seek funding through shares that would be sold over the Internet. At this time, it was claimed that the bank had backing of $2.8m. The bank also claimed to have 144 accounts with account holders in 43 countries. The largest deposit was apparently $400,000. Mancroft admitted that the benefits of banking with European Union Bank included tax evasion is an attraction for prospective customers, noting in an interview that, "we offer no frills. Customers do not get clogged down with paperwork". At the same time he denied allegations that the bank was involved in money laundering, claiming that most money laundering was done "under the noses of established banks in western capitals". He also claimed the bank had hired a former official of the U.S. Department of Justice to ensure the probity of the bank's dealings.

The reassurances about money laundering were belied by the bank's advertising, which was explicitly aimed at persons seeking to evade taxes or find a haven for dirty money where it would be beyond the reach of law enforcement and emphasized that this was "the least expensive and securest means of client bank interaction ever". Some of the world wide web advertisements are reproduced in Box 8. As the June 1996 issue of Money Laundering Alert noted, "the EUB allows customers access to a full range of offshore private banking services from any country ... Customers can open numbered accounts, in which the customer's identity is known only by an EUB private banker, or coded accounts, which are numbered accounts that operate by passcode rather than signature". Customers could also incorporate a business on-line "under the Antiguan International Business Corporations Act which requires no

disclosure of shareholders or of beneficial owners”.

Not surprisingly, European Union Bank came to the attention both of those monitoring organized crime activity and bank regulatory bodies. Indeed, almost from the outset red flags were raised by the auditors, Coopers and Lybrand. On July 31, 1995, their report noted that they were unable to satisfy themselves as to the collectability of the loans due from the parent company and, consequently, were unable to state whether the financial statements presented by the Bank present fairly the financial position of the company as of December 31, 1994. The collapse of the bank, however, was preceded by a series of much more public warnings and ultimately by indications that the government of Antigua, responding to international pressure, was taking steps to move against it.

One of the most important warnings was issued by the Bank of England in October 1996. The Bank of England advised intending depositors to carry out appropriate due diligence on the European Union Bank noting that there was no guarantee for their deposits.

At around the same time, U.S. News and World Report warned that Antigua had an unregulated banking industry, with no reporting requirements and secrecy laws that punish violations of client confidentiality. It suggested that many banks on the island consisted of “nothing but a brass plate or a room with a fax machine”.
An article in the Washington Post by Douglas Farah raised similar concerns. It was becoming clear that there was little or no due diligence in Antigua regarding bank charters so long as the person setting up the bank had $1 million – the amount necessary to open a bank on the island.

In the Spring of 1997, the State of Idaho took out an injunction to stop the bank from soliciting deposits through the World Wide Web. The Idaho Department of Finance issued the Order

ABOUT EUROPEAN UNION BANK

The European Union Bank strives to give our European and international clients easy, quick and secure computer access to European Union Bank's complete range of offshore banking services.

Incorporated in Antigua and Barbuda under the International Business Corporations Act (IBC) of 1982, European Union Bank provides multicurrency banking and financial services to clients throughout the world. With utmost privacy, confidentiality and security, European Union Bank clients receive excellent interest rates, offered in a stable, tax free environment.

Oppressive and chaotic tax structures in many countries dilute capital investment and force prudent investors to seek tax shelters and protection. European Union Bank, operating fully within the law, offers tax protection to clients who seek to wisely protect their assets by using favorable Caribbean tax shelter programs that have long been available to international financial and business communities. Most major banks and financial institutions maintain offshore subsidiaries in the Caribbean for these reasons.

Since Antigua does not impose any taxes on a bank's income or accounts, European Union Bank is able to pay interest rates that are higher than banks in other countries. Additionally, since there are no government withholding or reporting requirements on accounts, the burdensome and expensive accounting requirements are also reduced for you and for the bank.

European Union Bank maintains the strictest standards of banking privacy in offshore business and financial transactions. Indeed, Antigua has stiff penalties for officers or staff that violate the banking secrecy law.

Until recently, the only barrier to offshore banking was the remoteness of the bank from its clients. Modern technological advances and world telecommunication improvements have removed that barrier. Now clients of European Union Bank can communicate with the bank at anytime from anywhere via the Internet. From the convenience of their office or home, account holders can check balances, wire money, or take out a loan as easily as if they had been transported to Antigua. With an Internet connection, you also can take advantage of the financial rewards of offshore banking with European Union Bank. Modern computer communications make this way of banking the easiest, least expensive and securest means of client-bank interaction ever.

European Union Bank account holders can receive banking information, transfer money and give any other instructions to the bank 7 days a week, 24 hours a day with Bank Online computer services.

Clients may also provide European Union Bank with instructions using more conventional methods of communication, such as telephone, telefax, telex or mail, each employing time-tested, effective security procedures.

Services available from banking with European Union Bank include:

Multi-currency current and time deposit accounts
Numbered accounts
International wire transfers online
Portfolio management
Foreign exchange transactions
Letters of credit
Tax protection
A number of other specialized bank services to meet individual needs.
Banking services are free when minimum deposit levels are maintained.

NUMBERED AND CODED ACCOUNTS

A major concern of all banking clients but particularly those that are involved with offshore banking is for the complete security and secrecy of their financial transactions. European Union Bank is very aware of the concerns of its clients and is therefore offering two separate but related accounting functions that will give its clients maximum security but at the same time enable the clients to have easy access to their funds.

There is nothing new about the concept of a numbered account: they have been offered in Swiss banking circles for centuries. However, many clients do not fully understand how they can take advantage of this possibility. A numbered account is where a number is allocated by the Bank in the form of a random selection of numbers and letters and used as the identification for a particular account. Any instruction from the

account holder to the bank for wiring money, making payments, investments, etc. will be done using this number only so the client's name will never be used in any correspondence.

It must be emphasized that the only persons who know the identity of that particular numbered account holder will be the private banking officer in the Bank and the account holder. The customer must fully understand that the numbered account, i.e. the identifying number, in lieu of the customer's name, is different from the account number which refers to the normal "named" account.

Use of the numbered account gives complete anonymity to the client while still retaining the client's full control over her or her funds.

Coded Accounts

European Union Bank, with the high tech advances in electronic banking, is well aware that the authority to operate a customer account can no longer be the simple signature of yesteryear. To give the clients the availability of managing their funds using personal computers, there must be a method put in place which will ensure that the only person activating that account is the person who has the necessary authority.

A coded account is a numbered account where not a client's signature, but a special personal passcode is used as the identification of the client. Any instruction to the bank for wiring money, investments, etc. will be considered valid if it carries the account number, the code, and is given in accordance with the specified procedure. At European Union Bank a client can choose from several possible authentication procedures, one which suits his/her need the most. Use of coded accounts gives absolute privacy to the client.

The banking secrecy law

Under Antiguan law, no person shall disclose any information relating to the business affairs of a customer, that he/she acquired as an officer, employee, director, shareholder, agent, auditor or solicitor of the banking corporation, except pursuant to the order of a court in Antigua. The court can only issue such an order in connection with an alleged criminal offense.

Antiguan International Business Corporation as a perfect privacy tool

Bearer Shares allowed
No public share register
No shareholder disclosure
No beneficial ownership disclosure
Corporations are not required to file any corporate reports

European Union Bank can register a corporation for you within 48 hours for as little as US$995.

Box 8: Promotion of the European Union Bank on the Internet

on May 29, 1997. The Cease and Desist Order required European Union Bank of Antigua, its officers, directors, employees and agents to cease soliciting deposits from Idaho residents. According to the Order, European Union Bank was not chartered to operate as a bank or any other form of financial institution in the State of Idaho and it was therefore unlawful for it to engage in banking by soliciting deposits in the State. The difficulty for the State of Idaho, of course, was that it had no power to implement the order. Nevertheless, this was another red flag with Idaho, echoing the Bank of England and warning that deposits were not protected by the Federal Deposit Insurance Corporation.

There were also growing pressures on Antigua itself. Antigua shut down five Russian and Ukrainian banks and asked for the assistance of Rodney Gallagher, an adviser on Caribbean financial services to the British Foreign Office and author of an important report on offshore banking in British crown dependencies. In a letter in March, Antigua's Finance Ministry told European Union Bank that it was “not in good standing”. Nevertheless, this did not prevent it from continuing its operations, leading the Ministry in June to warn potential investors to proceed with great caution. A few weeks before the collapse, the government of Antigua also asked Coopers & Lybrand, the auditors, to investigate the bank – and just prior to the collapse the office of national drugs and money laundering policy issued a fraud warning. All this was not only too little too late, but might even have been a factor in encouraging the bank owners to abscond with the deposits. In an important twist on the classic stable door metaphor, this was a case of encouraging the horse to bolt – in this case taking with him all the depositors’ money – by threatening to shut the door rather than actually doing it. The two Russians – Serbeveo Ushakov and Vitaly Papsouev – who at this point seemed to be the owners of the bank apparently fled to Canada.

In the aftermath of the collapse, the head of Antigua's Office of National Drugs and Money Laundering Control Policy, noted that new legislation requires all banks to disclose
information about owners, directors, and investors and that he was committed to cleaning up offshore banking on the island. The question is whether there will be sufficient resources to enforce the regulation.

The Johnny Kyong Case

In 1990 Johnny Kyong was convicted of supplying heroin to the New York mafia. Apparently he moved his profits through bulk shipments of cash to Hong Kong or through a Venezuelan company to bank accounts in Hong Kong and from there used the fie chien or Asian underground banking system to move funds to Burma and Thailand to purchase more drugs.

The Spence Money Laundering Network in New York

An intriguing example of money laundering was uncovered in New York in 1994.

It involved a network of 24 people including the honorary consul-general for Bulgaria, a New York city police officer, 2 lawyers, a stockbroker, an assistant bank manager in Citibank, 2 rabbis, a firefighter and 2 bankers in Zurich. A law firm provided the overall guidance for the laundering effort while both a trucking business and a beer distributorship were used as cover. The Bulgarian diplomat, the firefighter and the rabbi acted as couriers picking up drug trafficking proceeds in hotel rooms and parking lots, while money was also transported by Federal Express to a New York trucking business. The two lawyers subsequently placed the money into bank accounts with the assistance of a Citibank assistant manager. The money was then wired to banks in Europe including a private bank in Switzerland, at which two employees remitted it to specific accounts designated by drug traffickers. During 1993 and 1994 a sum of between $70M and $100M was laundered by the group.

The Franklin Jurado Case 1990–1996

One of the most fascinating convictions in the United States in recent years for money laundering was that of Franklin Jurado, a Colombian economist and Harvard graduate who not only laundered significantly amounts for Jose Santacruz Londono of the Cali cartel, but developed an explicit and well thought out scheme for cleaning money.

Jurado was arrested in Luxembourg in 1990 where law enforcement officials also seized computer disks with records of 115 bank accounts in 16 nations "from Luxembourg to Budapest" and details of a vast money laundering scheme. The five stages of the scheme were designed to clean the proceeds of drug trafficking and make them immune from seizure. In many ways, they are no more than a variant on the classic money laundering cycle described in section II of this report. In Jurado's view, however, the phases were carefully designed so that the assets would "move from a higher to a lower level of risk". The five stages were as follows:

The initial deposit, which is the riskiest stage because the money is still close to its origins and therefore still tainted. Panama was used at this stage.

Transfer of the funds from Panama to Europe. "Over a three year period, Jurado coordinated the transfer of U.S. dollars from the Panamanian banks into more than one hundred accounts in sixty eight banks in nine countries. Austria, Denmark, the United Kingdom, France, Germany, Hungary, Italy, Luxembourg, and Monaco" with deposits from $50,000 to $1 million.

Transfer to an account in the name of European individuals. As one commentator observed, the purpose of this phase was to obscure "the nationality of the account holders by transferring assets into new accounts opened under European names such as "Peter Hoffman" and "Hannika Schmidt' Assigning accounts to fictitious Europeans removed the "political" barrier the heightened surveillance generally given to Colombian or Hispanic surnamed accounts".

Transfer to European front companies that would not arouse suspicion and

provide no reason, "geographic, legal, political or psychological to investigate the assets".

The return of funds to Colombia through investments by the European front companies in Santacruz's "legitimate" businesses such as restaurants, construction companies, pharmaceutical enterprises, and real estate.

According to one report, Jurado laundered 30 million French francs through accounts in large French banks. He had noted that in the "Blue Book" of laundering countries, France was worth a detour; and had identified French financial institutions that were particularly accessible to laundering.

In Jurado's assessment, however, there were higher ratings for Austria, which he observed was "extremely open to our type of deposits" and offered "extraordinary facilities in terms of confidentiality and banking discretion"; for Hungary which desperately wanted western capital, and the Channel Islands, which was a "financial paradise". Switzerland, in contrast, he believed should be avoided because United States pressure was creating a "lack of trustworthiness in reference to confidentiality".

In spite of his research and his carefully phased strategy, Jurado was arrested in Luxembourg in 1990 – apparently before funds were transferred to the European front companies. His arrest was accompanied by the seizure of $46 million from 140 bank accounts in Europe and Panama and this was followed closely by the seizure of funds by several New York bank accounts including $3.4 million held by a Panamanian company, Siracusa Trading Corporation. In April 1996, Jurado was sentenced to seven and a half years in prison.

Refrigeration USA

In a case in Florida, an executive and several other employees of Refrigeration USA, a Miami and Hallandale, Florida based corporation pled guilty to conspiracy to import the controlled refrigerant gas, CFC 12 into the United States without the permits required by the Clean Air Act. Their scheme involved false bills of lading filed with United States Customs as well as the Environmental Protection Agency, and the IRS. The CFC 12 was bought in Europe and payment was made from accounts opened under fictitious names in Switzerland and the Channel Islands. Nominee corporations in the Turks and Caicos islands were used for concealing activities and to impede the IRS in collection of excise taxes. Bank records were used in the trial after being provided by the Turks and Caicos in accordance with the Mutual Legal Assistance Treaty between the United States and the United Kingdom. The sums involved were substantial with almost $4.5 million in cash held in offshore accounts. This was forfeited along with property in Miami and London, worth over $3 million and cylinders of CFCs with a market value of $6.7 million.

American Express Bank International

In June 1994, Antonio Giraldi and Lourdes Reategui, officials with American Express Bank International (AEBI), were convicted of laundering drug trafficking proceeds for Juan Garcia Abrego. As a spin-off from the investigation a major Texas drug trafficker was also arrested. He had become a client of Giraldi and Reategui at Bankers Trust, (New York) and later at AEBI. The bank officials "created a series of offshore holding companies for the defendant and opened bank accounts in the names of the various offshore companies, into which the defendant secreted his drug trafficking proceeds via electronic wire transfers. From February 1989 through 1993, the defendant wire transferred approximately $17 million into these accounts. All of the $17 million was traced to Mexican banks or to accounts held by Mexican banks in US banks in El Paso, Texas. During 1993, the defendant liquidated the funds held by his offshore companies through wire transfers to Mexican bank branches and to another offshore investment company". Mutual Legal Assistance Treaty (MLAT) requests to Mexico, Switzerland, and the Cayman Islands were critical in compiling evidence and in June 1997, after pleading guilty, the Texan trafficker was sentenced to life imprisonment.

The Fortuna Internet Fraud Case

In February 1997 the United States Department of Justice announced that it had recovered $2.8 million for victims of fraud. The money had been obtained through a fraudulent marketing scheme run by Fortuna Alliance on the Internet. Promising consumers enormous profits for a modest enrollment, Fortuna wired the money it received to offshore trust accounts in the Swiss American Bank, Limited, in St. John's, Antigua. The Department of Justice on behalf of the Federal Trade Commission, succeeded in obtaining an order from the High Court of Antigua freezing the funds.

The Sagaz Case

In March 1998, Gabriel Sagaz, the former president of Domecq Importers, Inc., pled guilty to a charge of conspiracy to defraud for actions that had taken place between 1989 and August 1996. Sagaz and several colleagues had embezzled over $13 million directly from the company and received another $2 million in kickbacks from outside vendors who invoiced for false goods and services. Sagaz approved the phoney invoices and after the vendors were paid by Domecq Importers, Inc they issued checks to shell corporations controlled by Sagaz and his colleagues. The checks were deposited in offshore bank accounts opened by Sagaz and his colleagues, thereby adding tax evasion to the charges.

The Harrison (Iorizzo) Oil Gasoline Tax Fraud Case

In June 1996 the U.S. Department of Justice announced that Lawrence M. Harrison, formerly known as Lawrence S. Iorizzo, had been sentenced to over 15 years in prison for a tax fraud in Dallas. He had been convicted in March 1996 on charges of motor fuel excise tax evasion, conspiracy, wire fraud and money laundering. Iorizzo had

been the key figure in motor fuel tax evasion schemes that had proved so lucrative for Russian criminal organizations in New York and New Jersey, and Florida in the 1980s – and which also included payments to some of the New York Mafia families. After going into witness protection. Harrison along with other family members and associates had purchased a small Louisiana corporation, Hebco Petroleum, Inc., in 1988 and became involved in the Dallas/Ft. Worth wholesale diesel fuel and gasoline markets. Although Hebco's invoices included state and federal taxes, the company kept this revenue. According to the indictment, between June 1989 and January 1990, Hebco grossed approximately $26 million in fuel sales. During the same period, the company sent approximately $3 million from Texas bank accounts to a Cayman Islands account from which it was forwarded to European bank accounts – apparently to fund a similar fraud scheme in Belgium.

The Petroplus Case

In August 1995, 25 persons, 15 of whom were Russian immigrants, were indicted for their role in another fuel tax evasion scheme that defrauded the United States Government and the state of New Jersey of over $140 million in tax revenues on approximately a half billion dollars of motor fuel. The scheme involved the purchase of hundreds of millions of gallons of tax-free home heating oil, which was then sold to a firm called Petroplus as tax paid diesel fuel. The process was hidden by inserting sham and nominee companies (known as "middle companies") in the distribution chain to generate false and fraudulent invoices. A financial consultant employed by one of the organizers arranged for the use of several foreign bank accounts to conceal the proceeds.

The Russo Cable Case

This was a case involving fraud in the sale of cable television converters and descramblers which allowed the purchasers to obtain free access to cable television services. It also involved bribes by a company called Leasing Ventures, to a security agent who turned out to be working undercover for the FBI. In July 1994 one of the defendants actually traveled with the agent to the Cayman Islands to establish an offshore bank account. This was done at the Guardian Bank, where the chairman John Mathewson, who was also named in the indictment, opened a bank account that allowed for the concealment and disguising of the origin of the payments from Leasing Ventures. Mathewson also created a sham entity named the Hanson Corporation to receive payments for the security agent and provide false invoices. The bank account was accompanied by the issuance of Visa Gold credit cards “that permitted access to monies in the Hanson account by the holder in the United States without revealing the existence or ownership of the offshore bank account”.

A bank account in London was also used by one of the defendants to collect and make wire transfer payments in connection with parts used for cable piracy. As the indictment noted, this offshore banking arrangement concealed the cable piracy operations “by creating the appearance that an independent foreign entity was conducting the sales”.

The scheme involved proceeds somewhere in the region of $10 million so was certainly not negligible. It also had a fascinating footnote. Mathewson attempted to plea bargain with prosecutors by turning over the records of the Guardian Bank. The Cayman Islands government came to court in the United States in an attempt to prevent this. In effect, it wanted to avoid the release of information on tax evasion and thereby protect its status as a secrecy jurisdiction. The case, however, was thrown out by a Federal judge.

The Singh Brothers Case

In May 1996 in a case involving the proceeds of drug trafficking and alien smuggling, the Singh brothers were convicted of laundering approximately $5 million. The brothers used the South Asian underground banking system known as the "hawallah" system, and also placed deposits – small enough to avoid cash transaction reports – into both personal and corporate bank accounts under their control. These funds were wire transferred to foreign accounts.

The Herman Case

This was a case resulting from a joint investigation by U.S. Customs and the Corpus Christi (Texas) Police Department's Organized Crime Unit. The operation began in 1992 and involved undercover agents as drug transporters. The leader of the trafficking organization, however, believing that the transporters were part of a large Colombian drug trafficking organization, however, offered to launder money for them. This was done through bank accounts in Spain, Britain, Antigua, Aruba, El Salvador and Mexico. Subsequent convictions for money laundering included both American and Mexican bank officials and several businessmen and accountants in Corpus Christi.

The Detroit retired bank executive case 1996

In a 1996 money laundering case in Detroit a retired banker (along with his son) was convicted of money laundering and sentenced to over 15 years imprisonment and the forfeiture of his $400,000 home and $2 million in cash. The result of a joint investigation by DEA and the IRS Criminal Investigation Division, the case involved a Jamaican cocaine, heroin, and money laundering organization based in Detroit. The defendant had been a bank executive at the Gulf Bank of Kuwait New York City branch and between 1984 and 1992 apparently laundered about $7 million, depositing it in secret bank accounts in the Cayman Islands, and Kuwait. In 1993 and 1994 he was the subject of a “sting” operation in which he laundered $100,000 in cash. The money brought to him by undercover agents was deposited into a Michigan bank account of his automobile export corporation and used to buy automobiles which were then shipped to Kuwait. The customers wire transferred their payments to Barclays Bank in London and the undercover agent was given access to this account.

The Globus Case April 2, 1997

In April 1997 indictments were issued against a group, largely comprised of Russian emigres, for allegedly operating a massive securities fraud scheme, involving misrepresentations about a company called Globus Group, Inc. The misrepresentations resulted in the price of Globus shares rising from 25 cents in January 1996 to $8 per share

by September. In October, after the defendants stopped pushing the stock, the Globus share price collapsed to less than forty cents, with the result that legitimate investors incurred substantial losses. Although Globus was portrayed as an Internet service provider linking importers to exporters, it was in reality a shell company with no assets. The directors of Globus had offshore bank accounts in the Bahamas and elsewhere in the Caribbean in the names of various fictitious corporate entities, such as “Virgo Bay, Ltd.” and “Leeward Cove Holdings, Ltd”. Globus stock was sold to the public via these corporate shells. The proceeds were deposited in the offshore accounts, then back to the defendants.

BAJ Marketing

In March 1998, the US Attorney’s office in New Jersey asked for a temporary restraining order to stop four offshore corporations in Barbados from marketing fraudulent direct mail schemes to consumers in the United States The order was directed against BAJ Marketing Inc., Facton Services Ltd., BLC Services Inc. and Triple Eight International Services With no offices or sales staff in New Jersey or anywhere else in the U.S. the businesses trick consumers into sending “fees” to win prizes of up to $10,000 – prizes which never materialize. The companies were actually owned or controlled by four individuals from Vancouver, British Columbia, all of whom had actually been indicted in Seattle for operating an illegal gambling scheme.

The Vito Pietanza Case

This was a fraud scheme involving stolen checks from Schenkers International Forwarding, Inc. a company which arranged for the shipment of IBM products overseas. IBM paid Schenkers for its services by check on a monthly basis. Some of these checks were diverted and cashed in the Cayman Islands. The laundering was simple with the defendants traveling to the Cayman Islands and returning with several cashiers checks under $10,000.

The Defrauding of National Heritage Life Insurance Corporation

In 1997 a case in Florida involving fraud and money laundering as brought to trial. Five people over a five year period had used various schemes to defraud National Heritage Life Insurance Corporation. One of the counts was against a former attorney who had transferred around $2.2 million to an offshore account in the Channel Islands.

The Juarez Cartel Case

In March 1998 it was reported that the Juarez cartel, one of Mexico’s most powerful drug trafficking organizations had bought a small domestic bank in 1995. By November 1996 the organization had reportedly laundered more than $ 50 million through the bank and its subsidiaries in the Cayman Islands.

A Lawyer Case

In one case in the United States, used by the Financial Action Task Force to

illustrate the role of professionals such as attorneys in money laundering, a lawyer created a sophisticated money laundering system which utilized 16 different domestic and international financial institutions, including many in offshore jurisdictions. Some of his clients were engaged in white collar crime activities and one had committed an $80 million insurance fraud. The laundering was hidden by "annuity" packages, with the source of funds being "withdrawals" from these. The lawyer commingled client funds in one account in the Caribbean and then moved them by wire transfer to other jurisdictions. Funds were transferred back to the United States either to the lawyer's account or directly to the client's account. The lawyer also arranged for his clients to obtain credit cards in false names, with the Caribbean bank debiting the lawyer's account to cover the charges incurred through the use of these cards.

The Manchester-Hong Kong Connection

This case involved a group of drug traffickers in Manchester, England , the leader of whom made considerable profit from importing cannabis. $2 million of the proceeds was transferred to Hong Kong, much of it through a shell company the leader had bought and that was operated on his behalf by a secretarial company. Large cash deposits in British banks were used to purchase bank drafts and cashier checks that were payable to the shell corporation. Several other companies, some legitimate, were also recipients of the proceeds which were then sent to several other jurisdictions including Switzerland.

The DeBella Case

This involved a British businessman who commissioned a banker in Antigua, Michael DeBella, to collect money owed as a result of a Nigerian oil deal. Although DeBella was successful in collecting the funds he not only failed to pass the money on to the businessman but also failed to return a $600,000 escrow payment the businessman had deposited in a bank in Antigua. Subsequently, DeBella pleaded guilty in a U.S. court to other instances of defrauding clients, but the bank refused to return the businessman's money and indeed, the bank responded to the requests seeking its help recovering the money by alerting the account holder to move the money – an excellent example of the walking accounts discussed in Section III.

The Salinas Case (MLA)

One of the most notorious cases of alleged money laundering in recent years has been that involving Raul Salinas, brother of the former Mexican president. It has been claimed that Salinas, taking mordida to new heights accepted bribes not only from drug traffickers, especially Juan Garcia Abrego and his organization, but also from multinational corporations. One of the most remarkable aspects of the case is that a senior bank officer – whose testimony on the practice of due diligence had helped lead to the conviction of Giraldi in the American Express International case discussed above – played a pivotal role in helping Salinas move money out of Mexico. Accounts for Salinas were established in the names of Cayman Islands corporations and in false names

in several Swiss banks, where $84 million was reportedly deposited in the name of Juan Guillermo Gomez Gutierrez, one of the names used by Salinas.

The Danish Drug Trafficking and Money Laundering Case

This was case which began with suspicious transaction reports relating to instances at Danish banks in which large amounts of money were deposited into accounts and quickly withdrawn as cash. Although the account holders were not known drug traffickers, subsequent investigation revealed that they were involved in the importation of hashish. After withdrawal from the banks the cash was transported to Luxembourg where 2 of the individuals had 16 accounts in different banks, or Spain and subsequently Gibraltar, where they had 25 accounts. Critically, in avoiding suspicion at these later stages, the receipts from the Danish banks for the withdrawn money were used to prove the legal origin of the money – even though the same receipt was sometimes used at several banks. In the end, the traffickers were convicted and confiscation orders were issued for $6 million and $1.3 million respectively.

The Santa Fe de Bogota Case

Reportedly, a group of companies successfully laundered approximately $150 million, through foreign investment operations using fictitious corporations in Panama, the Cayman Islands, and the Isle of Man. This was a classic case of the third phase of money laundering outlined in Section II. In order to bring proceeds of drug trafficking home to Colombia front companies were created that were ostensibly to receive foreign investments. The companies were given names similar to large multinational firms. A network called Mobil Ami was used to process the substantial "foreign investments" that, in four to six months, included over $178 million from Panama and $121 million from the United States.

The Yamaichi Securities Co.

In November 1997 it was revealed that Yamaichi Securities Criminal organizations., one of the top four Japanese brokerage companies, had liabilities exceeding 200 billion yen which had been hidden from Japanese regulators through the use of dummy companies in the Cayman Islands. The debts seem to have been run up through improper "tobashi" trading activities, (in which brokerage firms temporarily shift investment losses from one client to another in order to prevent a favored customer from having to report losses) but were then booked at the dummy firms in the Caymans that were not subject to the same scrutiny as Yamaichi's consolidated account.

A Case of Payable-Through Accounts

This was a case involving an investigation by the Internal Revenue Service (IRS) Criminal Investigation Division into tax evasion by three suspects living in Florida. It

was important not so much for the crime as for its relationship to pass through accounts or payable through accounts (PTAs) – accounts held in U.S. banks by foreign financial institutions to allow customers of these institutions to use the banks for withdrawals, deposits and wire transfers. The case involved Ansbacher, a financial institution specializing in trusts and located in the Bahamas. Ansbacher, a subsidiary of the First National Bank of Southern Africa, had an arrangement to receive deposits from U.S. customers through a pass through account at Marine Midland Bank in New York. Unlike many other PTAs, Ansbacher's account did not use sub
accounts or numbers to identify the transactions of its customers. The IRS was alerted to the account when the suspects cashed three checks totaling $500,000. Subsequently, a summons was issued to Marine Midland requiring production of records covering all transactions through the PTA over eight intermittent months ending in February 1997. Ansbacher appealed against the summons on the grounds that it required production of bank records wholly unrelated to those persons being investigated. The IRS contended that the lack of sub
account designations in the Ansbacher account made it necessary to examine the use of nominee accounts. In July 1997 a federal Court in New York ruled that the IRS be given access to all the records of all customers with banking privileges at the PTA held by Ansbacher at Marine Midland – albeit with the proviso that the access was to be used exclusively in the investigation of the suspects. The judgment was greeted in parts of offshore world as a real threat. Ansbacher's managing director in the Bahamas was actually reprimanded for cooperating with the United States and not informing the Central Bank of the Bahamas promptly that the IRS was seeking information about its clients. It was suggested that he had failed in his "duties and responsibilities" regarding the preservation of bank secrecy.

Assessment and Commentary

After examining these cases, there are several conclusions that stand out:

Successful prosecutions in this area are not frequent. This is partly because of the complexity of dealing with other jurisdictions, the numerous opportunities for money laundering, and the inherent advantages accruing to the launderers. Not surprisingly, in most of the cases identified, law enforcement investigations started with an identified crime and followed the money trail from this crime. Moreover, where the investigation involved international cooperation, this was facilitated by the fact that law enforcement authorities knew exactly where to go and what kind of financial information they needed to obtain. In the majority of cases the offshore financial institutions are not readily identifiable and the success rate of investigations is very low. The concomitant of this is the paucity of cases which initially detect money laundering and then work back from there to the original crime.

The variety of the ways in which offshore financial centers are used. While they are used to launder money from the proceeds of crime, they are also used to establish companies that can then be used to perpetrate various kinds of fraud. The offshore location of a financial institution is a critical ingredient in certain kinds of fraudulent

activity, appealing to certain kinds of depositors while allowing the criminals a base from which to operate at relatively low risk. In addition, money is sometimes moved through offshore financial centers in order to establish a financial basis elsewhere to engage in further criminal enterprises.

The varying levels of sophistication with which the facilities of offshore financial centers are used for money laundering. In some cases, the use of offshore facilities was no more than a visit to a bank in the Cayman islands to exchange checks for cashiers' checks of less than $10,000. In other cases, money was transferred through a variety of accounts in schemes that were clearly designed to make the trail very hard to follow. The most explicit and carefully worked out of the schemes was that devised by Jurado although, in this case, sophistication did not prevent him from making stupid mistakes that alerted law enforcement authorities and led to his capture and the seizure of significant assets.

The advantages of collusion with bank employees. In one of the cases cited, the involvement of an assistant bank manager was critical in getting the money in the system and moving it to Switzerland. At this point two Swiss bankers moved the money into the account of a major Colombian drug trafficker, highlighting even more clearly the advantages of collusion or connivance. In another one of the cases delineated above, the manager of a bank in the Cayman Islands was directly implicated in a laundering scheme. The manager set up a sham corporation to receive payments and provide false invoices and also issued a gold credit card that would not be linked to the recipient of the bribes. This was a classic laundering circle and one that would have not been easy to detect, if the recipient of the bribes had not been working with law enforcement. Perhaps the most obvious case of connivance or collusion, however, is the assistance Citicorp gave to Raul Salinas – assistance that highlights one of the weaknesses of private banking – which is that a large and apparently respectable customer can obtain assistance in banking transactions that are patently not respectable.

The more sophisticated cases tend to involve the use of multiple jurisdictions and multiple mechanisms and instruments for money laundering. As one analyst has observed, "once the proceeds of crime are successfully deposited in the financial system many laundering operators take the precaution of moving money, not just offshore, but through more than one tax haven and through a maze of shell companies and respectable nominees". In such cases there are real problems for investigators. Not only do they encounter various layers of secrecy and non-disclosure, but they have to face the complexities created by the multiplicity of institutions and the various jurisdictions, each of which has its own distinct set of laws and practices regarding secrecy. Even in those cases where there is cooperation, the process is rarely fast, so that following the money is rather easier than catching up with it.

Although the offshore banking community is undergoing increasing scrutiny and more careful supervision, this is easily circumvented by bank officials and other members of the offshore financial community who are anxious to attract funds and please customers and have little inclination to exercise due diligence or to know your customer.

The people who operate shell companies and corporate entities on behalf of clients do not necessarily engage in due diligence.

Several of these case are examples of the way in which criminals exploit what for them has, in effect, become a borderless world. Their financial managers and money launderers take the proceeds of crime and move them outside the country. The difficulty is that subsequent investigations by law enforcement immediately run up against national sovereignty. It is sometime claimed that location is no longer of any importance in financial matters, but clearly it is of importance when it comes to investigations. Indeed, the notion of a haven, with the various services it offers, is quintessentially territorial. The paradox is that the movement of funds to the haven, (passing through a series of other havens on route) from virtually anywhere in the world transcends geographic restrictions. It is this combination of rapid and largely anonymous transfers and protective destinations that anti-money laundering efforts need to pierce.

V Offshore finance, banking secrecy and the organization of crime

Introduction

'No man is an island, entire of itself. Every man is a piece of the continent; a part of the main.'
John Donne: Devotions XVII

In this section, the aim is to apply in the context of money-laundering and banking secrecy the sort of logic used increasingly in modern discourses on crime prevention. The policy drivers for a global anti-laundering and mutual legal assistance policy are:

The international focus on supply-side narcotics control, a collateral part of which is the desire to use the money trail to catch offenders, confiscate their assets, and/or prevent/deter them from engaging in criminal business by making it harder for them to generate a seemingly legitimate "front" for their financial transfers;

Concern about international fraud and the use of overseas jurisdictions and their legal instruments (among which are to be numbered trusts of various secrecy levels and International Business Corporations) to "front' frauds (e.g. the European Union Bank); to hide beneficial ownership of both the companies/institutions and their assets; and to frustrate asset recovery on behalf of victims or governmental agencies

Concern about tax evasion masquerading as tax avoidance, sheltering the locus of control via trust companies and international business corporations

Most recently, concern (i) about a "level playing field' in business competition for contracts and, arguably, (ii) about the loss of welfare in less developed countries arising from high-level corruption, leading to the extension of the US Foreign and Corrupt Practices Act-style liabilities upon the rest of the world through the mechanism of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, signed by all OECD countries (with varying degrees of enthusiasm) in December 1997. If this is to be effective, controls – including auditors' reports – will have to extend to all finance centers to which funds are paid, to check whether or not any of their visible or beneficial ownership may be the objects of bribery.

Except perhaps in the area of mutual enforcement of other countries' tax regimes, it has gradually become accepted in principle that harmonization is a good thing in the war on crime. But the question of how, given traditional conceptions of sovereignty, international comity and harmonization/legislative congruence can best be achieved remains a subject of heated debate. This is partly a question of respect for autonomy and partly a question of diplomatic realpolitik; but the favored international model following up Treaties and Conventions and regulatory agreements has been the "mutual evaluation"

strategy adopted by FATF, now developed by the EU and the Council of Europe. There is scope for divergence of opinion as to whether, as a matter of practicality of resource limitations, the FATF has been able to achieve substantive as well as procedural equivalence: in part, some member countries and financial institutions (sometimes on a global basis) have sought to become "market leaders" in compliance, thereby intentionally creating an un-level playing field, though one with virtuous intent. (Such super-virtue sometimes follows a scandal which produces a regulatory credibility problem, whether for a bank or for a country.) However, it is inherently a difficult empirical matter to determine the extent of compliance of institutions and countries under current and indeed under all conceivable conditions, since so much financial behavior is not transparent. For example, even where compliance is high for most clients, some few specially favored clients may be treated differently, and even a rigorous UNPROFOR-type approach of unannounced total inspection rights might not yield sufficient evidence to demonstrate compliance or non-compliance at critical moments (whether these "moments" are created by multi-million dollar deposits offered by relatively unknown figures from the underworld or by well-known but apparently respectable senior government ministers from countries generally believed to be highly corrupt).

So, although it would be unfair to categorize FATF methodology – now adopted by the Offshore Group of Banking Supervisors as well as the offshoots such as CFATF – as ensuring procedural rather than substantive compliance, the focus on the procedural was an inevitable first stage strategy on the route to greater international harmonization and it is not always easy to see what "functional equivalence" amounts to at the working level. A similar argument could be made in relation to international mutual legal assistance, especially where legal systems (e.g. common law versus civil code) are so radically divergent.

Inhibitors and Facilitators of Crime: The Role of Regulation and Financial Structures

Measures against money-laundering and the promotion of mutual legal assistance are properly viewed as a sub-set of strategies to disrupt, regulate and inhibit criminal markets. Interest in the functioning of criminal markets other than narcotics has been both late and intermittent. The reasons for this are a poor analytical focus on macro-features of markets and an unduly narrow "take" on situational opportunity and routine activities. It has become conventional not to ask wider policy or political questions about what motivates potential offenders and the way that this is affected by their life-chances or by social exclusion, but to concentrate instead on the "routine activities" that surround the immediate act, though a recent shift in approaches to crime prevention signals a greater appreciation of the need to take account of social and cognitive elements in the motivational environment. Thus, conventionally, crimes are committed as a result of:

- The availability of suitable targets;
- The absence of capable guardians;
- The presence of motivated offenders.

It is not our task here to examine in detail the motivations of offenders who wish to launder money, even though interesting questions may be posed about why, given similar opportunities, many do not engage in laundering or tax evasion, and why the proportions doing so or not doing so might vary in different countries and cultures. Nor, for that matter, will we examine the imaginative component of ideas for property crime, which in this case lie well beyond the mundane activities (such as vandalism, shop theft, and burglary) from which the situational opportunity focus sprang: many "objective" opportunities for fraud and money-laundering remain unrealized, not just because non-offenders lack the motivation or greed, or fear the consequences of involvement, but also because many non-offenders cannot readily envisage (or are insufficiently rigorous in thinking through) the possibilities that do in fact exist. But, in spite of these deficiencies, there is no a priori reason why one should not apply this sort of logic – suitable targets, incapable guardians and motivated offenders – to the extent and organization of crime, provided that one does not confuse (i) activity measures – such as seizures of drugs, number of suspicious transaction reports, proceeds of crime seized and/or confiscated or even arrests of major offenders – with (ii) final outcome measures, such as lower narcotics consumption, reduced fraud, etcetera, as is all too commonplace in practice among law enforcement officials and politicians. For example, if drug seizures go up, does this mean that drug consumption is rising or is it simply that drug production and distribution to or through particular geographical "hot spots" are rising? Yet a third alternative is that customs and police are becoming more efficient. It is also possible that the seizure rate increase reflects a combination of these factors. Similarly, if we reduce the number of countries or territories that launder the proceeds of crime (consciously or not) – an activity measure – we will have a major effect on the level of crime (or on the level of the particular type of crime in which we are most interested) – an outcome measure – only if:

- We are able to isolate and in some ways punish the remaining "hot spots" to which criminals are attracted;

- Or we deter most professionals from assisting laundering (because they would have to use companies registered in places that were "obviously" disreputable and they would harm their reputations and/or feel that what they were then required to do would be "obviously" criminal);

- And the difficulty of laundering has a substantial effect on motivation and capacity to commit crime(s).

Such effects might vary by type of crime. By stressing the importance of judging performance against clear objectives, we are not denying the value of incrementalism or of crime reduction as an end in itself: enormous progress has been made in increasing international transparency and in achieving functional equivalence in regulation, and to reduce harm is itself a considerable benefit even if harm (whether serious drug abuse or fraud and corruption) is not eliminated altogether. (For retributivists, the conviction of serious offenders and/or the deprivation of their proceeds of crime is an inherently good

thing, and it often makes us feel better to see "bad people" put out of circulation. But it is an empirical question whether or not such punitive actions lead to less crime overall, whatever the effects on the criminal behavior of offenders thus punished. If organized crime is modeled like an illicit corporation, the removal of executives may make only a modest difference to the activity levels as a whole, though one could equally counter that removing the "old guard" may encourage blood-letting between rival successors and ambition by young pretenders.)

Another key issue that is not normally thought through in other areas of crime is the depth of field in money-laundering and in the drugs distribution and fraudulent fronting businesses. Transnational flows and business deals may be put together simply to de-motivate and deter financially limited criminal investigations – as we have pointed out earlier, it is not just the absence of formal cooperation in mutual legal assistance but also the cost and delays in undertaking investigations that give criminals the edge – but multi-site activities also may be put together as genuine parts of the business front to frame professionals' views about their legitimacy and, in the case of frauds, to "con" potential investors and depositors and trade creditors. (Why else name a bank "European Union Bank', and why else would it seem plausible to target victims that a bank with such a name would be operating out of Antigua!) Ironically, it is the "offshore" status of an institution – with all the cultural paraphernalia of tax evasion and exchange control circumvention that the term historically evokes – that lends credibility to the scam, except among the cognoscenti such as in the Jurado case discussed in section IV. Perceptions of risk may take some time to permeate the globe, which is why multiple Internet banking frauds operating out of the same jurisdiction are possible, presumably with different victims.

Bankers and professionals (accountants and lawyers) are, or can be made to become, "capable guardians" by imposing liabilities of various kinds upon them, relating both to general systems performance, (e.g. the legal requirement to have adequate anti-laundering mechanisms in place), and personal performance, (e.g. stringent criminal penalties for those assisting in disposing of the proceeds of crime). In practice, the effects of these commandments will vary depending on what professionals and "primary offenders" believe to be the chances and consequences of their being detected and acted against (not necessarily by means of criminal law): this in turn depends on the nature of the rules governing behavior, and the loopholes – such as reliance on the due diligence of others further up the line – that exist unintentionally or deliberately, following lobbying or even governmental complicity in reduced compliance. As suggested above, professionals' ingenuity means that there is no level playing field. The more that criminals can use a reputable country and/or reputable firm of professionals, the less likely it is that anyone will question their bona fides. The fact that mainly legitimate complex routing of deals happens for tax and exchange control avoidance and for "corporate raiding" makes similar transfers by criminals less suspicion-generating than they might otherwise have been. But, as legitimate rationales for offshore finance center utilization diminish – as highlighted elsewhere in this report – the ability of criminal transactions to hide in the interstices of legitimacy ought logically to diminish also, since there is more scope to look at the commercial rationality of transfers on the part of those

financial institutions and company formation agents who are genuinely interested in preventing laundering. The greater the reality that is given by banking and other financial supervisors to the requirement to have “adequate” systems for the detection and reporting of money-laundering, the harder it will be for the institutions to evade problems by choosing not to ask or by failing to consider asking “too many” questions.

Individual motivation and social networks are key components of explaining criminal markets, but to broaden such an approach into one more suited to analyzing a market, one must note that motivated offenders are required to face the following problems:

1. Financing the criminal opportunity;

2. Obtaining the prerequisites of whatever crime they are contemplating (from precursor chemicals, through nuclear material, to credit cards);

3. Using the materials to commit crime;

4. Transforming the direct products of crime (drugs, nuclear materials, arms, checks) into the desired form, probably monetized;

5. Evading conviction;

6. Evading asset confiscation.

For simpler crimes for gain – street robbery, for instance – no finance capital is needed and only evading conviction is likely to be (eventually) a problem, though evading asset confiscation might be more salient if profitability was enhanced by an effective distribution and disposal method for stolen credit cards; for other offender types, all of these stages might have to be dealt with. The extent to which witting or unwitting facilitators of crime actually have to face these problems depends not only on the jurisdictions in and from which they operate but also on what role they can be proven to play in the crime. The less “hands on” they are, the more difficult it may be to convict them, but also – subject to their expected capacity for violence – the less control they will have over being cheated by partners. Whatever the circumstances, however, when dealing with organized crime control “success” even at the law enforcement level (of activity measures) has to be seen in relation to all the roles that are played in the setting up of the crimes, in the commission of crimes, and in turning the proceeds of crime into utilizable media.

Part of the “costs and benefits” of crime include attitudes to particular forms of behavior among the social groups – if any – to which the potential offender belongs or with whom he identifies. Thus, ways of rationalizing behavior may enable “offenders” to feel more comfortable about their actual or contemplated crimes. Examples of such rationalizations in the realm of money-laundering and organized crime are: “if I don’t take this money, some of my competitors will and so I will be worse off and society will

be no better off'; "I followed the procedures but we don't have the resources to monitor accounts intensively once opened'; "I didn't know the funds were proceeds of crime'; "I thought that the funds came only from tax evasion, so there was no problem; "This is a demand problem that requires action by the West, and it's not our responsibility'; and, though less common among professionals than among criminologists, "There is no point in trying to enforce supply-side controls – they'll never undermine market demand for drugs, so why enforce stupid anti-laundering rules'. Many lawyers, accountants and bankers are (often unselfconsciously) adept at not asking questions that would require them to refuse business or even to report their clients or potential clients to the authorities. But a major component of the motivation for crime is also the expected probability and scale of reward: the reverse side of this is the expectation (if contemplated) of prevention and/or salient punishment. Any form of crime for economic gain can have its relative attractiveness rating altered significantly by changes in detection and sanction levels both for it and for other crimes such as narcotics sales.

Action against financial intermediaries

Conceptually, and at the risk of straying into political science and diplomacy, it is useful to divide countries into "victims', "offenders" and "intermediaries" for any given type of offence, whether it be drug trafficking, fraud, tax evasion, etcetera. Some countries – England and Switzerland, for example – contain all three categories, but others may have a different "product mix'. The appreciation by "victim countries" that offshore financial centers play a key role in facilitating criminal objectives – whether intentionally or unintentionally – as "intermediaries" has produced the demand for international enforcement powers through FATF and mutual legal assistance measures, civil and criminal and corporate and individual. The more fraud and drug use that offshore financial centers experience – i.e. the more frequently that they and/or their citizens become victims – the more likely they are to cooperate voluntarily with such measures for international comity: but that is not the case at present, nor are many "offshore finance" territories the primary source of fraudulent or drugs trafficking activities: they tend to be more intermediaries through which the primary villains channel their funds, demonstrating again the importance of depth of field when looking at criminal behavior as an international system. If more Caymanian banks like First Cayman collapsed leaving Caymanian victims without recourse to assets which allegedly had been spirited overseas to banking secrecy jurisdictions, then – even with the new compensation scheme in place – the costs rather than just the benefits of secrecy would be more salient in the minds of the locals. If locals on the Cook Islands, Niue and Sark were to become victims of the frauds committed by companies incorporated there or by residents there (or in other similar "proceeds of crime havens'), then they might shift their views on the benefits of secrecy. Whether offshore centers like it or not, the pressures for transparency and for greater local accountability will grow, and this will shift the cost-benefit analysis for those that use financial services products, wheresoever advertised (e.g. on the Internet; in The Economist; the International Herald Tribune; and in other locations such as airline magazines). For example, if the Channel Islands are subjected to a clamp-down, this will have a knock-on effect on those trusts that are used to set up another layer of secrecy but that operate through Guernsey and Jersey, because of the individual and corporate liability rules established thereby.

Looked at from the perspective of legitimate business, tax avoidance, and criminals alike, there is some sort of trade-off between shelter from external surveillance and from legal cooperation with “victim countries’, on the one hand, and the desire to keep one’s investment safe, on the other. The countries that offer the most secret facilities – the Cook Islands, for example – may not be seen as places where one is free from the risk of having one’s capital stolen. Furthermore, those with accounts or companies there may find financial institutions in mainstream countries reluctant to accept their bona fides. In the olden days, Switzerland offered both confidentiality and security of capital (at least for those who, unlike Holocaust victims, were still alive): now it offers security and banking competence but only modest confidentiality (and low or negative interest rates). But Swiss banks have moved many of their operations to other jurisdictions (such as Liechtenstein) in response to tax and disclosure regimes at “home’. Under legal changes discussed later (as well as political pressures), the Channel Islands have been moving in the same direction as Switzerland. One unintended effect of this is to distort the meaning of data about size of financial sector in any one jurisdiction: if many Swiss banks are operating in Jersey, Cayman, Liechtenstein, etc., what effect does this have on statements about the “decline of Switzerland” as a banking center or about “greater regulation of banks in Switzerland’? The latter would mean “greater regulation of Swiss banks” only if in practice as well as in the Procedural Manual there were harmonized anti-laundering regulations applied world-wide within the banks (which often does happen for convenience of group compliance audits).

Given the substantial measure of success in passing first anti-drugs trafficking and then “all crime” anti-laundering (and, up to a point, proceeds of crime confiscation) measures in the developed world, one of the key remaining facilitators of crime has been the tax avoidance/evasion exemption in the laundering regulations of many countries. It may not be essential for tax evasion to be a predicate offence for money-laundering charges: the US, for example, does without this. But if financial and other institutions are permitted not to pass on information about conduct that otherwise would be “suspicious” on the grounds that they think (or say they think) that the funds are “only” “tax money’, this offers both them and their customers an easy way of rationalizing “doing the business” for themselves, and representing to a court or regulators in future that they did not think the funds were proceeds of crime but rather tax “dodges” – thereby evading conviction and/or severe regulatory action. Thus, the US does include tax matters in its suspicious transaction reporting regime. Given that few institutions have satisfactory methods of satisfying themselves and others that particular funds were not the proceeds of crime and were tax avoidance/evasion, the “tax exemption” both facilitates the cognitive judgement that they can do the business without informing the authorities and denies the authorities information that might be used for identifying the laundering of drugs and fraud proceeds. (We are not denying that some tax regimes may be viewed as oppressive, nor that such information about money transfers is sometimes used improperly by the authorities in their official capacity or by individuals in a corrupt capacity: but provided that taxation levels – however high – are democratically decided, residents arguably are obliged to pay what the law requires.) Financial institutions in offshore centers themselves commonly argue that they are no longer dependent on

"hiding" the proceeds of tax evasion or even avoidance, and that their market niche arises from nimble and flexible responses to market conditions: to the extent that this is actually so, the removal of the "tax exemption" from anti-laundering regimes would have little effect on their main source of business, and would isolate the non-compliant nations.

The greater the domestic clamp-down on taxation and the more resentful that citizens are about paying taxes (or anti-laundering measures), the greater will be the demand for banking secrecy: but for basically legitimate persons and corporations, the greater the extra-territorial liabilities placed upon them for avoiding responsibility, the more they endanger themselves by using off-shore services provided that there is a substantial risk that the secrecy will be overcome or that local accounting treatment will nullify the advantages of moving their funds offshore. The market for secrecy is partly reflected in differential pricing of incorporation in different countries, though that is not the sole determinant of pricing policy. But the greater the secrecy in the jurisdiction, the more tempted some countries (or, for that matter, enterprise criminals of a particular genre) are to achieve their objectives by "extra-territorial" means, whether those means be attempts to excommunicate the "offender" country economically or the physical kidnapping of individuals therefrom.

The sorts of measures that make sense against facilitators of crime (by increasing inhibitors) depend on the sorts of crime involved and the diplomatic possibilities. Where crimes have victims (including governments) with civil causes of action as plaintiffs, this sets up a different set of possibilities than where there are no discernible victims. The U.S. resolves this difficulty (or seeks to do so) by means of the legal fiction that all proceeds of drugs trafficking are the property of the government;other countries do not. But given the competitive market for financial services products, devices such as the "walking accounts" discussed in Section III clearly act as facilitators of crime and inhibitors of responses by making it very much more expensive, if indeed possible at all, to pursue the defendants either for evidence or for recompense. Since the desire to get one's money back is one of the primary motivations for reporting fraud
, no civil plaintiff and few governments will be willing to make a massive outlay if they expect very little prospect of return and in practice, the aims of justice will be defeated without this necessarily appearing in case law, since anticipated returns determine actual cases brought.

At the time of writing, some major issues remain uncertain, even at a conceptual level. One of the highest profile ones is the extent to which the alleged embezzlements of many millions by one-time Heads of States (e.g. from Haiti, Pakistan, Philippines, Zaire) are likely to be made more returnable ex post facto and deterred in future by the array of legal changes, including the OECD Convention. If all that is achieved is that the major prestigious finance centers avoid direct deposits from such sources but that the proceeds of crime (whatever their institutional form) are distributed elsewhere, then there will have been some gain in reducing the risk of local corruption (if any were needed), but little else. It is precisely for this reason that global action is a prerequisite of successful laundering reduction rather than simply displacement strategies.

Legal provisions as inhibitors and facilitators of crime

Even human rights supporters must logically acknowledge that the law itself is an important facilitator or inhibitor of organized crime: the principal issues are whether repressive law can be effective and whether the need for "order" should be sufficient to justify such repression of civil rights. If mutual legal assistance is available only for indictable crimes, and tax offences are merely summary offences, this will make a difference to international investigations. This is one reason why drugs-only anti-laundering measures were inadequate, and though tax evasion can be made a reportable suspicion even if a country does not permit mutual legal assistance on tax matters, its value is likely to prove considerably weakened as a result. If a company director is permitted to resign immediately upon incorporation and/or hand an undated letter of resignation and assignation of rights over to the beneficial owner, this makes a difference. In the island of Sark, for example, the same individual can be a director of over a thousand British companies, and hundreds of Manx and Irish companies, and the speed of incorporation implies very little due diligence indeed. However, the very fact that a place is (or is believed to be) under the general supervision of an American or British or Dutch or French regulatory and legal system is a major factor enabling it to succeed in imagery as respectable. Here, we will concentrate on English and Commonwealth legal provisions, because although they by no means have a monopoly on abuses, they (along with Dutch overseas territories and Liechtenstein anstalts) are where a lot of the criticism – both accurate and otherwise – of offshore finance centers has arisen in the international arena.

Corporate Criminal Liability

One of the means by which countries seek to implement policy on business activities that normally belong outside the Public Law sphere is through corporate criminal liability and individual liability for the acts of corporations on the part of executives: those who are colloquially known in the US as "Vice Presidents responsible for going to jail'. Again, the fundamental theory is a pragmatic one: that if one imposes vicarious liability on the company and/or its directors and officers, directors will pay greater care to their responsibility than they would otherwise do. The assumption often implicit in such conceptions is that the companies made liable were intended to remain in operation anyway: otherwise, there is less of a controlling effect from the lifting of the corporate veil, though even there, the possibilities of financial recovery from individual directors may be enhanced. The common law countries may have had difficulties of implementation and case law, but historically, the civil law countries of continental Europe have never been able to countenance the concept of liability for an entity that has no consciousness, though they are beginning to do so now. It is a fair summary that corporate criminal liability has been going through an expansionist phase during the 1990s, reflecting the greater realism of the courts towards modern large companies and the practicalities of decision-making therein. The typical nineteenth century model of the owner-manager of a closely managed company has been replaced by a complex hierarchy of control and devolved budgeting and responsibility in flatter structured corporations where performance targets are set by the center and it is up to the sub-groups to decide

how (subject to the law) they are to attain them: the courts have gradually realized this and adjusted corporate criminal liability to the new situation.

Nevertheless, except in the US, the area of corporate criminal liability has been much neglected outside of areas such as corporate manslaughter (with which we shall not be concerned here). The agreement to execute unlawful conduct is an offence from the moment the agreement is made and ends only when the act is performed, abandoned, or frustrated. A director of a company who is solely responsible for the conduct of the company's business cannot be convicted of conspiracy, since the director's mind and that of the company are inseparable, even though the company is a separate legal entity. However excepting that "sole director" situation, the company may be convicted of conspiracy with the director or with other parties, and may be convicted of conspiracy to defraud, on the grounds that these must be performed by a human agency and can become acts of the company.

The company in principle may have imputed to its "state of mind" the acts and state of mind of its directors and managers who represent its "directing mind and will'. But what happens if not all directors and managers are of the same mind? In Meridian , the Privy Council ruled that corporate criminal liability for failing to declare a substantial shareholding applied even where the chief investment officer and the senior portfolio manager of an investment management company in New Zealand bought shares in another company without telling their own managing director or the board (and with apparent intent to skim most of the profit from the deal for themselves personally). It seemed obvious to the trial judge that if the chief investment officer and senior portfolio manager had authority to buy the shares, their knowledge that they had done so should be attributed to Meridian, the company. The style of management of Meridian may be familiar to any offshore finance center: the members of the board lived in different parts of the world and met only once a year, before the annual general meeting; other matters which required a board resolution were circulated by post; and there was only modest supervision by the managing director (raising, in my mind, questions about how the board's salaries were merited!)

Lord Hoffman, for the Privy Council, sought to make more modern and intelligible the doctrines of corporate responsibility, civil and criminal. He argued that the primary rules of attribution of responsibility – the articles and memorandum of association – are "obviously not enough to enable a company to go out into the world and do business'.

It therefore builds upon the primary rules of attribution which are equally attributable to natural persons, namely, the principles of agency .To say that a company cannot do something means only that there is no-one whose doing of that act would, under the applicable rules of attribution, count as an act of the company.

Their Lordships clearly reasoned that of corporate liability required knowledge by the board, companies could easily defeat the objectives of disclosure requirements simply by paying little attention to the acts of their servants (though from the point of view of

preventing internal fraud and corruption, this is a very risky tactic, if genuinely practised). Likewise, it affirmed that where a servant had a duty to make a tax return, the failure to do so honestly should be attributed to the company. Nonetheless, they left some scope for argument:

> It is a question of construction in each case as to whether the particular rule requires that the knowledge that an act has been done, or the state of mind with which it is done, should be attributed to the company.

Taxation and Liability

Another area of importance for this group arises from a toughening of attitude on taxation in the English courts. In March 1997, two professionals and a lay client were convicted for tax offences (R. v. Chipping and others, unreported). The prosecution case was that while the lay client was stated to be only a consultant to three Jersey companies, central management and control actually lay with him, so their failure to notify their liability for what should have been UK corporation tax constituted a conspiracy to cheat the Revenue. The Jersey companies could just as easily have been ones from any "offshore center" specializing in incorporation, except that Jersey companies might look more "normal" and respectable to tax inspectors because of the island's proximity to the UK. In the first count, the lay client was convicted because the jury were convinced that monies paid to one of the Jersey companies were his own income rather than that of the company or its (nominee) shareholders. The second count involved convincing the jury not just that the documentation was incomplete but that the client rather than the Jersey director was the person who was in substantive charge of the activities of the company (as testified by witnesses to dealings): the company had told the Revenue that it was foreign resident, making it hard to claim later that this was not the objective of the scheme. Prima facie, if Chipping was correctly decided, then anyone – including an accountant – who is concerned with the operation of such a company and who knowingly participates in causing the company to "neglect" to make a tax return could be convicted. The point is that in an ambience of plea bargaining or the attempt of the other parties involved to negotiate their way out of prosecution by casting "what happened" in a favorable light to themselves, any professional adviser takes risks unless they are sure that the plan has been properly worked out. This does not necessarily mean that anyone in an offshore center will be prosecuted for complicity, nor that some accountants – faced with the loss of income from their demanding employers or worse if those employers are, say, Colombian narco-trafficantes – will not carry on with the schemes and hope that they will not be detected. But it may reduce general levels of demand for offshore center services.

Constructive Trust Liability

During the 1990s, there has developed in common law but not civil code countries the concept of constructive trust, which is particularly important in dealing with fraud and corruption cases. The idea behind constructive trust liability is to make professionals such as accountants, bankers and lawyers who act as intermediaries in financial transactions liable to those who are actually the owners of funds even if they did not personally steal or benefit unlawfully from the transactions (other than by way of

professional fees). The object is first, to provide some effective avenues of financial compensation for those who suffer loss (especially where the principal offenders and their assets cannot be found or recovered) and second, to motivate intermediaries to take greater care that their clients are behaving properly than they might otherwise be motivated to do. Even the profits that can be made from corrupt investments, for example, can be reclaimed. An early example that struck terror into accountants, lawyers and bankers was Agip Africa, in which accountants in the Isle of Man were held liable to account for funds stolen from Agip by ex-employees who employed them to set up companies through which they funneled the fraudulent money transfers.
The judge (now Lord Justice Millett) in that case may have been influenced by the low prestige not just of the companies but of the accountancy firm, as well as by the fact that the companies had plainly been set up solely for these transactions and had not conducted any legitimate business (though – taking a generous view – the company formation agents may not have known this when they "did the deed'). But the fact remains that the "attribution rules" (discussed earlier in Meridian) also can fix liability on intermediaries in civil actions.

Essentially, there is little doubt that those who either deal with assets in breach of trust or implement a fraudulent scheme in which they steal assets for their own benefit can be held liable to the beneficiaries of the trust or the fraud victims. But in many cases, civil remedies against "offenders" will be useless because they appear to have no money or are "unavailable" because of "walking trusts" or other overseas asset protection trust devices, leaving "deep pockets" intermediaries (or their insurance companies) to pay if anyone at all. (An example is the Maxwell case, where bankers and accountants contributed almost all the funds to repay victims: this has been the pattern in most major fraud cases where the money has gone on personal high life or incompetent business activities, leaving the counter-parties to the transactions as the non-criminal beneficiaries without any liability.) In this respect, the Privy Council decision in Royal Brunei Airlines Sdn Bhd v. Tan is crucial.

Prior to Tan, a party – whether individual or corporate – who was not himself subject to a trust relationship could be required to account for losses as a constructive trustee if he either

Received trust property in circumstances which required him to account to the beneficiary of the trust (i.e. he was in "knowing receipt'); or

Assisted consciously in a dishonest or fraudulent design of the trustees (i.e. he gave "knowing assistance'). The test of this is whether a reasonable person in his position would or could have found out what was happening, thus not granting a premium to the "willfully blind'.

The key problem with this was that whereas a civil or criminal prosecution against the principal perpetrator would have to prove fraud or a dishonest breach of trust, those intermediaries who neglected to make inquiries with sufficient effort would be

liable for the full loss caused by the fraudulent plan. The courts gradually imposed further necessary conditions before accessories were made liable, including “want of probity
– which means not acting as an honest person would in the circumstances – though any accountant or solicitor who failed to comply with his professional “best standards” might be liable under the “want of probity” principle.

In the Privy Council judgement, Lord Nicholls observed that “dishonesty on the part of the third party would seem to be a sufficient basis for his liability, irrespective of the state of mind of the trustee who is in breach of trust.’

He went on to argue that:

The standard of what constitutes honest conduct is not subjective. Honesty is not an optional scale, with higher or lower values according to the moral standards of each individual .In most situations there is little difficulty in identifying how an honest person would behave. Honest people do not intentionally deceive others to their detriment .Unless there is a good and compelling reason, an honest person does not participate in a transaction if he knows it involves a misapplication of trust assets to the detriment of the beneficiaries. Nor does an honest person in such a case deliberately close his eyes and ears, or deliberately not ask questions, lest he learn something he would rather not know, and then proceed regardless.

However, there are situations, he acknowledged, where honesty is not self-evident, and one such relates to the taking of risks. In addition to the circumstances known to the third party at the time, the “court will also have regard to the personal attributes of the third party such as his experience and intelligence, and the reason why he acted as he did” (p.107). It looks as if this grants an unfair advantage in reduced liability to the junior lawyer of modest intellect who states that he was “simply following orders’. But (p.108) in relation to negligence, “as a general proposition, however, beneficiaries cannot reasonably expect that all the world dealing with their trustees should owe them a duty to take care lest the trustees are behaving dishonestly”. Nevertheless, there may still be a successful claim in negligence, even if constructive trust offers no remedy. So when acting for a company, as for an individual, professionals will be expected to take those steps which an honest person can be expected to do (as adjudged by the courts, not by their golfing or sailing companions) unless they are to fall foul of constructive trust liabilities in fraud and corruption cases. In drugs laundering cases, however, except where one party steals from another and they choose to go to court while expecting mutually to conceal the source of the funds (since the court as a matter of public policy will be unlikely to enforce such trusts for the proceeds of crime), considerations of constructive trust do not apply.

Enforcement of Remedies

(Applications to trace assets) develop into an international paper chase, in which disclosure of documents by one respondent leads to applications for further information

from another respondent and so on. My impression is that these exercises are often not cost-effective ... the outcome is often no more than a few miserably small sums remaining in disused bank accounts. The bulk of the money has been dissipated in ill-advised commercial speculations, such as the Maxwell share support operation.
Issues of national and/or territorial sovereignty have been implicit or explicit in many of the major laundering investigations of the past twenty years. During the 1990s, the trend has accelerated by which – reflecting the globalization of commerce – the courts have granted the power to enforce not just judgements but also pre-trial disclosure and asset-freezing orders in various parts of the world. As (now Lord) Hoffman J. has noted in relation to yet another "fraud case" that led to no criminal prosecutions but was rather dealt with through the civil courts:

In many large cases involving allegations of fraud and embezzlement, the greater part of the interlocutory stages of the action is concerned with the endeavours to trace assets against which a claim can be made. The function of the judge at this stage is not so much to decide or even define the issues between the parties as to supervise the investigation by the plaintiff . It is a remarkable fact that this whole panoply of remedies, frequently trenching upon principles of civil procedure previously regarded as settled, has been created by the judiciary without any statutory assistance.
These remedies are having to be applied in a number of large alleged frauds where funds held in trust are transferred through a myriad of offshore finance center companies: for example, senior corporate officers were alleged to have stolen funds from the Spanish corporate arm of the Kuwait Investment Authority, and the English court rejected the proposition of the defendant that he had no obligation to disclose the whereabouts of his assets world-wide before the resolution of his challenge to the jurisdiction of the court.
In Credit Suisse Fides Trust SA v. Cuoghi, the defendant lived in England and – with a Swiss employee of the plaintiff – was sued for $21 million which they allegedly had defrauded. The court held that a world-wide Mareva injunction and an ancillary disclosure order in England should be awarded against him, despite the fact that no substantive proceedings were taking place in England nor were any of the assets in dispute there. (The Swiss have no power to order a non-resident to disclose assets outside Switzerland.) The Court of Appeal took the fact that Cuoghi was domiciled in England as sufficient to base its powers, though whether they got the full sum back seems doubtful. Sometimes, large sums have been recovered for creditors – £72 million in Derby v. Weldon
and, with much circumlocution, as the funds (even without a "jurisdiction-hopping" trust deed) were whizzed around various jurisdictions, £1 million from the corrupt former Deputy Crown Counsel in Hong Kong
– and both the English and US courts are capable of striking out the defenses of non-resident defendants and entering judgements for the plaintiffs. Where a witness is in fact the agent of the defrauded company plaintiff, even banking secrecy can be overcome in countries such as Switzerland. But often, the money has gone completely and neither civil litigation nor confiscation of the proceeds of crime in the criminal courts can bring it back even in principle.

Frustration at the inability to control crime in some other jurisdiction, especially in the American courts, often leads to the preference for "order" rather than "law" internationally as well as domestically. In the US, s.442 (2) of the Restatement (Third) Foreign Relations Law states: If disclosure of information located outside the United States is prohibited by a law, regulation or order of a court or other authority of the state in which the information or prospective witness is located, or of the state of which the prospective witness is a national,

A court or agency in the United States may require the person to whom the order is directed to make a good faith effort to secure permission from the foreign authorities to make the information available;

A court or agency should not ordinarily impose sanctions of contempt, dismissal or default on a party that has failed to comply with the order for production, except in cases of deliberate concealment or removal of information or of failure to make a good faith effort in accordance with paragraph (a);

A court or agency may, in appropriate cases, make findings of fact adverse to a party that has failed to comply with the order for production, even if that party has made a good faith effort to secure permission from the foreign authorities to make the information available and that effort has been unsuccessful.
In cases involving US claims to extra-territorial jurisdiction, the English courts have tried to steer a middle course and have treated potential civil claims of constructive trust as a reason for refusing payments to account-holders, while not granting them to the American courts either.
The English courts have dealt with this creatively by granting the means to ensure as far as possible that the objective of equity would not be undermined by allowing defendants to hide and/or dispose of their assets prior to judgement so that the plaintiffs end up with vast legal expenses and no effective relief.

But this cannot be done without producing some conflicts of laws with those jurisdictions that offer banking secrecy and other devices as a marketing tool for what economists term "the law of comparative advantage'. One way of dealing with such conflicts is to adopt the "balancing of interests" approach.
But this is conceptually vacuous unless there is some methodology specified about how one might prioritize one set of interests over another in a principled way, (rather than "the US can give us more problems so we had better do what they say') and might get other countries to go along with one's priorities.

Although there is no power to require full discovery from an individual or corporate third party who is not a defendant, the English developed a principle in Norwich Pharmacal:

If through no fault of his own a person gets mixed up in the tortious acts of others so as to facilitate their wrong-doing, he may incur no personal liability but he comes under a duty to assist the person who has been wronged by giving him full information and disclosing

the identity of the wrong-doers.

The object of this is to trace the funds, and this is so even where there is no trial in immediate prospect because without the writ, there could be no identification of the defendants.

Finally, the Privy Council case Brannigan and others v. Davison (1997) ANTICIPATION 238 (PC) dealt with a New Zealand Court of Appeal case known as Controller and Auditor-General v. Davison (1996) 2 NZLR 278. This related to a major scandal known colloquially as the Winebox case, in which New Zealand First leader Winston Peters MP – then in opposition, now in the Cabinet – accused the Commissioner of the Inland Revenue and the Director of the New Zealand SFO of covering up tax fraud involving misuse of tax credits issued to a number of substantial New Zealand companies – not fly-by-night fraudsters or drugs traffickers – by the government of the Cook Islands (which are administered by New Zealand). Witnesses in New Zealand were given disclosure orders by a Commission of Enquiry, with which they refused initially to comply on the grounds that answers were forbidden by the secrecy laws of the Cook Islands, flourishing court orders from the Islands to support their stand. The New Zealand Court of Appeal rejected a (perhaps half-hearted) appeal from the Controller and Auditor-General of New Zealand that the Cook Islands government had sovereign immunity from a New Zealand court order to disclose documents, and this was not appealed further. In the end, the Privy Council upheld the view of the Court of Appeal that they were required to comply. We have been unable to gather data on the economic effect of this ruling on demand for Cook Islands companies, but this would be one measure of impact (depending also on international knowledge, rather than rumor, about the law and also depending on expectations about future levels of international efforts to overturn secrecy in any given country – these might all be areas of imperfect market knowledge).

Concluding Comments

Inhibitors and facilitators of crime – especially those types of crime that do not evoke "innate" social sentiments – are not natural phenomena: they are socially and legally constructed. What is relatively novel about international organized crime phenomena is that they involve the physical and jurisdictional distancing of part of the system of crime beyond the reach of the countries where the victimization occurs, whether the crimes be illegal drug use, fraud, illegal arms possession & use, illegal immigration or tax evasion. (These are the principal revenue-generators that require money-laundering, though there are obviously other cross-border crimes such as car theft and major robberies.) There are many aspects of modern commercial life that facilitate crime: digital mobile pay-as-you use phones that require no registration of ownership, making surveillance much more difficult, are simply one example. In form, the types of facilitation that affect our subject matter of international crime for gain include:

Rationalizations for crime (denial of harm; denial of responsibility; and condemnation of the condemners);

Legal rules and lax professional regulation permitting the absence of "due diligence" in company and trust formation, and in the opening and subsequent use of

banking facilities;

Mutual legal assistance rules enabling or even requiring non-cooperation with internal and external requests for information, at their most extreme allowing there to be insufficient evidence within or outwith the jurisdiction to enable investigators to learn the identity of beneficial owners (e.g. unregistered ownership and bearer shares)

Inadequate number and competence of regulatory enforcement staff;

Corporate liability rules that are not based on simple principles of residence or place of incorporation (e.g. it may be easier for the UK to strike off the register Sark-incorporated companies and to disqualify Sark-resident multiple directors from acting as directors in future than to do so in Ireland, where different company law principles apply);

Large denomination currency issues (or currency equivalents) such as the 1,000 Deutschmark note or the proposed 500 Euro note (approximately $530 U.S.).

Inhibiting factors typically take the form of national and international action that counteracts "abuses" after they have developed, often being scandal-driven. The principal forms of abuse of secrecy appear to have shifted, as controls have been developed, from individual bank accounts to corporate bank accounts and bureaux de change operations and then on to trust and other corporate forms that can be purchased readily without even the modest initial and ongoing due diligence that is exercised in the banking sector. Fake or partly genuine charitable trusts – used to conceal commercial bribery, for example by assisting the children of the target bribee, and to launder funds supposedly accruing from fund-raising – can be constituted more or less at will, subject to the definition of charity at law. (National rules vary: in Bermuda, for example, the same person or entity can both establish the trust and be its beneficiary; in the Channel Islands, they cannot, at least not without losing tax benefits that are a principal rationale.) Sovereignty itself has been franchised, with Panamanian or London lawyers able to create Niue companies from their own offices without anyone having to leave their own jurisdictions, making the concept of territorially based law redundant, despite the hubris with which attempts at extra-territorial powers are greeted. In the case of trusts, the rule against perpetuity has been revoked, with Cook Islands trusts able to manage forever the assets of beneficiaries whose identity is not disclosed and cannot usually be inferred from trust deeds. Irrespective of the particular places – which change over time as regulation bites – the conceptual basis for these methods of hiding ownership and quantum of assets appears hard to justify.

In response, we can see a substantial shift in policy across the board in imposing duties to assist in preventing laundering and in ex post facto cooperation provided that these requests can be framed within the rubric of mutual legal assistance treaties and other instruments, such as Interpol or the Commonwealth Scheme. Informants state that in practice, US "requests" (and the contemplation of U.S. requests) do act as an incentive to due diligence practices by professionals in, for example, the Caribbean and even Switzerland, precisely because it is known that the US is likely to take severe extra-territorial measures (a.k.a. "play hardball'). But regulatory jurisdiction-shopping by offenders still abounds.

However, some of the key practical questions we must address are:

How are these "problem countries" distributed? This requires the separate elaboration of nominal (or formal) and substantive compliance, reviewing the speed of

assistance as well as whether or not there are formal measures in place.

But to create "pariah territories" in such a way as to anathematize some whilst ignoring the malefactions of others may not only be morally questionable but also empirically unsound, unless "plaintiff" countries can back up their claims of hierarchy of non-compliance with data on attempted but unsuccessful requests. There is room for much self-delusional mythology, especially in the perceptions of probabilities, e.g. even if all bankers in country N are willfully blind, the proportion of money-laundering that involves country N may be very small.

What would people in the "pariah" territories do to make a living were it not for offering questionable "banking services'? It may be ambitious to suggest a financial services equivalent of a drugs crop substitution program, but one should explicate the "costs and benefits to whom" issue. For example, one might differentiate the impact on, say, a Caribbean territory/country according to whether the principal benefits go to expatriate professionals or to indigenous peoples (though this might be hard to do in practice as they would be mixed). Obviously, even in the former case, there is a trickle-down from fees to the permanent resident population, but there may be less harm done to locals in the latter than in the former conditions (though this may not be reflected in political protests). There is also the dignity issue of being engaged in something in economies that are difficult to diversify.

How important is the laundering process to crime commission? This depends on the type of crime and on the income flow and savings preferences of the offender. We take it for granted that if laundering were actually harder, there would be a lot less crime. But quite apart from enhancing conspicuous consumption or, in the case of many terrorist groups, simply distributing regular cash hand-outs to the "foot-soldiers" it may be that criminals will simply deposit their money in safe deposit boxes rather than reduce their velocity of crime.

Part of the answer to this depends on how corruptees and drugs or arms suppliers wish to be paid. If they wish to be paid in cash – perhaps because they do not trust the purchasers with any other form of payment – then the laundering needs of the purchasers fall correspondingly, though this does not resolve the needs of the vendors; if they want to be paid through the banking or real estate system – e.g. the simple transfer of ownership of a property-holding trust or company – then the purchaser's laundering needs are greater. Serious persistent offenders are unlikely to be able to do without laundering in some form, because (with the possible exception of gambling) there is a limit to how much one can spend on "home improvements" and on leisure pursuits if one has a large flow of income.

There are costs to independent self-government and the democratic right to be different that arise from international harmonization. Furthermore, the appropriateness of any balance between national rights and the interests of crime prevention are not always self-evident to all parties or even to neutral observers. However, in teasing out the global infrastructure of crime and its interaction with social values and legal rules, we hope that we have sharpened the focus necessary to take informed decisions on these important issues. Against this background, the next section delineates those considerations that need to be taken into account in devising policy options to combat money laundering and other financial crimes that are implemented through offshore financial centers and bank secrecy jurisdictions.

VI. Issues For Consideration

Non-intervention; the sale of sovereignty.
A fundamental concept, agreed to by the member states of the United Nations, is the principal of non-intervention in the internal affairs of other states. Consistent with this principal of non-intervention, the authors have adopted as a basic principle the proposition that no member state should assist citizens or residents of another state in the violation of the laws of their home country. That principle is applied herein to the issues of financial secrecy and offshore financial centers.
The concept of sovereignty as applied in the United Nations Charter and the law of nations gives the sovereign state control over its territory, its citizens and its residents. Some states have expanded the concept to include actions which have impact on its citizens and its territory.
Much of the difficulty raised by issues of bank secrecy and offshore financial centers arises from the broad way in which some jurisdictions have interposed their own sovereign status to block the power of other states in the exercise of their prerogatives on their own citizens and residents regarding their actions in their home countries. These sovereign states have offered tools explicitly designed to defeat the laws of other countries. Many of these tools are made available only to nonresidents and can only be used offshore. This sale or rental of sovereign status degrades national legal institutions. Further, it blocks the development of an international rule of law which is an essential concomitant of a globalized economy.
Although there are times when international law properly allows one state to shelter the citizens of another from the operation of the laws of their home country, the circumstances are extremely limited. Examples include the political exceptions in extradition treaties, the grant of asylum for those fleeing political persecution, and the protection of individuals against crimes against humanity. These exceptions are recognized in international conventions. They are morally justified and the problems they address must be considered when privacy and secrecy are debated. These exceptions aside, the fact is that almost everything hidden by bank secrecy and financial privacy laws is being hidden to protect the owner from taxation, criminal prosecution and civil court judgements.

Secrecy Issues
The issues of financial secrecy encompass broad issues of the right to privacy. As noted earlier these questions are quite complex and are treated differently around the world. This study has focused on the narrow issue of the right of a government to obtain information from other governments and foreign institutions in the pursuit of a criminal investigation.
The much broader issues of information privacy are becoming more complex by the day because of the growth of global databases and the speed and ease of communication. And the most serious aspects of the question relate to private efforts to access information – not the formal legal efforts of other nations. There is no clear understanding among

nations regarding the legal jurisdiction to regulate and protect data privacy. Although some nations have put strict policies in place, if information is accessed from a remote location through some form of intrusion, the international machinery for protecting against the intrusion is all but nonexistent. As noted earlier, data generated in one country can be located on a computer server in another country, controlled by an operator in yet another country, and be about a person or entity located in a fourth country. All four countries may have an interest in either obtaining or protecting the information. Assuming the person the information relates to has a right of privacy, which country is obliged to protect that right from private efforts to get the data?

Even if an understanding about primary responsibility existed, as a practical matter, enforcement of privacy rules has become next to impossible. Consider, for example the difficulty of prosecuting a person who has hacked into the telephone records of a person in another country and then sold the information to a person in a third country.

Because of this growing complexity, it is suggested that member states may wish to begin discussions about new conventions regarding the legal status of information-based issues. Unless the issues are addressed in agreements that go far beyond today's mutual legal assistance treaties and the 1988 Convention, the ability of the world's judicial systems, both civil and criminal, to handle problems arising from global business transactions will be seriously compromised.

A range of treaties and conventions on judicial cooperation and on the specific issue of the prevention of money laundering call for the exchange of information in response to a formal request from a signatory government. Unfortunately, the mere existence of an agreement is not an appropriate measure of the reality of cooperation. Effective cooperation requires effective response machinery. An investigator looking for the proceeds of a drug crime needs information in hours not months or years. To make information exchange work there must be political will and a commitment to the rule of law. In a number of cases governments have agreed to cooperate but the agreement has been a cosmetic cover to protect the local money laundering industry.

For example, in response to bilateral pressure, one country adopted requirements relating to the identification of the beneficial ownership of all corporations incorporated under its laws. The law firms in that country immediately made arrangements to become the authorized agents for the chartering of corporations in other jurisdictions which have no requirements for identification of beneficial ownership. In other cases, the countries lack adequate machinery for responding to requests, a circumstance which delays the delivery of the information to a point where it becomes useless.

Money launderers use a variety of devices to make the investigation of financial crimes and the recovery of criminal proceeds difficult. The next suggestions relate to the control of the working tools of money launderers. These tools are used in almost all money laundering arrangements.

International Business Corporations

International Business Corporations ("IBC"s) are at the heart of the money laundering problem. As noted earlier in this report, virtually all money laundering schemes use these entities as part of the scheme to hide the ownership of assets. A threshold question for consideration by member states is whether International Business Corporations should be

permitted to do business, open bank accounts and trade outside of the jurisdiction of incorporation under any circumstances.

The corporation was created as a legal entity in order to give businessmen the opportunity to conduct their affairs without risking all their assets. At its heart was the concept of limited liability. As a general rule this protection from liability required the corporation to have a certain stated capital which had to be paid in. Liability was then limited to the amount of paid in capital.

Incorporation also allowed the separation of ownership and management. A shareholder in a corporation need not be an active partner or participant in the business. This separation has allowed the creation of companies which have broad public ownership and which can seek capital in the world markets. None of the advantages offered by the corporate form require anonymity of either ownership or management.

In the world's leading commercial jurisdictions corporations are required by law to have regular meetings and keep books and corporate records. Failure to follow these corporate formalities will end the protection of the corporate form. The corporation is subject to service of legal process through a "registered agent" in every place it "does business." In short, in exchange for giving the owners of the business limited liability and access to passive capital investment, the state which authorizes incorporation insists that there be a real business, that it has been capitalized, and that the entity is subject to the jurisdiction of its courts.

In contrast, in most jurisdictions the International Business Corporation operates without any government requirements. On the condition that it do no business in its home jurisdiction, the IBC may hide its ownership, and need not pay taxes. In many jurisdictions it is not required to keep books and records. The purpose of the IBC's corporate form is to enable its owners to act with complete anonymity, but the concept of limited liability has been extended to a concept of no legal responsibility for any action. IBC's are routinely used in money laundering schemes because they provide an impenetrable layer of protection around the ownership of assets. They are central to virtually every effort to conceal the origin and destination of goods in international commerce, to circumvent arms control laws, and to evade taxes by moving profits and assets out of the reach of the tax collector.

One approach to the problems raised by this new kind of corporation would be an international agreement to not recognize corporate entities which do not have full authority to do business in their home jurisdiction. This agreement would bar IBCs from opening bank accounts and engaging in securities and commodities trading. It would deny them the right to own real property outside of the country of incorporation, and deny them the right to do business.

A second, and less drastic approach would be to limit the use of the IBC to regulated financial institutions. For example, many banks currently refuse to open accounts for IBCs that have not been formed by the bank itself. These banks believe that under the prevailing due diligence rules they must know the beneficial owners of the company. A bank that creates the corporation will always know its beneficial owner. Thus, it will always be in a position to respond to official requests in connection with a criminal investigation.

Trusts

Trusts are important and useful instruments in the transfer and management of assets. A

creation of the common law, trusts allow the holders of assets to put them in the hands of others to protect the interests of minor children, and to care for incompetents. They allow for the distribution of family assets in the future according to the needs of family members. They are also used to transfer and hold assets for charitable purposes. These purposes are commendable. The problems arise when the trust is used to conceal the origin and distribution of illegal funds. Unfortunately, trusts which hide the identity of the grantors and the beneficiaries have become a standard part of money laundering arrangements.

In the older common law jurisdictions, trusts are governed by a substantial body of law which places limits on their term and imposes obligations on the trustees to protect the interests of both settlors and beneficiaries. Trustees cannot be removed without a legal challenge and the terms of the trust are fixed. Unless these features are present, the law regards the trust property as the property of the trust settlor and subject to legal process and seizure as if the settlor owned the assets directly. In the major common law jurisdictions, these requirements limit the usefulness of the trust for concealing and protecting the proceeds of a crime.

In recent years a number of jurisdictions have amended their trust laws to make them attractive as a way to conceal assets. These jurisdictions offer trusts which are designed to place the assets out of the reach of the settlors' home country governments. The trust laws include provisions which make a trust immune from foreign lawsuits once it has been in place for one year. This makes it impossible for foreign law enforcement authorities to question whether the trust has been established with the proceeds of a crime and impossible to recover the funds if in fact it has.

The laws of these offshore center jurisdictions permit trust instruments to be written in a way which hides the identity of both the settlor and the beneficiaries. The true beneficiaries are indicated in side letters, frequently termed "letters of wishes." In some cases these instructions are called a memorandum of wishes. The settlor can retain control of the assets through a person designated the "trust protector." The trust protector has the power to change the beneficiaries and to change the trustees.

Just as in the case of the International Business Corporation, these specially designed trusts have gone far beyond their original purpose of having assets managed and controlled for the benefit of others.

Many money laundering schemes marry an international business corporation to an offshore trust. The shares of the IBC are held by the trust. The trustees make the grantor of the trust the chief operating officer of the corporation and give him the authority to draw assets, pay himself, and use a corporate credit card. This way the beneficial owner of the assets has instant access to his money and control over his assets without any of the normal indicia of ownership. Efforts to go after the assets of the corporation will be blocked by the laws of the trust situs.

To curb abuse of offshore trusts, states may wish to consider limiting the scope of protection given to nonresidents and non-citizens who establish trusts. At the very least states may wish to consider imposing requirements that will enable investigators to identify the beneficial owners of all trusts. Some possibilities include:

Requiring the identification of the trust settlor and the trust beneficiaries in the trust instrument.

Requiring the registration of information about the settlor and the beneficiaries with a local court.

Requiring that all the terms of the trust be included in the trust instrument. Thus, if a trust can be changed at the whim of the settlor, the instrument should show that on its face.

Prohibiting provisions which instruct the trustee to terminate the trust and move the assets if the trust becomes the subject of an investigation or legal proceeding – so called "walking trust" provisions.

Allowing the challenge of any trust on the basis that it was established with the proceeds of a crime.

Allowing the assets of the trust to be frozen in criminal investigations until their provenance can be ascertained

States may wish to consider limiting offshore "asset protection" trusts. These trusts protect the assets of individuals from civil judgments in their home countries. A common provision of asset protection trust law will be that the courts of the trust domicile cannot entertain a challenge or a claim made against the assets of the trust if the claim is filed more than one year after the date the trust is created. The question of whether sovereign states should use their status and legal authority to protect the assets of citizens of other states from their own civil and criminal justice systems is an important issue. In common law countries, civil courts act as a first line of defense against fraud. Suits for fraud allow the victim to recover consequential damages which survive bankruptcy proceedings. In fact, most fraud cases are remedied through civil litigation which acts as a substantial deterrent. If criminals can shield assets by using an asset protection trust the only deterrent will be criminal prosecution.

In many jurisdictions, trusts and international business corporations are administered by unregulated "trust companies." Criminals can use a trust company which operates in an offshore financial center with secrecy legislation to completely conceal the transfer of assets. They do it by moving the shares of a corporation from one account to another, by changing corporate names, by merging corporations and by changing trust documents on the instruction of the settlor. Although they are not deposit takers, the opportunity they offer for illegal behavior poses risks for the entire international business community. These companies should be subject to the same regulatory standards as banks. They should be held to the same know your customer standards. They should be required to keep careful records of stock transfers and to insure that transactions which they undertake do not become a substitute for regulated bank transactions.

In addition to acting as "black boxes" for financial transactions, unregulated trust company operations in secrecy jurisdictions have been known to manufacture false paper trails and false documentation to assist smugglers, tax evaders, and money launderers. They have routinely provided invoices, receipts and other documents to help fool the customs and tax authorities of other countries. This service is not legitimate and should be illegal even if the clients are in another jurisdiction and the documents will have no impact in the place where they are created.

Lawyer-client privilege: the role of the professional

Money launderers frequently use lawyers and accountants to help them hide funds. All too frequently, unscrupulous lawyers provide advice on money laundering to their clients on the assumption that they will be protected by the rules of privilege which protect the

confidentiality of the lawyer/client relationship. The protection of privilege is often quite effective because the people who ask for help in concealing assets frequently consult lawyers who do not live in their home country. For example, an American wanting to hide money may consult a lawyer in the United Kingdom who will then enlist the assistance of another lawyer in the Cook Islands. Together they will produce shell companies and trusts in jurisdictions they have selected and will provide bank references to open the doors of the international financial system.

This professional assistance in hiding money is inappropriate in both civil and criminal cases. No lawyer can justify assisting in concealing the proceeds of a crime. Further, lawyers should be the subject of professional discipline if they know that to keep the money hidden the client will have to lie under oath.

If the funds the lawyers are protecting are the result of criminal activity in any jurisdiction, it should be a crime for professionals to assist in hiding the funds. Lawyers and accountants should be cautioned that if they help hide criminal proceeds they will be held responsible for assisting in a crime. Further, their advice in this area should be placed clearly outside the bounds of professional privilege and confidentiality.

Credit Cards

Credit and debit cards are the way people who have laundered money draw ready cash without leaving a financial trail. As one advertisement for a bank put it, it is the best way to stay in touch with “your offshore account.” Most credit card accounts outside of the United States are tied to a bank account. Many of these accounts are in banks in countries which have stringent bank secrecy laws. The banks assure their clients that the card account information is protected by the same rules that protect the other account information.

It may be useful for states to consider an agreement that the state where the credit card or debit card is used has equal rights to, and equal control over the account data. Without that level of control the citizens and residents of a country will be able to put much of their financial life beyond the reach of inquiry by their own government. Obviously, states will also have to address the questions of privacy, but this issue is secondary to legitimate requests for help from a law enforcement agency in pursuit or a criminal investigation.

Currency

The worldwide circulation of banknotes by the United States, Germany, the United Kingdom and a few of the other leading developed countries has created a store of value for criminals around the world. Because currency is anonymous, most street level crimes including drug purchases are made in cash. The drug business generates a massive amount of currency through its street sales. Thus, the first step in any money laundering scheme is to place the currency in a bank. National governments have instituted controls on large cash deposits to block initial placement. As controls on currency in domestic banking systems have grown tighter, the launderers have looked for alternative ways of converting the currency to bank entries. Their search has led to international markets.

The currency of choice for illegal transactions is the United States dollar. The dollar circulates widely outside of the borders of the United States. Indeed, of the $400 billion in U.S. currency in circulation $300 billion is in circulation outside the United States. The dollar is freely convertible and is easy to exchange anywhere in the world. The ideal country for the placement of drug money is one in which the U.S. dollar circulates as a

parallel currency. In that setting the presence of large amounts of cash is easily explained. Some countries such as Panama, which uses the dollar as it currency, are particularly vulnerable. Other Caribbean countries, and countries in the former Soviet Union in which the dollar circulates as a parallel currency, are similarly vulnerable. The introduction of the Euro in European nations may provide another widely usable currency for illicit transactions. In this regard, some observers have pointed out that issuance of large-denomination Euro notes (eg. 500) could facilitate the movement of bulk cash and thus assist money-launderers.

Selling currency to foreigners for foreign use is a highly profitable business for national treasuries. Currency may be viewed as an interest-free loan to the issuing government. The issuing government captures the interest it would otherwise have to spend. The United States Federal Reserve estimates its income from the foreign purchase of U.S. banknotes at $16 billion a year.

One radical way to control the illegal use of currency would be to periodically recall it to exchange it for another form of bank note. During a recall, any holder of a large amount of unexplained currency would be in a difficult position. A recall would force criminal organizations caught with a large amount of currency to absorb huge losses. It would create uncertainty and difficulty for them. So far, this solution has not been attractive to the countries which have currencies that circulate outside of their own borders. Apart from the problem of the feasibility of such an approach, the issuing governments would likely fear that regular recalls would destroy the attraction of holding foreign banknotes.

Elimination of free trade zone abuse

When tariffs were high, free trade zones could be justified as a place to assemble goods and a place to break large shipments into smaller lots for transhipment without imposing another layer of tariff. Since tariffs have declined, the usefulness of free trade zones for legitimate purposes has declined as well.

In recent years the zones have become centres for re-papering shipments to conceal the origin, the ultimate destination and the value of goods in international trade. The zones have been used for illegal drug shipments, illegal arms shipments, the movement of stolen and counterfeit goods and the violation of international embargos.

Today the zones are convenient places to arrange to have drug money pay for goods that will generate bank deposits in other countries. The way this type of money laundering works is that the trafficker pays for the goods with drug proceeds in the country where the goods are manufactured. The goods are then shipped to a company in a free trade zone to conceal the source of the payment. They are then shipped to the final destination where the goods are sold for the local currency and a local currency account is created. A legitimate trade transaction has thus covered criminal laundering.

States may wish to consider whether the time has come for reevaluation of the trade zone concept. A critical evaluation of the legitimate uses and benefits of the zone is overdue. It may well be that a substantial cutback in the use of zones is appropriate. The limitation on the uses of zones would have the significant additional benefit of limiting customs fraud and the movement of diverted and counterfeit goods.

If the zones are to continue in operation, the documentation relating to shipments in and out of the zone must become transparent. All goods transiting through a zone should be required to have the paperwork relating to the original purchase of the goods accompany

them. The documentation should include the source and method of payment, and the identity of the purchaser for each transaction from the point of origin onward. The trade zone should require documentation of shipments in and out and should be prepared to make the documentation available to criminal investigators.

Gambling as a cover.

Gambling casinos have been used to hide the proceeds of drug sales for more than fifty years. Casinos are ideal vehicles for laundering because they generate large amounts of unaccounted for cash. The cash can be deposited as the evening's take without attracting attention. Casino gambling has expanded dramatically around the world over the last few years. Casino chains are operating in Africa, Asia, Latin America and Europe. They are also a feature of a large number of financial havens.

Because of the vulnerability of casinos to money laundering operations it is essential that the industry be more carefully regulated. For example, before a casino license is granted, the identity and bona fides of the beneficial owners must be verified. All casino employees should be screened for past criminal connections. Finally, casinos must be monitored to see whether the business done relates to the cash deposited. In this way, regulators would be better able to spot suspicious transaction trends.

Need for essential data

Early in work on this study it became apparent that detailed and accurate information on the size and scope of offshore financial center activity is impossible to obtain. Many countries do not publish statistics on their international banking and business operations. Little or no data is available on the number of international business corporations which have been formed, on the number of trusts under administration, or on the size and type of assets these entities hold. In cases where the data is available it is presented in a form that may lead to double counting of amounts.

The data on financial center operations of banks is somewhat better because banks are more strictly supervised. Home country regulators require their institutions to produce information on offshore operations. But brokerage firms, trust companies, and corporate "service" firms do not report their activities, which means that much of the public discussion is based on guess work.

All financial center countries should publish data in a reasonably coordinated way to form a basis for informed answers to serious policy questions. The data should include information about banks, brokerage firms, trust companies, mutual funds and insurance operations. It should also include information on both the asset holdings and the flows of funds through accounts of all types. In addition, it would be useful for the international community to be able to identify by nationality and residence the customers of the centers.

Good information will help determine the importance of the financial center operations to the local economy. It will help in the evaluation of the nature of the business the centers attract, and changes in the flows will help in evaluating the presence or absence of drug money.

Intelligence and Information exchange.

Good intelligence is essential to effective control of financial crime. Victims of fraud are slow to report the crime because they fear embarrassment. Often they do not want to be seen as an attractive target for a further hit from another group of criminals. Money laundering itself is a consensual crime, and as such, leaves no angry victims behind. As a

result it is unreported. All too frequently money laundering investigations grow out of the follow-up to a drug case during which police search for the drug trafficker's money. As a result the police reaction to the groups that support the crime of money laundering is often slow and ineffectual. It is essential to have substantial amounts of police effort focused on the people who assist and enable the crime.

For money laundering and financial crime investigations to be successful they must be based on the intelligent use of intelligence. If ten drug cases produce a money trail that leads to the same bank or group of banks, it should be obvious that the banks should be the next targets of investigation. The difficulty is that the information that would allow the targeting of the bank is rarely collated and analyzed.

Similarly, when a criminal gang is involved in prime bank fraud or securities fraud and it victimizes people in four or five different countries, the police in each country treat the case as sui generis. It may take months or even years of investigative work for law enforcement agencies to recognize that they are dealing with a well organized multinational enterprise.

Solving this problem requires well developed international police intelligence capacity. The specific crime reports must be gathered in a single location, analyzed for common elements, and forwarded to the police agency in the best position to act. The governments of the European Union are attempting to meet this need through Europol.

Historically this kind of police intelligence activity has raised concerns about misuse of the information. The 20th century is replete with instances of governmental spying on its own citizens. The problem is finding a way to balance the needs for intelligence with the need to protect the rights of citizens.

One possibility is assisting the development of non-governmental tools for assembling intelligence about fraud and money laundering. Several examples already exist. The international art community maintains data bases to enable the tracing of stolen art. Several major international banks share information on efforts to compromise their security. In the United States, the National Consumers League maintains the National Fraud Information Center which takes calls from people who believe they have been victimized. The Center refers them to the appropriate law enforcement agency. It then collates the data on complaints which allow the identification of criminal gangs. This privately collated data is then turned over to law enforcement authorities.

Another possibility is an international agreement which would create specialized law enforcement systems to deal with limited categories of international crime. For example, the World Bank and its affiliates have been victimized by fraud in their operations but that fraud is not the subject of criminal law and has rarely been prosecuted. States may wish to consider creating a series of "international crimes" and appropriate international law enforcement machinery to deal with fraud directed against international institutions.

Similarly, it may be possible to define international crimes on a regional level. For example, there are a number of fraud related crimes which have the European Union as their victim. These include agricultural subsidy fraud and cigarette and alcohol smuggling. A number of European Union nations are about to launch the Euro. However, there is no international police agency with the specific task of protecting the currency from counterfeiting and fraud. It would make sense to consider the creation of Union-wide crimes and appropriate law enforcement machinery to deal with these crimes.

On the more immediate level, an important initiative for the United Nations is the development of an expanded international criminal law library and data base, including criminal law texts and case materials from all member countries. It should also include related regulatory material such as the banking and securities regulations relating to information. It should include the rules and procedures for gathering of evidence in a criminal case. This library information should be available on-line, in electronic form. The availability of a library of this nature would enable prosecutors and law enforcement officers to find out how to get information from another country at the touch of a computer key.

The database should also include up to date directories of the responsible officials in each country. Law enforcement and private security officials should be able to identify the responsible official in each country by consulting an on-line directory. In the current environment it may take weeks of work to find out which agency has responsibility for a particular area of investigation and who the responsible person to deal with is.

The expanded on-line library might also include information about pending cases of money laundering and other financial crime from around the world. This would enable law enforcement officials to stay current on crime typologies and on new developments. In assembling the information and obtaining financial resources it would be appropriate to consider inviting the participation of private institutions such as the loss recovery departments of insurance companies, the private security officials of financial institutions and other NGO's.

Offshore Banking.

Over the last fifty years all of the world's major banks have opened branches in offshore financial centers. The branches serve a variety of purposes. Some are "brass plate" banks – legal fictions which are used to book deposits and loans so that they fall outside the regulatory rules of the bank's home country. Others have substance and either service the local market or operate as service centers for the international business community. Whatever the purpose, the operations have become very substantial. Indeed the parent bank cannot be effectively supervised without a comprehensive review of these operations.

In the past these offshore financial center banks have been covered by the local rules of bank secrecy. These rules have blocked home country regulators from direct supervisory activity in the offshore centers. Supervision has been accomplished through indirect audit techniques. Following the BCCI affair, the bank regulators and central bankers have proposed that all banks be open to on site visits by home country regulators. This higher level of supervision will allow regulators to insure bank compliance with due diligence and know your customer rules.

The dangers created by the gap in bank regulation of branches and subsidiaries in unregulated jurisdictions have been demonstrated time and again. The Venezuelan banking system was destroyed by the unregulated offshore operations of its banks. Japan has faced a series of banking crises which have involved the movement of bad loans, improper securities transactions and outright fraud to offshore subsidiaries and affiliates. Similarly the international community has had to deal with the consequences of allowing a bank with a home office in a jurisdiction with little regulation to operate internationally. BCCI used the division of responsibility between regulators and among auditors to make

itself a global criminal enterprise. Following BCCI the OECD countries have set high standards for authorizing foreign bank operations in their territory. The ownership of the bank must be revealed and the bank must be subject to supervision.

The “international” bank -- chartered by a financial center but not regulated, and not allowed to offer services to residents of its home country -- remains a major gap in the control system. A number of jurisdictions have been willing to “charter” banks upon presentation of the required fees. As long as they do not do banking business with the local population, their books are unexamined and their practices are uncontrolled. These “banks” can offer criminals full access to the world banking system through their relationships with major banks.

Once a shell bank has established correspondent accounts it can use those accounts to accept money and make payments without being subject to the rules of the country where the correspondent bank is located. For example, in a recent case a shell bank in Beirut was used to handle the proceeds of financial fraud originating in Germany and the United States. The victim was directed to deposit funds with the American correspondent for the credit of the shell bank for the further credit of the criminals. Under the prevailing rules of international banking, once the funds have gone to the “shell” bank’s account it is outside of the reach of the correspondent bank’s jurisdiction.

States may wish to consider an international agreement on the subject of limiting shell banks. The issues which might be addressed are:

Should shell banks be chartered?

If they are chartered who should regulate them and how should the regulation be assured?

Do they serve any legitimate purpose?

Should shell banks be given access to the international banking system?

Should the major clearing banks be required to investigate the background of shell banks before establishing a correspondent relationship?

Should the chartering government be required to identify responsible persons at the bank who can answer for the bank’s operations?

Securities firms.

As noted earlier, criminals can use securities brokerage firms to launder money as easily as they can use banks. Until recently, the entire focus of anti money laundering efforts was on banks. It should now be clear that regulators will have to treat other financial institutions in much the same way that they treat banks.

Brokers will have to be held to the same due diligence standards as bankers. They will have to be required to report suspicious transactions and they will have to be sure they know the beneficial ownership and the provenance of funds that they manage.

Law Enforcement cooperation

The world’s law enforcement agencies have made commendable progress in improving international cooperation in money laundering and financial fraud cases. Their efforts have been aided by the growth in the network of mutual legal assistance treaties and by the informal network of law enforcement officers who work together on these problems. Despite the improved cooperation, problems remain.

The growing volume of financial crime has placed impossible demands on the existing systems. National police agencies are faced with the dilemma of whether to allocate resources to national investigation or to international cooperation. At the same time,

speeding up information exchange and responding to requests for investigative help are becoming ever more urgent issues as the scope of international financial crime grows. The present system is essentially bilateral and case driven. The country and the law enforcement agency which initiates a criminal investigation is in charge. Requests for assistance come from that agency as the investigation proceeds. This case driven system is poorly equipped to deal with very large and very complicated cases. It relies on the country initiating the investigation to cover all the costs and provide all the manpower. It tends to overlook full development of aspects of the case which cannot be prosecuted in the courts of the initiating country. The effort given to the case may not be proportionate to its real importance because of the priorities of the initiating country.

A formal system of large case coordination would speed the law enforcement efforts. Investigators could be asked for information as the need arises in the investigative process. They could get permission to interview witnesses, apply for search warrants and look for evidence without clearing the bureaucratic hurdles that bedevil international investigations.

The system envisioned would not require any member country to change its investigative procedures or the rights it guarantees to its citizens. It would be designed to short circuit the process of formal intergovernmental communication and to place investigators from one country in the system of another country as the need arises.

It might also be possible for member states to develop a system under which the police and prosecutors of one country could be designated to act as police in other countries if they work under the supervision of the other country's government. Cross designation would solve the problem created by requests for information which are forwarded to foreign governments. The police assigned to those requests are not fully familiar with the case and often cannot ask the right questions. Moreover, there is a tendency for police to give foreign requests for assistance a low priority.

As cases grow in complexity member states may wish to consider the creation of an entirely new cooperative mechanism for management of the investigation and the gathering of evidence. For example, states may wish to consider establishing an international panel of judges and examining magistrates. Each country involved in a complex case would have its panel member participate in a case team which would coordinate investigation at the national level and expedite requests for information and cooperation. The panel would be in a position to insure that all evidence was gathered in a lawful manner and is admissible in the courts of other countries. They would be able to enlist the assistance of authorities in their own countries to initiate parallel investigations. They would be in a position to suggest priorities and evaluate prospective targets. They would be in a position to allocate costs and share in the recoveries.

Predicate Offences

Money laundering is a derivative crime. Its status as a crime depends on the genesis of the funds involved. As time has gone on, the international community has expanded the number of predicate offenses, and thus the definition of the crime. Much of the change in the definition has been on an ad hoc basis as particular crimes have come to public attention.

The time may have come to end the artificial division of criminal money into categories depending on the nature of the crime. As long as some criminal money can be laundered legally, the financial system will argue that its financial center arrangements to hide funds

have a legitimate purpose. Bankers and brokers who are asked to launder money will argue that they thought the money was legitimate because, although criminal in nature, it came from a non predicate crime. Saying that some money coming from some crimes is safe to help hide sends mixed messages and undermines efforts to solve the problem.
One possible approach would be to have member states agree that any funds which are derived through criminal activity are funds which can give rise to a charge of money laundering. Using this approach, if tax evasion is a crime in the country where the funds originated and the funds are being hidden because they are the result of a tax crime, hiding the funds and moving them would be money laundering.
Similarly, if the funds derive from bribes or other improper payment to government officials, it should be clear to the entire world financial community that the funds will be tainted and moving them will be the internationally recognized crime of money laundering. By placing all criminally derived funds in the category of "criminal" for money laundering purposes bankers and financial institutions will be reluctant to assist in the looting of countries.
The argument is often made that assisting legal tax avoidance is a legitimate function of the financial center. If the avoidance is in fact legal, the arrangements should not require secrecy. The legitimate inquiry of another government will lead to a satisfactory answer.

Training

Financial crime is complex and investigation of financial crime requires highly trained investigators with special skills. These skills are in short supply around the world. Traditional police training does not include courses in accounting, international finance, the international banking system, and the working of financial markets. Yet to follow the trail in a complex financial case a working knowledge of all these areas is essential. Further, police and prosecutors need specialized training in the legal problems that arise when they operate in the international environment. They need training in the procedures and legal systems of other countries, the legal machinery used to initiate cooperation, foreign rules of evidence and the differences in criminal law relating to financial transactions in different countries.
International organizations and a number of donor countries have made significant efforts to improve the training of law enforcement officials around the world. The United Nations and other intergovernmental bodies such as Interpol and the World Customs Organisation have all participated. But for these courses to be fully effective the participants need a knowledge base which is very difficult to acquire.
We suggest that in addition to the existing programs, a graduate program for mid-career law enforcement, legal, judicial, and private sector compliance officials should be established. The program should have a regular curriculum, a full time faculty and the capacity to provide training in a number of languages. It should offer a formal degree at the masters level. To accommodate the professional demands of the prospective students the school should include a six to eight-week residential segment and a six-month segment of supervised independent study. The model might be the mid-career business administration programs offered by the world's leading business schools. The programs bring the students together for an intensive two to three-week session as the year opens and then bring them back for a final month of intensive class work.
The program could be funded through tuition payments by private sector participants and by the governments which send officers for training. Donor countries could provide

scholarship funds for students from countries with limited budgets.
The program would have to be located near a major financial center so that it could draw on available local expertise and offer students direct exposure to the financial institutions they are studying. Location near a financial center would also permit the use of part-time faculty drawn from the business and banking community. A portion of the program might include internships at international financial institutions to provide participants with practical knowledge.
Such a program could also become an important source of research information, specialized publications, and new ideas for the control of financial crime.

Bankruptcy

Bankruptcy has long been the exclusive domain of national legislation. However, in recent years a number of bankruptcies involving large financial institutions and involving international financial fraud on a massive scale, have focused attention on the need for a global convention on the administration and investigation of the affairs of a bankrupt institution.
Some states have chosen to put a ring fence around the portion of the bankrupt enterprise within their jurisdiction and have barred receivers and trustees from other jurisdictions. When the cases have involved fraud and government corruption this splintered approach has added to the cost of managing the affairs of the bankrupt company and has helped criminals who played a role in the bankruptcy hide their trail. Nowhere was this more evident that in the collapse of BCCI which had been involved in laundering billions of dollars in criminal money.
Because records were scattered across the globe and because the rules regarding access to the papers were so complex many of the key figures in the investigation were able to evade prosecution. The criminal investigations became very costly and time consuming. Many important figures were never brought to the bar of justice.
Just as in a complex international criminal case a multinational bankruptcy case requires central management and administration. It requires the participation of officials from many countries and it requires the collection of records.
Because bankruptcy frequently involves issues of financial crime and money laundering, it is suggested that consideration be given to a convention governing the administration of the estate of the bankrupt. The convention should address issues of jurisdiction, polling the assets of the bankrupt for distribution and the relationship of the trustees and receivers to the criminal justice system.

Law Reform Commission

The United Nations has been engaged in drafting model laws for use by member states. This useful activity could be expanded through the creation of an international commission of jurists, legal experts, and academics who would meet regularly to consider drafts of uniform laws regarding issues of secrecy, laundering and financial crime.
The legal systems of member states have not kept pace with the evolution of international financial crime. The world legal systems are at their best when they deal with localized, understandable crime. As noted earlier in the report financial crime is elusive. It involves elements in different jurisdictions, a large number of people and institutions, and a range of complex financial instruments.
Many member states have begun to grapple with these problems. However, for any solution to be effective the international community will have to move along parallel

tracks. Most assistance and extradition treaties require the crimes which are the subject of the treaty to be defined in the same way in each jurisdiction. There are a wide variety of views about the authority of the courts and the role of the courts in a case which merely "passes through" a jurisdiction without causing identifiable damage.

Model laws which have been debated by a panel of international experts would be a helpful tool for national governments struggling with the issues. The prestige of the international panel would assist member governments in moving legislation forward.

It may be that the law reform efforts are best begun on a regional basis where the legal systems are similar and the countries are used to working together on these issues. Thus the well-developed cooperation machinery of the Caricom nations could provide a framework for the convening of an experts group to work on a model set of laws for the region.

Bank Secrecy

Today more than ninety jurisdictions offer themselves as providers bank secrecy. On the upper end of the range there are secrecy jurisdictions which have signed mutual legal assistance treaties ("MLATs") and which regularly and routinely cooperate in money launder investigations. On the other extreme are jurisdictions which assert their complete unwillingness to cooperate with any foreign investigation. Any effort to control money laundering and financial crime must address the secrecy issues head on.

The highly sensitive issues of banking secrecy and the security of financial information cannot be discussed in the abstract. The issues involve balancing the privacy interests of the individual against the commercial interests of the holder of the information, the law enforcement interests of the state or foreign country, and the public's right to know. How the balance is set will depend on what the information is about, who owns it, who wants it, and what it will be used for.

There is broad agreement on the need to protect the privacy rights of individuals. In the United States these rights have been given constitutional status by the Supreme Court. In Europe, the members of the European Union have adopted privacy standards that put a high value on the privacy rights of the individual. Many countries have appointed government ministers who have a "privacy" portfolio.

The concerns surrounding the issue of bank secrecy are very real. People with substantial private wealth are targets for criminals of all kinds. In some parts of the world kidnaping has become an industry. In a part of the former Soviet Union it has been said that criminal gangs bought banks to determine who had a big enough bank account to make kidnaping worthwhile. Equally serious issues arise when governments engage human rights violations. For much of the 20th century governments around the world spied on their citizens to maintain political control. Political freedom can turn on the ability to hide purely personal information from a government.

Privacy issues have been greatly complicated by the advent of electronic commerce and corporate global financial data networks. The networks that support ATM machine operations, service credit card networks and handle international wire transfers are examples. Credit card security operations monitor the spending patterns of individual cardholders to prevent fraud. Their computers have stored information about the spending habits of individual cardholders and are programmed to flag "out of the ordinary" transactions for further verification. Banks with global operations have centralized computer files that can be accessed from most of their offices around the world. These

electronic networks mean that information is at once nowhere, yet is everywhere. They make it possible for thousands of people around the globe to access highly sensitive data about individuals and corporations.

The right to transaction privacy is especially important. Every time an individual makes a purchase through the electronic banking system the individual leaves a trail. The trail can offer an incredible amount of very personal information. It can disclose where the person is, what he is doing, what his tastes are, and many kinds of activities which are perfectly legal but potentially embarrassing. Few people would argue that personal information of this kind should be easily available to third parties – private or governmental. When then, does the government right to know outweigh the individual's right to privacy?

The answer lies in the difference between privacy and impunity. In much of the world the most difficult issue facing the society is the fact that some members of the society, because of rank, or social position or wealth can do anything they want without being held legally accountable. For government to work, all citizens must be equally legally accountable for their actions. When the issue of legal accountability is at stake the right of privacy must give way.

For example, if a government wishes to recover money that one of its employees stole, that government has the clear right to information about what happened to the money. By engaging in the crime of theft the government employee gave up the right to keep matters relating to the crime, including financial information, secret from the government.

The bank secrecy laws in a number of financial center jurisdictions should be considered using the same balancing test. Are the laws protecting real privacy interests or are they protecting the account holders against accountability under the law? In the name of protecting "privacy" many of these jurisdictions have agreed to protect account holders from the demands of other governments for financial information in connection with criminal investigation. More often than not the real protection is against legal accountability – not against an improper invasion of privacy.

The financial center jurisdictions lack the resources and capacity to punish illegal private intrusion into global networks. Their criminal laws do little or nothing to prevent private commercial exploitation of the information or indirect exploitation by others with access such as the credit card companies and credit bureaus. There is no public machinery for tracking or policing the international banking networks against unauthorized disclosure – everything depends on the private efforts of the bank.

In fact, the privacy laws are only effective insofar as they bar another government from access to the information. Under the law of nations governments are restricted to making formal requests for information through appropriate channels. If information is disclosed to another government by a banking official who acts without authority, it will become public in the other jurisdiction when the case comes to trial. The banker who cooperated illegally will be exposed.

Looking beyond the bank secrecy jurisdictions, none of the world legal systems have kept pace with the changes in information technology. Some countries have passed laws to protect against illegal access to information, computer sabotage, and the distribution of illegally obtained data. But even these countries have a very limited law enforcement capacity. Illicit entry into systems is hard to detect and can be done from remote

locations. In several recent cases the hackers who gained access did it by working through dozens of telephone connections around the world. Very few law enforcement officials have the training and the ability to investigate these cases. Because the cases invariably cross international borders all the same problems of international law enforcement cooperation that hamper money laundering investigations hamper computer crime investigations.

The debate over bank secrecy is converging with a global debate about the issues of personal privacy and data protection. The growth of the Internet, and the growth of electronic commerce have raised many of the same questions as the issues of financial secrecy laws in financial centers. Internet browsers want to be sure that they can visit sites and access information anonymously. They would like to be able to make purchases over the Internet without leaving an electronic trail. They would like to be sure their messages are at least somewhat secure. Setting standards for privacy protection and encryption, policing the electronic networks for intrusion, and providing the possibility of private remedies will all require international agreement and international cooperation.

It may be that the time has come for a broad international convention on all the outstanding privacy issues including both electronic information exchange and banking privacy question. The convention could address banking privacy questions such as:

Which bank financial information should be protected?

In the case of banks should protection cover all information with respect to the account or merely some?

How long should the protection run? Account data which might have different levels of protection include the fact of that an account exists, the name, address, and nationality of the account holder, the date on which the account was opened and whether it is active or dormant. More strict protection might be considered for transaction information, such as information on the average account balance, the flow of funds through the account, and the source and destination of funds flowing through the account.

How should credit card information be treated? Should it be considered in the same way as bank data, or should there be exceptions for security purposes. How long should credit card transaction information be held? How should credit card data be disposed of? Should credit card information, such as the open balance, the itemized list of purchases, the timeliness of payments, be given to credit bureaus? If so, under what circumstances?

How should securities account information be protected? Is there any functional difference between a bank and a securities firm? Is the account information to be treated differently from the transactional information such as the size of the account, the details of the portfolio, and the nature of the account holdings?

Are all kinds of accounts to be accorded the same level of protection? Should corporate accounts, trust accounts, and charitable foundation accounts be treated the same way as individual accounts?

What is the objective of the protection? Is it to protect personal privacy, protect competitive information, insure personal safety (lower the risk of kidnaping), prevent the confiscation of assets for political reasons, or is it to help a client evade taxes, engage in financial fraud, or hide criminal proceeds from foreign authorities?

What uses of the bank information are permitted? Can information be given to

credit agencies? Under what conditions? Can credit information be sold in aggregated form to assist marketing? Can mailing lists be sold?

What remedies should an account holder have? Can the account holder take civil legal action against the bank for disclosure? If so where? What level of damages should be allowed? Actual or consequential?

How should private efforts to penetrate bank security be treated? Is there any difference if the attempt comes from a foreign jurisdiction through telephone lines? If the attempt is foreign will there be extradition? What proof is necessary for a conviction?

At the same time an international agreement sets real data privacy protections, it should make clear that privacy will not be accepted as a cover for evasion of legal responsibility. Thus the issue of secrecy in both civil and criminal cases should be discussed. If a civil fraud case requires data from a secrecy jurisdiction, states may wish to consider allowing some limited access by the civil litigants to information relevant to the case.

Subject to possible exceptions for cases of political persecution, an international agreement could also standardize the machinery for requesting and exchanging information, set the parameters for the use of the information by the requesting country, and set a uniform standard of "reasonable cause" on which requests for information in criminal cases can be based.

The definition of crimes vary significantly from country to country. Some countries have a crime of conspiracy while others do not. Some countries treat attempts at crime differently than others. Some countries criminalize tax evasion and others do not. As a result, member states may also wish to consider the idea of accepting the requesting country's definition of a crime when considering information requests. That way all foreign criminal acts will open the door to information.

At present most data requests to bank secrecy jurisdictions are made under bilateral mutual legal assistance agreements. A number of prominent jurisdictions have entered into agreements with the United States and the European Union. These include Switzerland and the Cayman Islands. The MLAT defines the circumstances under which the agreement can come into play, designates "Competent Authorities" in both the requesting and the receiving countries, and spells out the procedures for making the request. Most MLATs turn on an agreement as to what criminal offenses are covered, and most require that the dealings among competent authorities take place at the Foreign Office level.

This bilateral system of MLAT's contemplated investigations which involved information in a single foreign country. It grew out of the Lockheed aircraft investigations of the 1970's in which the United States developed information about bribes which Lockheed paid. A number of foreign countries, most notably Japan, asked for access to the U.S. investigative materials. This request evolved into the first MLAT.

As shown earlier in this report, most current international efforts to launder money involve several countries, many different bank accounts and many different entities. Even when there are MLAT's in place with a secrecy country, investigators must go through a time consuming process of making requests on a country by country basis, waiting to receive the data from one country before having enough information to make the request of another country.

This bilateral system is far too cumbersome and time consuming. In discussions of a broad convention on bank secrecy and money laundering cooperation member states may

wish to consider establishing a multilateral mechanism for managing information requests that would streamline and automate the process.

Why Reforms are Needed

The international narcotic trade launders a minimum of $200 billion a year. A substantial portion of that money moves through the bank secrecy, financial center jurisdictions. Law enforcement effort in the best of years recovers amounts in the range of $100-500 million. Although some participants in laundering schemes are arrested and convicted, the vast majority of professionals who assist are not. This is not a picture of success.

In addition, the number of fraud cases coming to public view is soaring. Many of these are large financial frauds in which large sums of money have disappeared and are beyond recovery. Around the world, member governments are searching for funds which have been taken from their treasuries by corrupt government officials. The list includes Peru, Ecuador, Panama, Haiti, Brazil, and Pakistan, among others. The missing money has been laundered using the machinery described in this report.

The international community has resolved to limit corrupt practices. New conventions on the subject have been put in place in the Americas and Europe. The European Union is working on machinery to control fraud directed at the Union as a whole. The Bank for International Settlements is working on enhancing its regulatory guidelines to prevent the use of financial centers to avoid regulation. The government of Venezuela is actively trying to recover money stolen from its banking system – an amount so large that it has ruined the economy and caused hardship for the majority of its citizens. Governments around the world from India to the United States, from Russia to Argentina are finding that they are losing much of the tax revenue due under their laws because of the calculated use of foreign secrecy. The situation is so bad that the opportunity to commit the crime of tax evasion is advertised openly on the Internet by hundreds of firms.

The time has come to connect the dots. The common denominator in all of these problems is the enabling machinery which has been created in the financial havens. The effectiveness of these centers in helping people and companies hide assets is not the result of any single device. Changing bank secrecy rules alone will not help. Rather the centers have created a tool kit composed of new corporate instruments, foundations, trusts, trust companies, banks and bank accounts. The tools are mixed and matched with jurisdictions that have made a point of non-cooperation with the rest of the international community in criminal and tax investigations.

What started as a business to service the needs of a privileged few has become an enormous hole in the international legal and fiscal system. We estimate that there are now more than one million anonymous corporations. Consultants for the offshore banking centers say that the centers are home to more than $5 trillion in assets – one trillion in bank deposits and four trillion held in the form of stock, bonds, real estate and commodities.

If the international community is to develop a rule of law to match the globalization of trade and the global movement of people the issues raised by this hole in the system will have to be addressed. The approach will have to be systemic rather than by individual cases and it will have to face the issues of the use of sovereignty by some countries to give the citizens of other countries a way around the laws of their own society.

Jack Blum, testimony in Hearing of the House International Relations Committee on International Organized Crime and Global Terrorism (Oct. 1, 1997).

Crime and Secrecy: The Use of Offshore Banks and Companies, Committee on Governmental Affairs Report to the United States Senate. Report 99–130 (Aug. 1985), p.4.

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This definition parallels, though is slightly different from, that suggested by the Financial Action Task Force which divided money laundering into placement (the fusion of cash into the legal economy or smuggling it out of the country); layering (separation from source by creating complex covering structures) and integration (placing laundered funds back into the economy). It also differs from the terminology used by the United Nations Convention Against Illicit Traffic in Narcotics and Psychotropic Substances where the terms preferred are conversion (of cash to another asset, possibly involving placement in a financial institution), concealment of the true source or ownership, and creation of a perception of legitimacy.

For an excellent and well-informed critique see William Cassidy, "Fei-Ch'ien Flying Money: A Study of the Chinese Underground Banking System", Address to the 12th Annual International Asian Organized Crime Conference (June 26, 1990).

The laundering techniques summarized in what follows are drawn from Naylor, Big Wash, Chs. 2–5.

The first money laundering case using transfer price manipulation was brought down by the U.S. late in 1996, See Money Laundering Alert (Jan. 1997).

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There is a sense in which one could describe the triumph of the toughest as a principle, but that is not what one normally means by the term. Theoretically, agreement to the methodology should lead to agreement to the results thereof, but this would require too much consistency from governments and courts around the world to be plausible.
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