

## Key Data Report

# Financial Secrecy, Banks and the Big 4 Firms of Accountants

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### Executive Summary

The evidence in this paper suggests that banks and the Big 4 firms of accountants appear to move activity to locations with a high level of financial secrecy offered by law and regulations because their opportunities to make profit appear to increase in conditions of secrecy. Such patterns of behaviour inevitably mean that they must on occasion, wittingly or otherwise, facilitate the handling of illicit financial flows, as evidence noted suggests to be the case. The reported conduct of these banks and accountants also suggests that on occasion they fail to meet the required standards of behaviour expected by law or codes of ethics.

In addition, the evidence noted suggests that a high number of banks and Big 4 firms per capita in a jurisdiction results in them having a disproportionate political influence, tending to lead to an increase in the financial secrecy offered by such places through law and regulations.

The first part of this paper collects and presents qualitative evidence that supports these two hypotheses.

Part two of this paper presents quantitative evidence that there is a systematic and positive correlation between the number of banks and the Big 4 firms in a jurisdiction on the one hand and the secrecy score of a jurisdiction as measured by the Financial Secrecy Index (FSI) on the other.

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**The results of this report support the conclusion that working in conditions of secrecy has become an inherent part of the work of bankers and accountants. Whether wittingly or unwittingly their presence in secrecy jurisdiction helps them or their clients avoid the impact of laws and regulations in those places where they undertake most of their trade. We suggest that this has led to a culture of creative non-compliance with laws and regulations that are likely to increase the volume of illicit financial flows and crime. At the same time, investment by banks and the Big 4 firms in lobbying for laws and regulations that reduce transparency is likely to have resulted in further opacity in the world's financial system.**

**The statistical correlation identified in part two of this research supports both hypotheses.**

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## What is measured?

This report quantifies the number of institutions allowed to undertake banking and financial intermediation in each secrecy jurisdiction surveyed<sup>2</sup>. It also identifies the number of offices in secrecy jurisdictions run by the Big 4 accountancy firms (in order of size: PricewaterhouseCoopers (PWC), Deloitte, Ernst & Young (E&Y) and KPMG) (hereinafter: the "Big 4") who combined dominate the world's auditing, tax and accounting markets. Together these banks, financial intermediaries and accountants can be termed "secrecy providers"<sup>3</sup>.

Ideally, this report also would have included data on the number of boutique law firms as well as accountants who provide accounting services, as many boutique law firms can and do play a pivotal role in providing financial services. However, there were several difficulties in obtaining the necessary data: firstly, while data on the number of credit institutions and banks in a secrecy jurisdiction is usually available, that on the number of lawyers and accountants is often more difficult to secure even though lawyers and accountants, like banks, are subject to scrutiny within international anti-money laundering frameworks.

Secondly, defining the terms "lawyer" and "accountant" proved to be problematic as it varies from one source to the other and there were many discrepancies among countries in the way of counting lawyers and accountants (e.g. in cases of countries without a single profession of "accountant"). Thirdly, at least in relation to lawyers, many of them do not provide legal services in areas related to finance (e.g. capital market, taxation, corporations, trusts) but rather in other law fields (e.g. family law, human rights), and as such they should not, of course, be included for the purpose of this paper as secrecy providers. As we could not find any source in which such a distinction is made, for the purpose of this paper we decided: firstly, not to include data on lawyers, and secondly, to focus on the number of Big 4 offices as a proxy for accountants. A main consideration for the latter was the fact that the Big 4 dominate the global

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<sup>2</sup> For a list of all jurisdictions surveyed, see <http://www.secrecyjurisdictions.com/jurisdictions/jr>; 21.8.12.

<sup>3</sup> For a definition of 'secrecy providers', see <http://www.secrecyjurisdictions.com/researchanalysis/onlineglossary?id=171>; 12.6.12.

accountancy industry and possess unique knowledge in providing accounting and tax services to multinational corporations<sup>4</sup>.

Regarding the data sources, we established the number of banks or credit/financial institutions (used interchangeably in this paper) from various sources, mainly: BIS statistics<sup>5</sup>; Peer Review reports prepared by OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes (GF)<sup>6</sup>; U.S. Department of state's International Narcotics Control Strategy Reports (INCSR)<sup>7</sup> and, whenever in doubt about inter-country comparability, the central banks' websites of the jurisdiction in question.

The definition used means as a consequence that the number of banks may not always be fully consistent across countries because there is no single globally agreed definition of what constitutes a 'bank'. Four key characteristics have been used to include categories of financial institutions as banks for the purpose of this research:

- banks are always regulated and supervised;
- banks are entitled to take deposits and to grant loans in the jurisdiction of concern;
- banks have access to central bank deposit insurance schemes; and
- banks are capable of making payments and offering current accounts to the public.

The data for the presence of the Big 4 and the location of their offices was taken from the Big 4's own websites.

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<sup>4</sup> The specific source for each particular number of the Big 4 and banks used in this paper can be found in the secrecy jurisdictions database .See

[http://www.secrecyjurisdictions.com/sj\\_database/menu.xml](http://www.secrecyjurisdictions.com/sj_database/menu.xml) (numbers 92-95); 12.6.12.

<sup>5</sup> This stands for "Bank for International Settlements". This bank provides, among others, locational banking statistics which gathers quarterly data on international financial claims and liabilities of bank offices (in the reporting countries). The statistics provide information for a considerable part of the secrecy jurisdictions. For more information please visit:

<http://www.bis.org/statistics/bankstats.htm>; 12.6.12.

<sup>6</sup> The reports can be found in the Exchange of Tax Information Portal website, an initiative of the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes. The Global Forum conducts peer reviews of its member jurisdictions' ability to co-operate with other tax administrations in accordance with the "internationally agreed standard".

For more information, please see: <http://www.eoi-tax.org/>; 5.10.12 and for a critical

appraisal of the "internationally agreed standard", please see

<http://taxjustice.blogspot.de/2012/03/new-study-reveals-serious-flaws-in.html>; 7.8.2012.

<sup>7</sup> See <http://www.state.gov/j/inl/rls/nrcrpt/index.htm>; 19.7.12.

## Why is it important?

Having a disproportionate number of players operating in the international financial sector of a secrecy jurisdiction contributes to and is an outcome of financial opacity, which imposes significant costs on society. Significant observational evidence over many years suggests that financial opacity creates a potentially criminogenic environment, in which financial regulations and transparency are undermined with the intention of attracting foreign funds. Such a potentially criminogenic environment not only increases (financial) market failure risks and therefore the cost of capital for all stakeholders, but also increases the risk of misallocation of resources<sup>8</sup>.

The range of crimes that can thrive in a secrecy environment include financial fraud, tax evasion, infringement of competition rules, bankruptcy fraud, hiding of the proceeds of corruption, organised crime (especially drug trafficking), illegal arms trading, trafficking in human beings, money laundering and more besides.

Part two of this paper presents evidence that there is a systematic and positive correlation between the number of banks and the Big 4 in a jurisdiction on the one hand and the secrecy score of a jurisdiction as measured by the Financial Secrecy Index (FSI)<sup>9</sup> on the other. While the statistical intensity of the correlation will be quantified in an academic paper at a later stage, the first part of this paper collects and presents qualitative evidence supporting the following two hypotheses which helps explain the correlation.

### 1. Hypothesis:

**Banks and Big 4 are likely to shift activity to locations with a high level of financial secrecy offered by law and regulations because their profitable business opportunities increase in conditions of secrecy.**

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<sup>8</sup> See page 2 in: <http://www.taxresearch.org.uk/Documents/Where4Art.pdf>; 12.6.12.

<sup>9</sup> The 15 indicators used for computing the secrecy score can be found here: <http://www.secrecyjurisdictions.com/researchanalysis/kfsi>; 5.10.12; the full methodology, including how the secrecy score is computed, is available here: [www.secrecyjurisdictions.com/PDF/SJ-Methodology.pdf](http://www.secrecyjurisdictions.com/PDF/SJ-Methodology.pdf); 5.10.12.

In conditions of secrecy the financial services industry can take advantage of low disclosure requirements for their clients' financial affairs and of their own activities. This increases the risk that such firms might, wittingly or unwittingly handle illicit financial flows.

For the purposes of this paper we define an illicit financial flow as money that is illegally earned, transferred or utilised. Breaking laws at any point during their transmission earns such funds this label. These cross-border transfers come in three forms: (1) the proceeds of bribery and theft by government officials; (2) criminal activities including drug trading, human trafficking, illegal arms, contraband and more; and (3) commercial trade mis-pricing and tax evasion. The latter is by far the largest, and is believed to comprise two thirds of the total<sup>10</sup>.

A culture of creative non-compliance<sup>11</sup> may develop as a consequence that may result in the maintenance of the appearance of compliance with regulation but which does so in a fashion that does not disclose the existence of illicit financial flows. Implementation of rules in this environment may be little more than "box-ticking" activity instead of genuine compliance.

Even if banks and Big 4 refrained from aiding or engaging in any activity at the very edge of legality, an environment of secrecy can incentivise business activity that clearly violates ethical codes that banks have committed to follow.

## 2. Hypothesis:

**A significant number of banks and Big 4 firms per capita in a jurisdiction results in them having a disproportionate political influence, resulting in an increase in the financial secrecy offered by law and regulation in such places.**

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<sup>10</sup> R. W. Baker, *Capitalism's Achilles Heel - Dirty Money and How to Renew the Free-Market System* (2005).

<sup>11</sup> A .K. Shah, "Creative Compliance in Financial Reporting", *Accounting, Organization and Society*, Vol. 21, No. 1, pp. 23-39, 1996; Shah's study found a close cooperation between accountants and bankers in the development of the creative compliance schemes. According to the study, the willingness of companies to pay considerable fees for these schemes is the driving force behind their market (p. 36).

Banks and Big 4 firms active in financial services are likely to have disproportionate economic and political power in any secrecy jurisdiction that is heavily dependent upon that sector for a significant part of its national income and foreign currency earnings. As a result, the laws and regulations of such places are likely to be increasingly shaped by the special interests of such firms (a situation known as 'state capture') that favour financial secrecy.

The first part of this research investigates the two hypotheses through case study analysis and process tracing. Then, statistical analysis is presented to provide further evidence to both of the hypotheses.

## Part 1: Qualitative evidence

### Examples of banks and Big 4 facilitating illicit financial flows

#### A. Banks

Various major banks have been involved in providing secretive accounts for different politically exposed persons (PEP), allowing these PEPs to enrich themselves at cost to their people and to hide their ill-gotten gain.

For example, in June 2012, a criminal complaint was filed in Switzerland against the Swiss bank **UBS**, by the Bruno Manser Fund (a Basel-based rainforest advocacy group) in relation to the bank's ties with a Malaysian PEP, named Musa Aman, who is the chief minister of Sabah, one of 13 states in Malaysia. Aman is accused of having laundered over \$90 million in corruption proceeds through a number of bank accounts with UBS in Hong Kong and Zurich. The Swiss Federal Justice Office has already confirmed that Switzerland had given legal assistance to Hong Kong authorities regarding the ties of Musa Aman with UBS<sup>12</sup>. Additional examples regarding the questionable business of banks with PEPs is provided in Appendix 5.

When banks operate accounts for alleged corrupt politicians or state officials, known as kleptocrats, they play an important role in facilitating illicit financial flows. Furthermore, the fact that major banks, directly or indirectly, assist PEPs to abuse their states' assets to enrich themselves

<sup>12</sup> See

[http://www.swissinfo.ch/eng/politics/foreign\\_affairs/UBS\\_faces\\_criminal\\_complaint\\_over\\_Malaysia\\_ties.html?cid=32886286](http://www.swissinfo.ch/eng/politics/foreign_affairs/UBS_faces_criminal_complaint_over_Malaysia_ties.html?cid=32886286); 5.10.12.

and to hide ill-gotten money, contradicts their public statements as members of the Wolfsberg Group<sup>13</sup>. This group portrays itself and its members as being at the forefront of fighting against the misuse of the financial system for handling money from corruption and crime, and has published principles on anti-money laundering (AML) for private banking.

However, the banks' role in facilitating illicit financial flows is not limited to PEPs' accounts. For example, banks have also facilitated various cases of tax evasion among wealthy people, as will be illustrated below.

In July 2012, German prosecution authorities targeted **UBS Switzerland** when it was announced that new CDs with bank account data of German tax evading clients at UBS have been purchased. According to some media reports, the material also incriminates the bank itself<sup>14</sup>. This case is the latest in a long series of purchases of data CDs with tax evader's bank client information by German authorities involving accounts at a number of Swiss, British, Luxembourg and Liechtenstein banks since 2006. A similar case, caused by an accidental transmittal of sensitive data by Swiss Crédit Suisse bank to German tax authorities, revealed in July 2012 how Crédit Suisse combined its subsidiaries in Bermuda and Switzerland to provide a multi-jurisdictional insurance wrapper to German tax evaders<sup>15</sup>.

Another example involves the **LGT Bank**, a leading Liechtenstein financial institution, owned by the Liechtenstein royal family. According to a report of the U.S. Subcommittee on Investigations, financial practices, used by LGT from 1998 to 2007, have led to tax evasion by U.S. clients. Some of these practices included the use of offshore jurisdictions to hide the clients' ownership of assets as well as the structure of clients' accounts in a way which enabled them to avoid disclosure requirements to the IRS under the QI programme. The report further determines:

***“LGT practices contributed to a culture of secrecy and deception that enabled LGT clients to use the bank's services to evade U.S. taxes, dodge creditors, and ignore court orders [...] These LGT accounts together portray a bank whose personnel too often viewed LGT's role as, not just a guardian of client assets or trusted financial advisor, but also a willing partner to clients wishing***

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<sup>13</sup> For more information please see <http://www.wolfsberg-principles.com/>; 21.7.12.

<sup>14</sup> See <http://www.ftd.de/finanzen/alternativen/:kauf-von-steuer-c-ds-wie-steuersuender-dateien-die-staatskasse-fuellen/70074689.html>; 4.9.2012.

<sup>15</sup> See <http://www.spiegel.de/wirtschaft/soziales/steuerskandal-was-den-kunden-der-credit-suisse-droht-a-844084.html>; 4.9.2012.

*to hide their assets from tax authorities, creditors, and courts. In that context, **bank secrecy laws have served as a cloak not only for client misconduct, but also for bank personnel colluding with clients to evade taxes, dodge creditors, and defy court orders.*** (U.S. Senate Report 2008: 5-6, 8, **TJN emphasis added**).

Another report of the U.S. Subcommittee on Investigations, published in September 2008, discloses various examples of major banks that make a massive use of offshore jurisdictions in order to enable their clients to dodge U.S. tax on stock dividends. According to the report, for over ten years, several financial institutions, including Lehman Brothers, Morgan Stanley, UBS and Merrill Lynch, have been structuring, marketing and implementing abusive transactions, a substantial part of which involved the use of secrecy jurisdictions in the Cayman Islands, Hong Kong and others<sup>16</sup>.

The report determines that the offshore dividend tax abuses by these banks have led to the loss of billions of dollars of tax revenues for the U.S. Treasury; for instance, that between 2000-2007 Morgan Stanley's dividend tax transactions enabled its clients to escape of more than \$300 million payment of U.S. taxes. Similarly, in 2004 alone, Lehman Brothers enabled its clients to escape approximately \$115 million of U.S. dividend tax payments.<sup>17</sup> Additional examples of banks facilitating tax evasion are provided in Appendix 6.

As an inherent part of handling illicit financial flows, banks often engage in regulatory non-compliance, among others, by opening bank accounts without properly applying "know-your-customer" rules (which they are obliged to do according to AML provisions), by facilitating hidden transactions or by turning a blind eye to suspicious transactions. This argument is illustrated below by the recent accusations made by U.S. and U.K. authorities against various major banks.

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<sup>16</sup> U.S. Permanent Subcommittee on Investigations, "Dividend tax abuse: How offshore entities dodge taxes on U.S. stock dividends" (September 2008), pp.2-12; In April 2011, 'The Telegraph' reported that UK banks hold 181 subsidiaries in the Cayman Islands. See <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9205647/Barclays-has-more-Cayman-Islands-links-than-RBS-and-Lloyds.html>; 30.8.12.

<sup>17</sup> U.S. Permanent Subcommittee on Investigations, "Dividend tax abuse: How offshore entities dodge taxes on U.S. stock dividends" (September 2008), pp.2-12.

On 12 July 2012, the U.S. Senate Subcommittee on investigations invited **HSBC** to a hearing regarding severe shortcomings in its AML operations, which may eventually result in a fine worth 1 billion US\$<sup>18</sup>. Following a long investigation, the Subcommittee's report focuses on five areas of abuse including: servicing high risk affiliates while treating them as low risk affiliates; circumventing U.S. safeguards designed to block transactions involving corrupt regimes and terrorists; providing services to some banks in Saudi Arabia despite links to terrorists financing; and offering accounts to more than 2,000 bearer share corporations, despite the high risk of money laundering and illicit conduct<sup>19</sup>. Furthermore, according to the report, HSBC Mexico division set up 60,000 accounts in the Cayman Islands. A substantial number of these 60,000 accounts facilitated the criminal activities of drug lords. That the owners of 41% of these accounts were unknown to HSBC placed substantial difficulties on governments' efforts to track these drug lords<sup>20</sup>.

The recent 'LIBOR scandal' provides another example for the result of a culture of non-compliance that banks have developed; on 27 June 2012, soon after the scandal was exposed, Barclays was fined approximately \$450 million by British and U.S. regulators for providing LIBOR submissions that according to the U.S. department of justice "at various times, were false because they improperly took into account the trading positions of its derivative traders, or reputational concerns about negative media attention relating to its LIBOR submissions"<sup>21</sup>. The agreement between Barclays and the U.S. department of justice discloses that over a period of four years (2005-2009) the bank has manipulated its submissions in order to "*benefit its trading positions and the media's perception of the bank's financial health*"<sup>22</sup>.

The LIBOR scandal has led so far to the resignation of Marcus Agius, chairman of Barclays, on 2 July 2012<sup>23</sup> and Bob Diamond, the chief executive officer of Barclays, a day after<sup>24</sup>. However, Barclays' settlement

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<sup>18</sup> See <http://www.reuters.com/article/2012/07/17/hsbc-compliance-senate-idUSL2E8IH1EU20120717>; 2.9.12.

<sup>19</sup> See <http://taxjustice.blogspot.de/2012/07/hsbc-pervasively-polluted-culture.html>; 5.10.12.

<sup>20</sup> See <http://www.guardian.co.uk/commentisfree/2012/jul/22/editorial-hsbc-tax-havens-avoidance>; 2.9.12.

<sup>21</sup> See <http://www.justice.gov/opa/pr/2012/June/12-crm-815.html>; 7.8.12.

<sup>22</sup> See <http://www.justice.gov/opa/pr/2012/June/12-crm-815.html>; 7.8.12.

<sup>23</sup> See <http://profit.ndtv.com/News/Article/barclays-chairman-to-resign-over-interest-rate-rigging-scandal-307175>; 19.7.12.

<sup>24</sup> See <http://www.bbc.co.uk/news/business-18685040>; 19.7.12.

was just the first one in a huge probe that spans more than 20 banks<sup>25</sup>. Six additional major banks (Deutsche Bank, Citigroup, JPMorgan Chase, Royal Bank of Scotland, HSBC and UBS) have already received subpoenas from the US state prosecutor, over their role in the alleged LIBOR scandal<sup>26</sup> and employees of the Bank of Tokyo Mitsubishi were also questioned recently in this regard<sup>27</sup>. Additional examples of a culture of non-compliance among banks are provided in Appendix 7.

It should be stressed, though, that not all banks are necessarily engaged in regulatory non-compliance or involved in misconduct in the jurisdictions in which they operate. However, it can be inferred from the examples above, that many, and maybe most, major banks have had opportunities to be involved in such activity even if they chose not to take them. Such opportunities are facilitated by the secrecy offered by jurisdictions that can enable banks to engage in various forms of creative non-compliance if they wish with what was considered to be little chance of discovery.

## B. The Big 4

The Big 4 operate from hundreds of cities in the world, including more than 80 offices in offshore tax havens which do not impose taxes or require companies to submit audited financial reports<sup>28</sup>. Through this almost global presence, the Big 4 are in a unique position to hide or disguise financial flows by devising complex multi-jurisdiction business structures and aggressive tax avoidance schemes. They possess the knowledge and capacity to embed and thereby disguise secrecy products in a wider business context, thus masking cases of regulatory non-compliance and financial impropriety, even if unwittingly.

The arguments above can be exemplified by the involvement of **PWC** in structuring leveraged partnership transactions for the US based Canal Corporation<sup>29</sup> and subsidiaries is another example. PWC assisted the

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<sup>25</sup> See <http://www.ft.com/intl/cms/s/0/2a4479f8-c030-11e1-9867-00144feabdc0.html#axzz24AExMy2S>; 21.8.12.

<sup>26</sup> See <http://www.ft.com/intl/cms/s/0/33e7e4d6-e713-11e1-8a74-00144feab49a.html#axzz24AExMy2S>; 21.8.12.

<sup>27</sup> See <http://www.ft.com/intl/cms/s/0/93e5a1b0-e200-11e1-b3ff-00144feab49a.html#axzz24AExMy2S>; 21.8.12.

<sup>28</sup> See <http://www.dailymail.co.uk/money/article-1351703/Big-auditors-embedded-tax-haven-world.html>; 19.7.12.

<sup>29</sup> The company, formally known as "Chesapeake Corporation", is now in bankruptcy (see <http://www.canalcorporation.com/>; 4.10.12). The company was originally incorporated and headquartered in Virginia in 1918 as a corrugated paper company. Its business has expanded over time into several paper industry segments, including merchandising,

company to structure its transactions in a way that was supposed to save Canal millions of dollars in tax payments. However, the tax authorities construed the transactions differently and imposed approximately \$36 million penalty on the company for substantial understatement of income tax. Although PWC was closely involved with the scheme, for a fixed fee of \$800,000 it gave an opinion saying that the transactions would not constitute a disguised sale<sup>30</sup>. The tax authorities' decision was upheld in 2010 by the Tax Court in the U.S. which criticised PWC for its part in the case:

*"[...] PWC crossed over the line from trusted adviser for prior accounting purposes to advocate for a position with no authority [...]. Any advice [...] received was tainted by an inherent conflict of interest. [...] Considering all the facts and circumstances, PWC's opinion looks more like a quid pro quo arrangement than a true tax advisory opinion".*<sup>31</sup>

Another example refers to the role of **E&Y** in devising tax avoidance schemes for Wal-Mart which enabled the global retailer to reduce its tax obligations by approximately \$230 million in 4 years. The scheme was rejected in 2005 and 2007 by several courts in the U.S.<sup>32</sup>. In one of the letters sent by E&Y to Wal-Mart, as disclosed in court, E&Y illustrates its role as a secrecy provider, by stating:

*"[...] we think the best course of action is to keep the project relatively quiet [...] if a broader group of people are knowledgeable about these strategies, there just seem to be too many opportunities for it to get out to the press or financial community[...]"*<sup>33</sup>

KPMG, meanwhile, was not sitting idle. In 2002 the U.S. Senate Permanent Subcommittee conducted an investigation into the development of abusive tax shelters by professional organisations (e.g.

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specialty packaging and land development. For more information please see [http://96.127.170.46/index.php?m\\_menu=10&post=13348](http://96.127.170.46/index.php?m_menu=10&post=13348); 5.10.12.

<sup>30</sup> A. Mitchell & P.Sikka, "The Pin- Stripe Mafia: How Accountancy Firms Destroy Societies" (2011), (hereinafter: "The Pin- Stripe Mafia"), pp. 39-40, in:

<http://visar.csustan.edu/aaba/ThePinStripeMafia.html>; 5.10.12.

<sup>31</sup> Canal Corporations and Subsidiaries v. Commissioner of Internal Revenue, 135 T.C.9. Docket No.14090-06 (2010).

<sup>32</sup> *Wall Street Journal*, "Inside Wal-Mart's Bid To Slash Taxes" (23 October 2007). See <http://online.wsj.com/article/SB119309882278867779.html> ; 10.10.12.

<sup>33</sup> See [http://online.wsj.com/public/resources/documents/wsj071023-walmart-tax\\_project.pdf](http://online.wsj.com/public/resources/documents/wsj071023-walmart-tax_project.pdf); 5.10.12; and also pp. 31-32 in The Pin- Stripe Mafia.

accounting firms, banks and law firms). The investigation resulted in several alarming findings on the role of **KPMG** as a secrecy provider, some of which are detailed below<sup>34</sup>:

Firstly, KPMG has invested substantial resources in developing and implementing potentially abusive and illegal tax shelters that U.S. taxpayers might otherwise have been unable to employ.

Secondly, KPMG has provided substantial fees to several major banks as well as investment advisory firms in return to the provision of investment services in potentially abusive or illegal tax shelters sold by KPMG.

Thirdly, KPMG has taken a number of measures to conceal its tax shelter activities from tax authorities and the public, including by refusing to register potentially abusive tax shelter with the IRS, restricting file documentation, and using improper tax return reporting techniques.

As a consequence of these acts, the U.S. government lost billions of dollars in tax revenues and sued KPMG. KPMG admitted in court it committed fraud in designing the tax shelters and in trying to conceal the shelters from the Internal Revenue Service. In 2005, KPMG agreed to pay \$456 million as part of a deferred prosecution agreement (DPA), in order to avoid criminal prosecution by the U.S. government<sup>35</sup>.

Senator Carl Levin (the current chairman of the U.S. Senate SubCommittee) summarised the phenomenon where secrecy providers create complexity to ultimately increase secrecy as MEGO "My Eyes Glaze Over"<sup>36</sup>:

*"Abusive tax shelters are usually tough to prosecute. Crimes such as terrorism, murder, and fraud produce instant recognition of the immorality involved. Abusive tax shelters, by contrast, are often 'MEGOs,' meaning 'My Eyes Glaze Over.' Those who cook up these connections count on their complexity to escape scrutiny and public ire."*

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<sup>34</sup> See p.3 in the U.S. Senate report on "Tax Shelter Industry: The Role of Accountants, Lawyers and Financial professionals", in:

<http://www.quatloos.com/TAXSHELTERREPORTFINAL.pdf>; 19.7.12.

<sup>35</sup>See

<http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aplebPwsO81k&refer=us;>  
5.10.12.

<sup>36</sup> See <http://levin.senate.gov/newsroom/release.cfm?id=308946>; 20.8.12.

This last example refers to **Deloitte**, which in 2004 was involved in designing a scheme for the London office of Deutsche Bank in order to enable it to avoid paying payroll tax and national insurance contribution (worth around £92 million) on employees' bonuses. The scheme, operated through a Cayman Islands registered investment vehicle, was ruled out by the Tax Tribunal in January 2011. Judge Williams, who presided over the tribunal, found that "the Scheme as a whole, and each aspect of it, was created and coordinated purely for tax avoidance purposes"<sup>37</sup>.

Common to the above examples is that the Big 4 worked to provide deals for their clients that were subsequently considered to be abusive tax avoidance schemes. The complexity used coupled with significant secrecy seemingly permitted a culture of non-compliance to exist in these cases which ultimately served to seek to undermine the rule of law.

Tax failures are not the only issue of note where the Big 4 are involved: auditing accounts is another of their activities. In this area there is evidence that they have given their seal of approval to questionable annual accounts by auditing them with little scrutiny, which eventually makes audit failures more likely.

An example of such a failure was highlighted by the lawsuit settled in September 2009 by the Hong Kong office of E&Y over its role in the collapse of Akai Holdings Ltd, a Hong Kong Company. Akai collapsed in 1999, only a few months after its audited statements showed that it had more than \$2billions in assets. The trigger for the legal action against E&Y was accusations of falsifying more than 80 documents as well as claims of negligence in its auditing of Akai<sup>38</sup>. As part of the settlement, E&Y agreed to make a "substantial payment" to the company's liquidator. In addition, following an internal investigation, E&Y suspended Akai's audit manager who was a partner in the E&Y Hong Kong office<sup>39</sup>.

The contribution of poor audits to the 2008 financial crisis can be further demonstrated by several examples: Lehman Brothers went bankrupt on 14 September 2008, only two months after its quarterly accounts received

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<sup>37</sup> Deutsche Bank Group Services (UK) Ltd v Revenue & Customs [2011] UKFTT 66 (TC) (19 January 2011), p. 29; See also <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/8423769/Deutsche-Bank-fights-tax-ruling-on-92m-bonus-pool.html>; 10.10.12; and pp. 43-44 in The Pin-Stripe Mafia.

<sup>38</sup> See <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a52w0Uba.WvA>; 5.10.12.

<sup>39</sup> See <http://www.ft.com/intl/cms/s/2/634b539a-a82b-11de-8305-00144feabdc0.html#axzz25qvTttNV>; 5.9.12.

a clean bill of health. Similarly, in March 2008, Bear Stearns, America's fifth largest investment bank, was sold to JP Morgan Chase due to severe financial problems, 2 months after it had received an unqualified audit opinion which didn't indicate on the problems. Finally, Carlyle Capital Corporation was placed into liquidation in February 2008, only a month after it received an unqualified audit<sup>40</sup>.

Following the failure of bank audits to provide warnings of the banks' imminent collapse, an inquiry was undertaken by the UK House of Lords economic affairs committee, regarding the quality and regulation of bank audits. The report, published in March 2011, accused auditors, among others, of a "dereliction of duty", "complacency" and of creating a "box ticking approach"<sup>41</sup>. The committee further determined:

*"We do not accept the defence that bank auditors did all that was required of them. In the light of what we now know, that defence appears disconcertingly complacent. It may be that the Big Four carried out their duties properly in the strictly legal sense, but we have to conclude that, in the wider sense, they did not do so"<sup>42</sup>.*

Another example refers to the collapse of MG Rover, the car giant, only six months after its annual report was finalised in October 2004. Following this audit failure, accountancy watchdogs were nominated to investigate Deloitte's work<sup>43</sup>. The main concern related to the relationship of Deloitte with the "Phoenix Four", who led the purchase of MG Rover from BMW in 2000. According to the disciplinary arm of the UK's Financial Reporting Council, Deloitte failed to adequately consider the public interest and to mitigate risks of conflicts of interests resulting from its advising MG Rover in a corporate finance capacity. As a result of the investigations, Deloitte

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<sup>40</sup> Prof. P. Sikka, 'Financial crisis and the Silence of the auditors' (January 2009), The university of Essex. pp.5-6, in: [http://www.essex.ac.uk/ebs/research/working\\_papers/WP\\_09-04.pdf](http://www.essex.ac.uk/ebs/research/working_papers/WP_09-04.pdf); 30.8.12; and see also <http://www.guardian.co.uk/commentisfree/2008/mar/14/watchingthedetectives>; 30.8.12.

<sup>41</sup> See pp.9, 45-46 in:

<http://www.publications.parliament.uk/pa/ld201011/ldselect/ldeconaf/119/119.pdf>; 30.8.12.

<sup>42</sup> See p. 51 in:

<http://www.publications.parliament.uk/pa/ld201011/ldselect/ldeconaf/119/119.pdf>; 6.9.12.

<sup>43</sup> See <http://www.accountancyage.com/aa/news/1773787/deloitte-awaits-probe-verdict-mg-rover> ; 10.10.12.

will have to face a pre-hearing meeting, in January 2013<sup>44</sup>.

Taken in combination, this evidence suggests that many banks and Big 4 have been repeatedly engaged in activities that fall below acceptable standards, for which penalties have been paid on occasions. A contributory, but not exclusive factor in many such cases, was their ability to operate free of constraints imposed by law, regulation and codes of conducts under conditions of what they thought to be secrecy. They are expected to systematically prefer locations where legal and regulatory frameworks are weaker and require less transparency<sup>45</sup>.

### **Examples of banks and Big 4 engaging in policy - making and lobbying**

Given the key role played by banks and accountants in the financial sector, both are expected to have at their disposal the resources to invest considerable efforts to promote laws and regulations that serve their interests, among others, by increasing the level of secrecy. The following examples provide evidence for this hypothesis.

#### **A. Banks**

In July 2012, the Bureau of Investigative Journalism exposed that the British Bankers Association (BBA) has proudly published on its members' newsletter, a list of significant policy wins in several issues, including CFC reform, VAT cost sharing exemption, and non-domiciled individual's taxation reform. Furthermore, according to the Bureau, in 2011 and 2012 the BBA had many meetings with government officials, where it could have influenced policy makers without disclosing to the public any details of the relevant discussions (as under government guidelines BBA is not required to disclose such encounters)<sup>46</sup>.

Switzerland's bilateral agreements with the UK and Germany (known also as the "Rubik" deals), signed in 2011, further illustrate the political

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<sup>44</sup> See <http://www.accountancyage.com/aa/news/2195031/deloitte-to-face-tribunal-over-mg-rover-role> ; 10.10.12.

<sup>45</sup> Research undertaken by Richard Murphy in 2009 for Trades Union Congress revealed that the UK banks: Lloyds TSB, RBS, HSBC and Barclays hold 1,207 subsidiary companies incorporated in tax havens. Of these, the most popular location is the Cayman Islands with 262 companies and Jersey is second, with 170 companies. For more information see <http://www.tuc.org.uk/economy/tuc-15906-f0.cfm>; 2.9.12.

<sup>46</sup> See <http://www.thebureauinvestigates.com/2012/07/09/bbas-secret-meetings-with-ministers/>; 21.7.12.

influence of the banking industry in promoting regulations that advance its own interests and preserve financial secrecy. Under these deals, Switzerland is supposed to apply withholding taxes on financial accounts and income held by UK and German taxpayers while keeping their identities secret and clearing all criminal tax liabilities<sup>47</sup>.

These deals were effectively designed by the Swiss Bankers' Association in order to sabotage European efforts to increase transparency to combat tax evasion<sup>48</sup>. Not only do these deals enable criminals to receive lifetime immunity, but they contain serious loopholes which are likely to fail the tax authorities in collecting the promised tax revenues<sup>49</sup>.

## **B. The Big 4**

The enactment of the Limited Liability Partnership (LLP) legislation in Jersey in 1994 provides a clear example for the influence of Big 4 on policy making. In this case, two of the Big 4 were colluding together in order to maximise their political influence and the money and efforts they spent on lobbying has definitely contributed to the result of severe audit failures. Research undertaken by Prof. Prem Sikka reveals that the Jersey LLP Bill was drafted by E&Y and Price Waterhouse (PW, now part of PWC) at a private cost of £1 million in order to dilute "joint and several" liability (a requirement that accountancy firm partners would be liable for each other's negligence and omissions) and reduce the redress available to audit stakeholders while maintaining tax advantages of partnerships.

The Bill was accompanied by a threat of these auditing firms that if the UK government failed to enact similar measures, the firms would relocate their operations to Jersey. Jersey hoped the lower liability obligations would attract major firms to locate and as a result improve government finances by paying annual registration levies. Nevertheless, in the final event, the accountancy firms did not migrate to Jersey. Rather, the firms succeeded to some extent to use the legislation to place pressure on the UK government. The UK eventually capitulated and provided LLP legislation (the Limited Liability Partnership Act 2000), albeit with some

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<sup>47</sup> See <http://blogs.euobserver.com/shaxson/2012/03/08/germany-sides-with-the-tax-havens-in-transparency-fight/>; and

[http://www.taxjustice.net/cms/upload/pdf/TJN\\_1110\\_UK-Swiss\\_master.pdf](http://www.taxjustice.net/cms/upload/pdf/TJN_1110_UK-Swiss_master.pdf); 22.7.12.

<sup>48</sup> See <http://taxjustice.blogspot.de/2012/08/its-official-swiss-admit-purpose-of.html>; 28.8.2012.

<sup>49</sup> See pp.3-4 in: [http://www.taxjustice.net/cms/upload/pdf/TJN\\_1110\\_UK-Swiss\\_master.pdf](http://www.taxjustice.net/cms/upload/pdf/TJN_1110_UK-Swiss_master.pdf); 21.8.12.

modifications, and allowed firms to retain lucrative tax concessions associated with partnership structures<sup>50</sup>.

Another example of auditors' political influence concerns a huge campaign, organised in June 2012 by auditors in Hong Kong, against a new Companies Bill that would make auditors criminally liable if they "knowingly or recklessly omit a required statement from an audit report." The Hong Kong Institute of Certified Public Accountants (HKICPA) tried to argue that the new law would not apply to Hong Kong-listed companies that are incorporated offshore, so as to allow companies to avoid the city's regulatory regime<sup>51</sup>.

In addition, information published recently reveals that as of May 2009, the Big 4 in the UK have given to the three main political parties in the UK donations of "staff costs" and consultancy work totalling almost £1.9m. Furthermore, the Big 4 "lend" staff to the government on a regular basis<sup>52</sup>. While one may claim that secondments do not necessarily indicate a political influence by the Big 4 because governmental contracts are subject to strict code of practice, it is obvious that an accountancy firm that provides secondees to work with politicians will have insider advantage by knowing when contracts are coming up or getting itself on a tender list. Given that the Big 4 work with almost all FTSE 100 and FTSE 250 companies, the scale of the political involvement of the Big 4 should raise concerns about their influence on UK policy makers<sup>53</sup>.

Furthermore, during its six-month presidency of the European Union, commencing July 2012, the Cypriot government borrowed a PwC technical expert, in order to assist it with promoting the accounting reform<sup>54</sup>. When a government, that has just started pushing forward a reform of the audit market, agrees to accept free services from one of the Big 4, there are high risks that such an arrangement will allow the relevant accounting firm to influence the reform.

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<sup>50</sup> Prof. P. Sikka, "Too Easy for Auditors?" *International Accountant* (April, 2007), pp. 1, 31-33, in:

<http://visar.csustan.edu/aaba/International%20Accountant%20%20April2007.pdf>;

21.8.12.

<sup>51</sup> See <http://www.reuters.com/article/2012/06/18/us-hongkong-auditors-idUSBRE85H06A20120618>; 30.8.12.

<sup>52</sup> See <http://www.thebureauinvestigates.com/2012/07/10/how-big-four-get-inside-track-by-loaning-staff-to-government/>; 7.8.12.

<sup>53</sup> See <http://www.guardian.co.uk/politics/2012/jul/10/lobbying>; 7.8.12.

<sup>54</sup> See <http://www.ft.com/intl/cms/s/0/6a9a8dd2-db1d-11e1-8074-00144feab49a.html#axzz22ISYNEvC>; 5.10.12.

The examples above support the argument that banks and Big 4 invest substantial efforts and resources to influence policy makers so that laws and regulations will be shaped in accordance with their interests. The results of these efforts are mainly the increase of financial secrecy and the descent in the liability thresholds of audit work.

## Part 2: Statistical evidence for banks' and Big 4's preference for secrecy

Much of the following section relies on a comparison of data between 71 jurisdictions included in the 2011 FSI<sup>55</sup> with data for the G20 countries. For the reader unfamiliar with the FSI, it is important to bear in mind that most (53) of the jurisdictions included in the FSI have been selected based on their tax haven and/or secrecy activities<sup>56</sup>. Only 20 have been selected because of their large market share in cross-border financial service provision<sup>57</sup>. Therefore, it is expected that the secrecy scores as determined by the FSI 2011 for the set of 71 jurisdictions is considerably higher than for the G20 countries<sup>58</sup>. Because we did not analyse all 19 of the G20 countries in our FSI 2011, we have a secrecy score only for 8 of the G20 countries<sup>59</sup>.

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<sup>55</sup> The FSI database includes data for 73 jurisdictions. However, as the data on the number of banks and Big 4 was very limited with regard to US Virgin Islands, we decided to exclude it this research paper. In addition, the secrecy score for France is temporarily not available and pending upon legal interpretation. Therefore, the number of banks and Big 4 in France was not included in the average and median calculations regarding the FSI jurisdictions, but only in calculations for the G-20 countries. Specific data for each of the 71 jurisdictions can be found in the FSI database:

[http://www.secrecyjurisdictions.com/sj\\_database/menu.xml](http://www.secrecyjurisdictions.com/sj_database/menu.xml); 3.10.12.

<sup>56</sup> For the explanation on the initial selection of the list of jurisdictions for the 2009 FSI, see pages 1-5 in [http://www.secrecyjurisdictions.com/PDF/SJ\\_Mapping.pdf](http://www.secrecyjurisdictions.com/PDF/SJ_Mapping.pdf) (29.8.12); the selection of the updated list of jurisdictions for the 2011 FSI is explained on pp. 2-3 in <http://www.financialsecrecyindex.com/documents/FSI-Methodology.pdf>; 29.8.12.

<sup>57</sup> See p.3 in: [www.secrecyjurisdictions.com/PDF/SJ-Methodology.pdf](http://www.secrecyjurisdictions.com/PDF/SJ-Methodology.pdf); 29.8.2012; and in [http://www.financialsecrecyindex.com/#which\\_jurisdictions](http://www.financialsecrecyindex.com/#which_jurisdictions), under the title: "How did we choose these jurisdictions?"

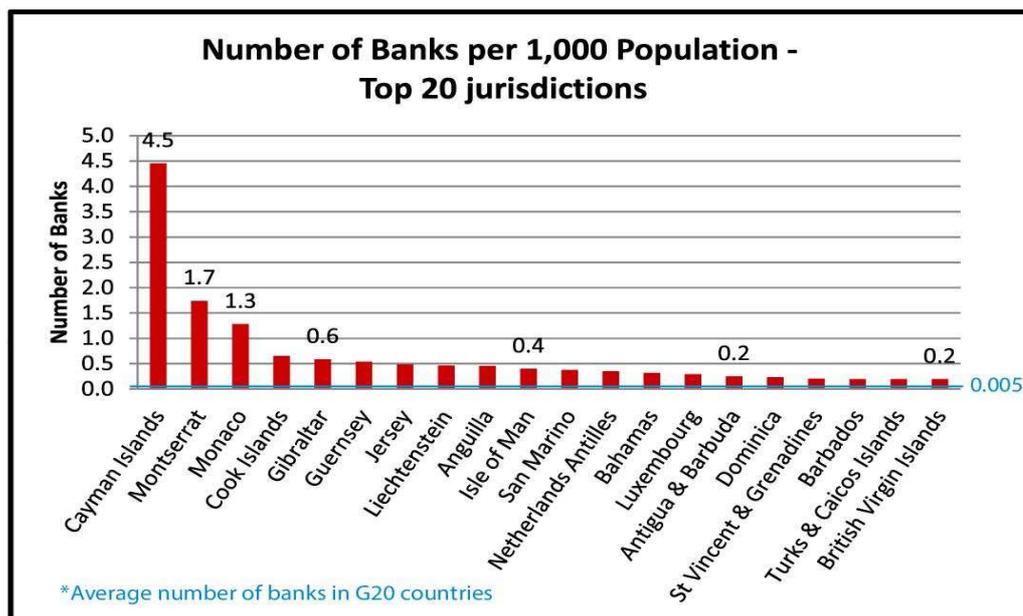
<sup>58</sup> For the secrecy scores of all the analysed jurisdictions, please see <http://www.financialsecrecyindex.com/2011results.html>; 29.8.12.

<sup>59</sup> The G20 countries included in the 2011 FSI (in an alphabetical order) are: Canada, France, Germany, India, Italy, Japan, Korea, United Kingdom and United States. However, as mentioned earlier, the secrecy score for France is temporarily not available and pending upon legal interpretation.

By relating the secrecy score of a jurisdiction (as measured by the FSI) with the number of banks and Big 4, a number of interesting observations can be made. The following descriptive statistics show a positive correlation between the presence of banks and Big 4 firms and the secrecy score of a given jurisdiction. This correlation could be explained by the two hypotheses as substantiated in the first part above. While the graphs presented below further increase the plausibility of the hypotheses, they do not represent conclusive evidence of a causal relationship.

As can be seen in Graph 1 below, within all 71 Jurisdictions analysed for the FSI, the highest numbers of banks per 1,000 inhabitants are found in notorious secrecy jurisdictions or tax havens. From Cayman Islands through to Luxembourg and the British Virgin Islands, the top 20 FSI-jurisdictions with most banks are countries which have an exceptionally large financial sector in excess of their domestic banking needs. The existence of banks in these jurisdictions must therefore be justified by the management of international financial flows, some of which will be illicit, as alternative evidence<sup>60</sup> and our prior analysis in Part 1 shows.

**Graph 1:**

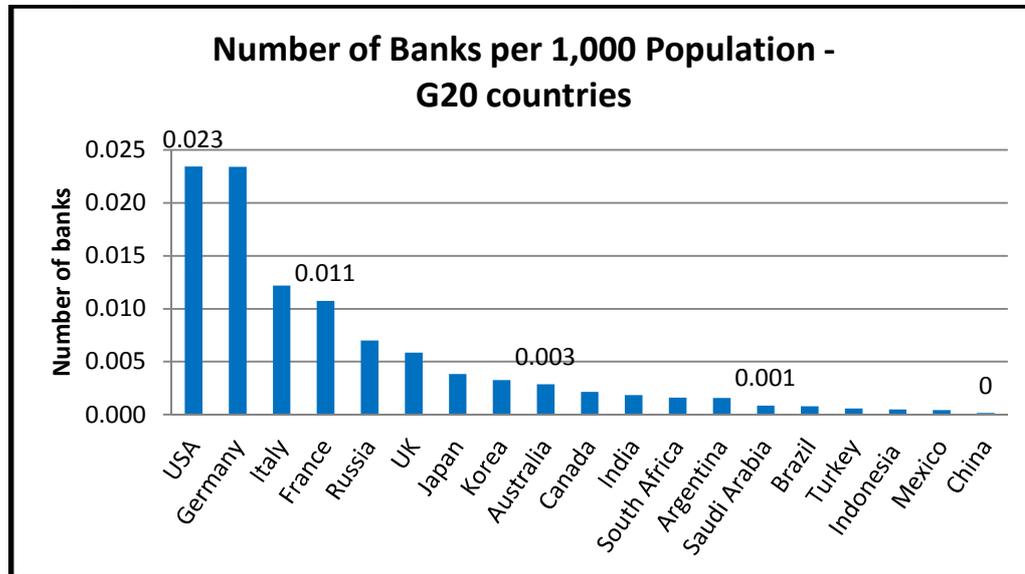


The extraordinary high ratio of banks per capita is evident if compared with the average number of banks per 1,000 inhabitants in G20 countries, as represented by the blue line in the Graph above (at 0.005). The detailed number of banks per 1,000 in G20 countries is presented in

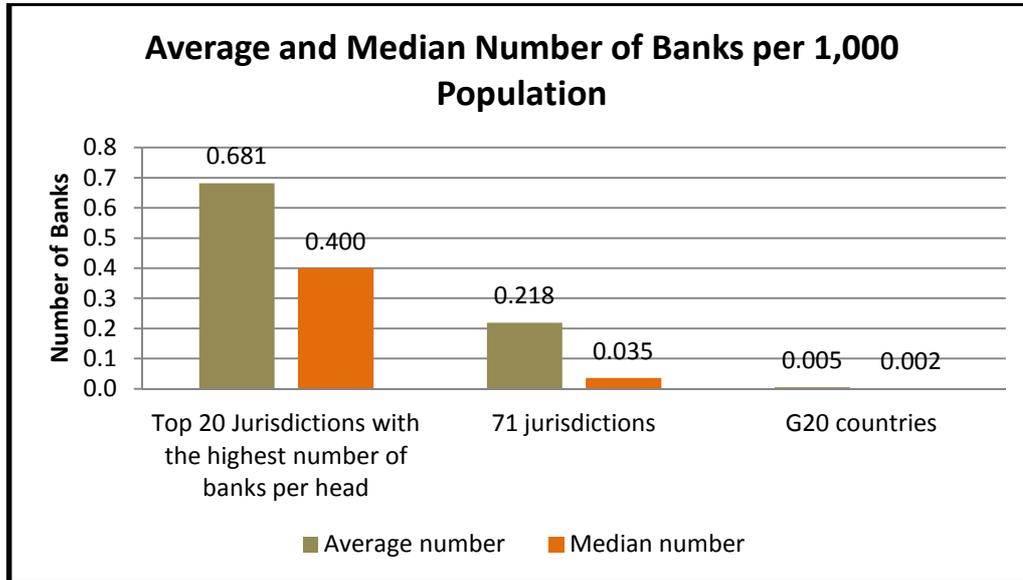
<sup>60</sup> See <http://www.gfip.org/index.php?option=content&task=view&id=274>; 20.8.12.

Graph 2 below. As can easily be seen, these numbers are consistently and considerably lower than the number of banks in the top 20 FSI-jurisdictions.

**Graph 2:**



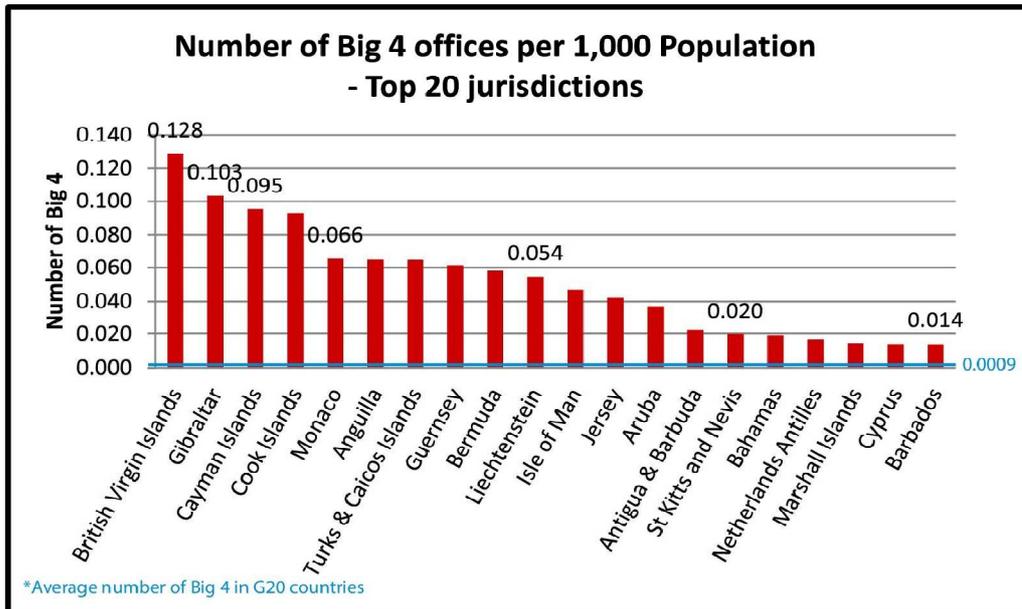
The great difference in the numbers of banks per head becomes even more telling in Graph 3 below, where we compare the average and median number of banks in the top 20 FSI-jurisdictions (those with the highest number of banks per head), with that of the G20 countries. As can be seen, the average number of banks per 1,000 inhabitants is 136.2 times higher for the top 20 FSI-jurisdictions than it is for the G20 countries. The median number of banks in the top 20 FSI-jurisdictions is 200 times higher than the median number of banks in G20 countries.

**Graph 3:**

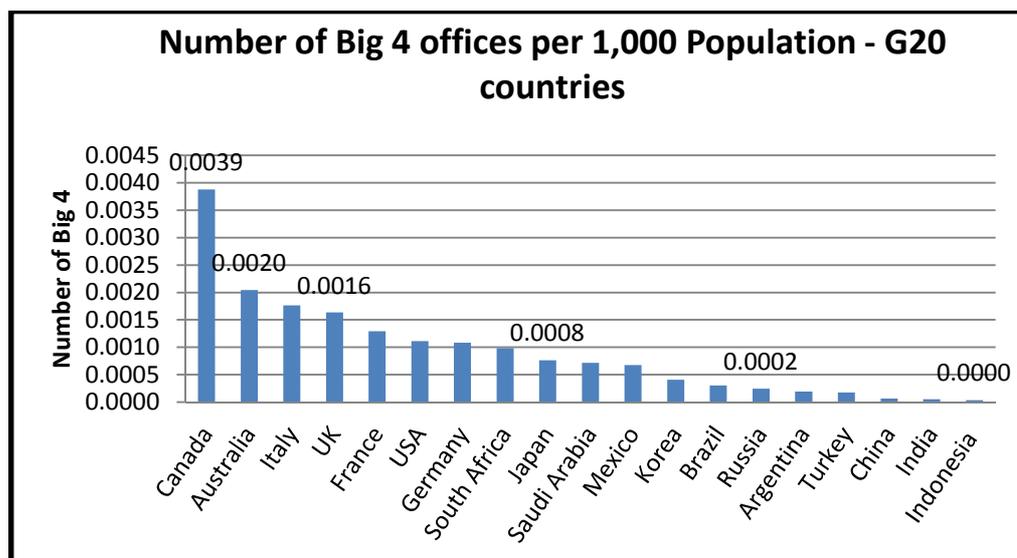
Additional two graphs showing the absolute numbers of banks (i.e. not per head of population) in both top 20 FSI-jurisdictions and G20 countries can be found in Appendix 1. The full dataset of the number of banks used for this research, both absolute numbers and per 1,000 capita, can be found in Appendix 2.

Similar to the banks, the Big 4 are heavily over-represented on an office per head of population basis in notorious secrecy jurisdictions as shown in Graph 4 below. As such disproportionate presence of accountants cannot be explained by local commercial needs, it is reasonable to conclude that the Big 4 mostly handle international commercial activity, which is outside of the jurisdiction in question, rather than local commercial activity. Such international activity refers, among others, to the creation of tax schemes products that may involve the abuse of transfer pricing, tax treaty shopping, etc.

Again, the extraordinary overrepresentation becomes salient when compared to the average number of Big 4 offices per 1,000 inhabitants in G20 countries, as indicated by the blue line (at 0.0009) in Graph 4 below.

**Graph 4:**

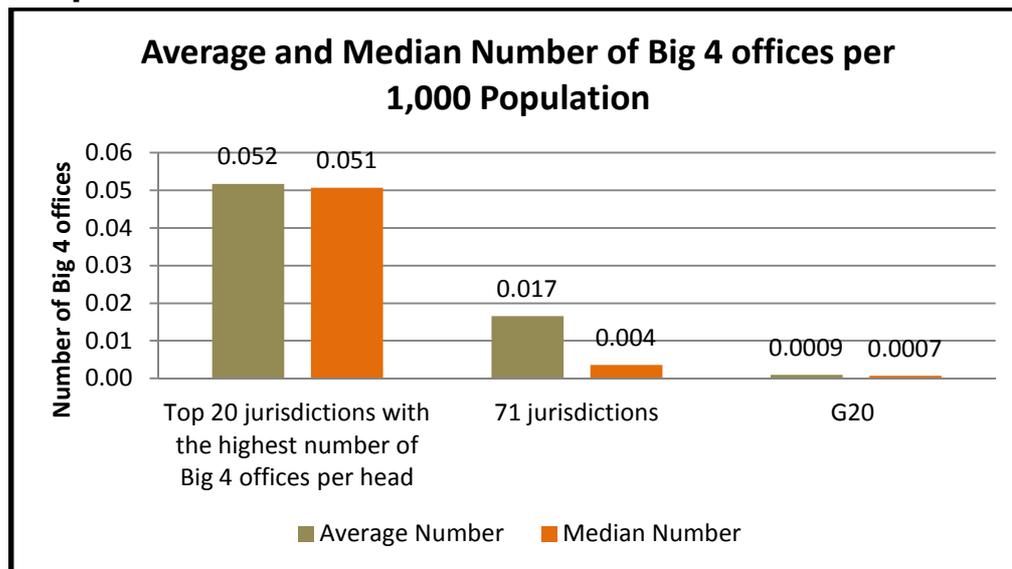
Each G20 country's number of Big 4 offices per 1,000 inhabitants is presented in Graph 5 below. Comparing it to Graph 4 above, this graph demonstrates that the number of Big 4 offices per capita in each of the G20 countries is substantially lower than it is in any of the top 20 FSI-jurisdictions.

**Graph 5:**

The differences in the numbers of Big 4 offices per head are further substantiated in Graph 6 below by comparing the average and median numbers of top 20 FSI-jurisdictions (those with the highest number of Big

4 per head) with that of the G20. It shows that the average number of Big 4 offices per capita in the top 20 FSI-jurisdictions is remarkably higher (more than 57 times) than the average in G20 countries. The median number of Big 4 offices per capita in the top 20 FSI-jurisdictions is 72.9 higher than the median number of Big 4 offices in G20 countries.

**Graph 6:**



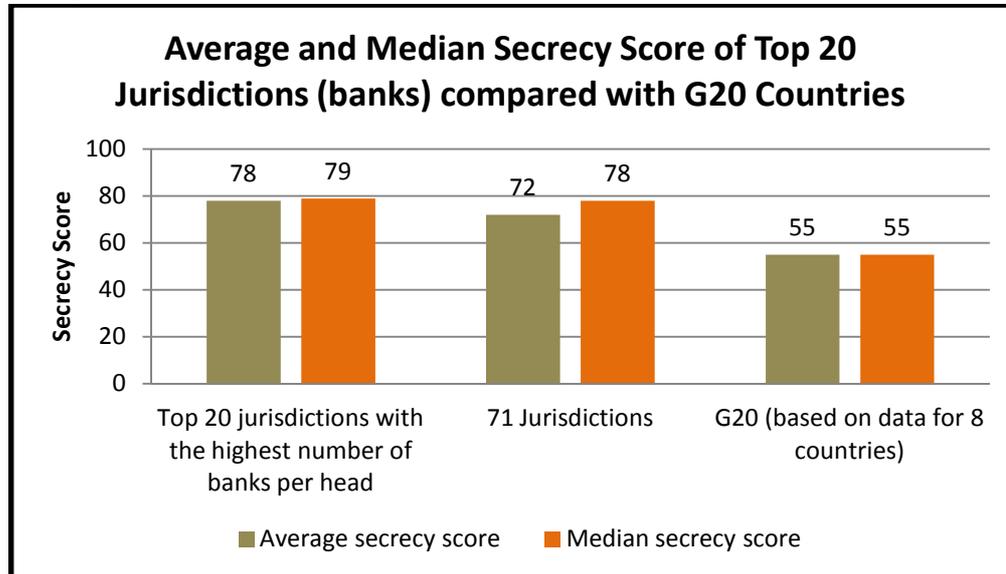
Appendix 3 includes two additional graphs providing the absolute numbers of Big 4 offices (i.e. not per head of population) in G20 countries and in the top 20 FSI-jurisdictions. The full data set of the Big 4 offices, both absolute numbers and per 1,000 capita, in all jurisdictions analysed for the FSI can be found in Appendix 4.

The graphs presented above provide first evidence that there is a substantially higher number of Big 4 offices and banks per head among the top 20 FSI-jurisdictions than there is in G20 countries. While this observation provides a strong indication for a significant correlation between the number of banks/Big 4 and the level of secrecy of a jurisdiction, the following graphs further corroborate this correlation.

Graph 7 below further deepens the extent of the correlation between the secrecy score given by the FSI to a jurisdiction on the one hand, and the number of banks and Big 4 on the other. The graph compares the average and median secrecy score of the top 20 FSI-jurisdictions (those with the highest number of banks per capita) to the average and median secrecy score of the G20 countries. As can easily be seen, both the average and

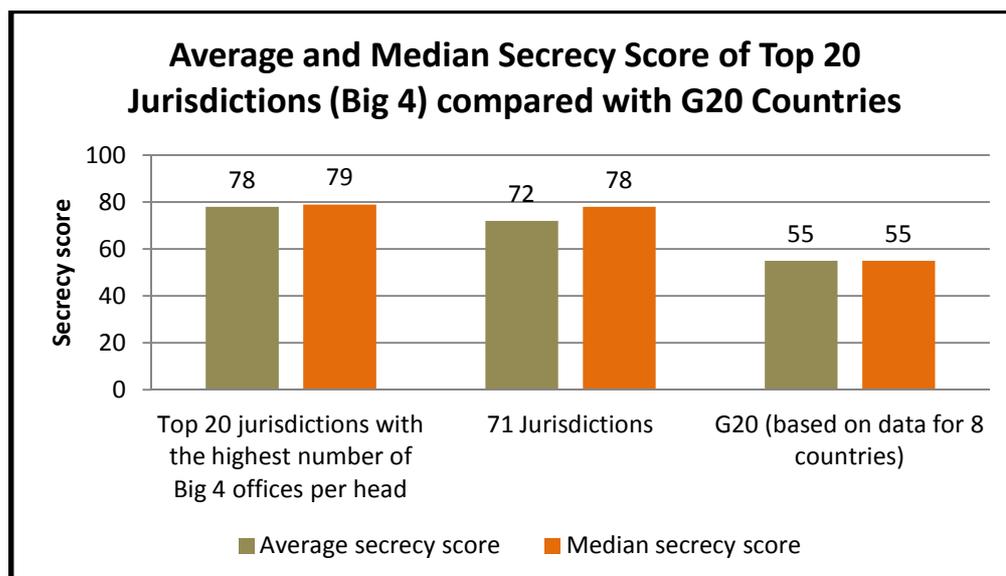
the median secrecy score of the top 20 FSI-jurisdictions are higher than those of the G20 countries<sup>61</sup>.

**Graph 7:**



Similarly, Graph 8 below compares the average and median secrecy score of the top 20 FSI-jurisdictions (i.e. 20 jurisdictions with the highest number of Big 4 per capita) to the average and median secrecy score of the G20 countries. Again, both the average and the median secrecy score of the top 20 FSI-jurisdictions are higher than those of the G20 countries.

**Graph 8:**

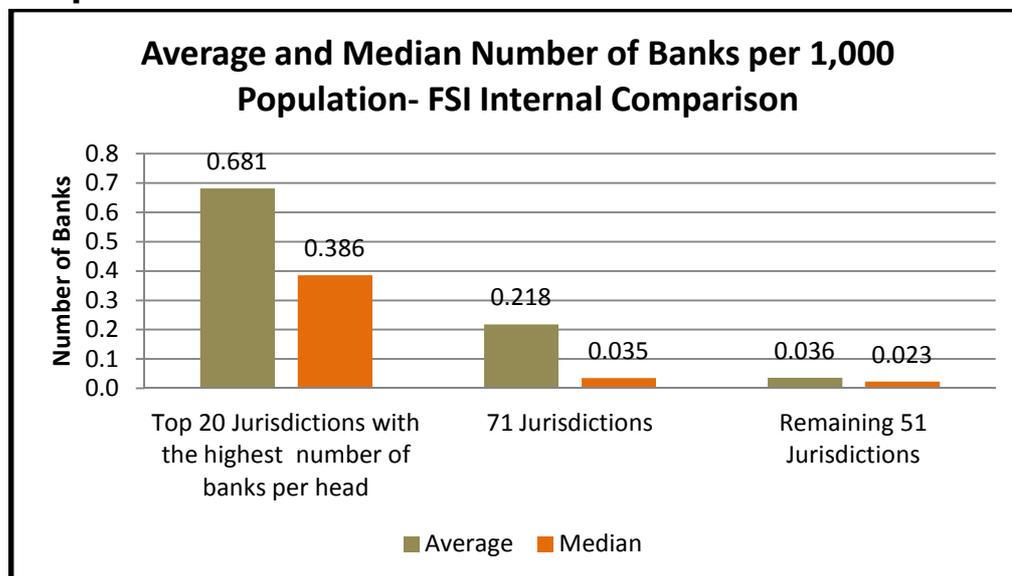


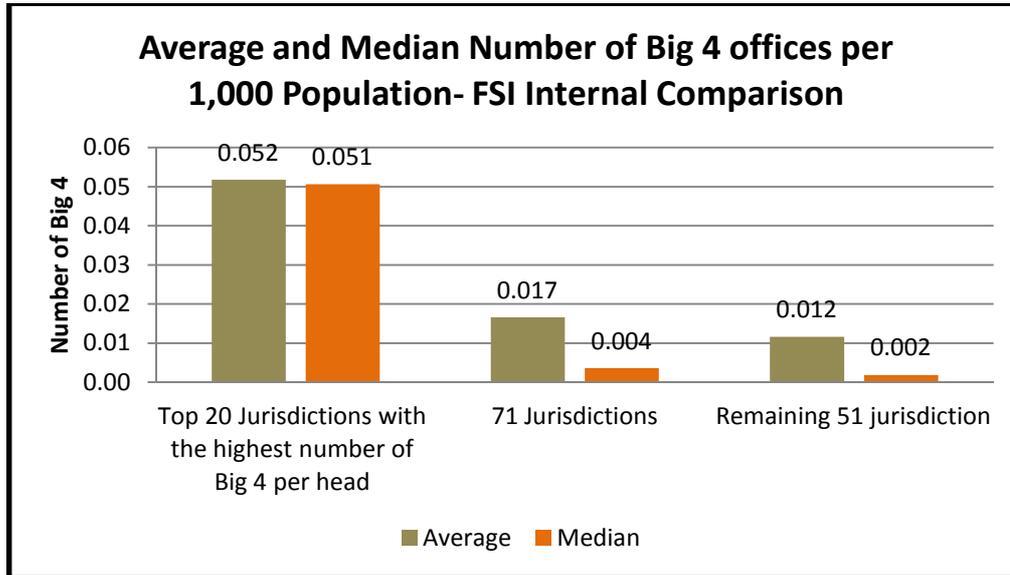
<sup>61</sup> Once we exclude the nine G20 countries from the 71 jurisdictions, the average secrecy of the remaining 62 jurisdictions score gets even higher and is equal to 74.

As expected by our two hypotheses, the graphs above demonstrate that there is a positive correlation between the numbers of banks and Big 4 offices per capita on the one hand, and the secrecy score of a jurisdiction as measured by the FSI on the other hand.

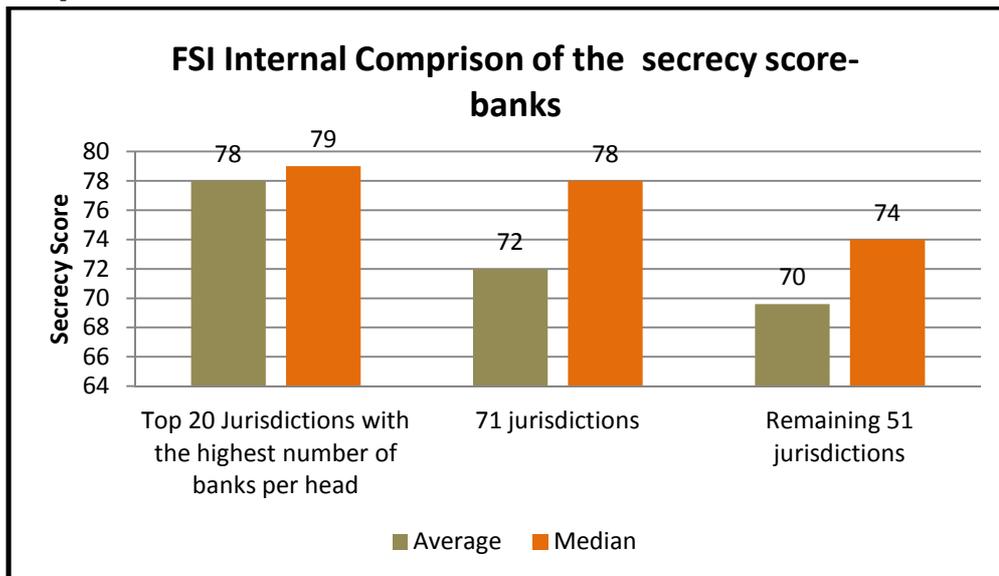
The high average and median numbers of banks and Big 4 offices in the notorious top 20 FSI-jurisdictions (as measured by highest numbers of banks and Big 4 offices per capita) is also substantiated by comparing these with the remaining 51 jurisdictions of the FSI. As can be seen in Graphs 9 and 10 below, the average and median numbers of banks and Big 4 offices in the top 20 FSI-jurisdictions are considerably higher than those of the remaining 51 jurisdictions.

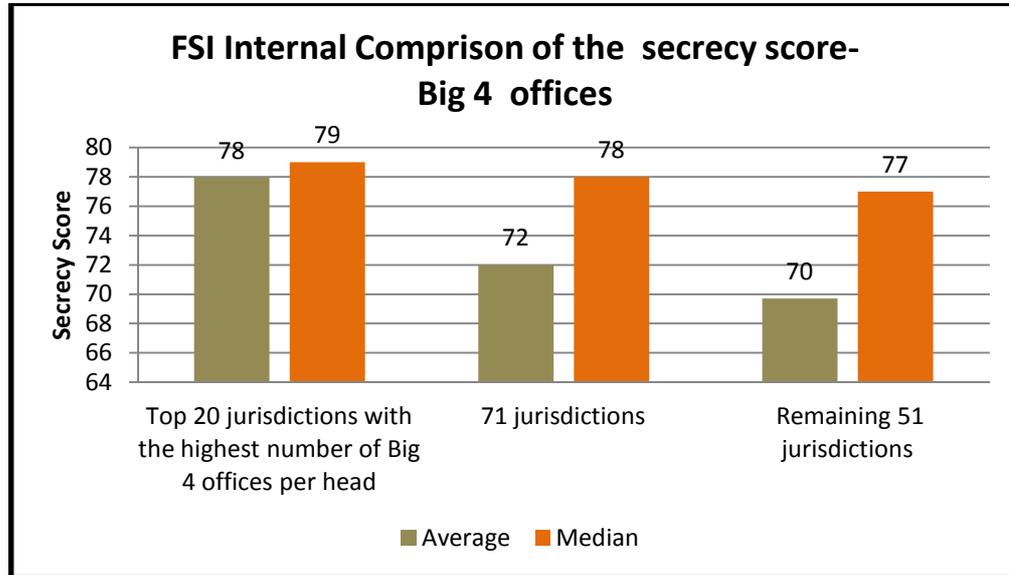
**Graph 9:**



**Graph 10:**

The linkage between the secrecy on offer and the number of banks and Big 4 per capita becomes evident by Graph 11 & 12 below. These graphs compare the average and median secrecy score of the top 20 FSI-jurisdictions (those with the highest number of banks and Big 4 offices per head) with the secrecy score given to the remaining 51 jurisdictions. As expected by our two hypotheses, the secrecy score is considerably higher in the jurisdictions with the highest number of banks and Big 4 offices per head.

**Graph 11:**

**Graph 12:**

Taken together, the graphs presented in part two of this research provide first descriptive statistics suggesting that there is a positive and systematic correlation between the secrecy offered by jurisdictions as measured by the FSI on the one hand and the per capita number of banks and Big 4 on the other hand.

Three kinds of statistical associations are presented by the graphs: first, the per capita numbers of banks and Big 4 in the top 20 FSI-jurisdictions are far greater than those in G20 countries; second, the identified difference in the numbers of banks and Big 4 is mirrored by an analogue difference in the secrecy scores (as measured by FSI) between both sets of jurisdictions; and third, by comparing the average and median per capita numbers of banks and big 4 in the top 20 FSI-jurisdictions with the remaining 51 jurisdictions of the FSI, we found a similar positive correlation between the secrecy scores and the numbers of banks and Big 4.

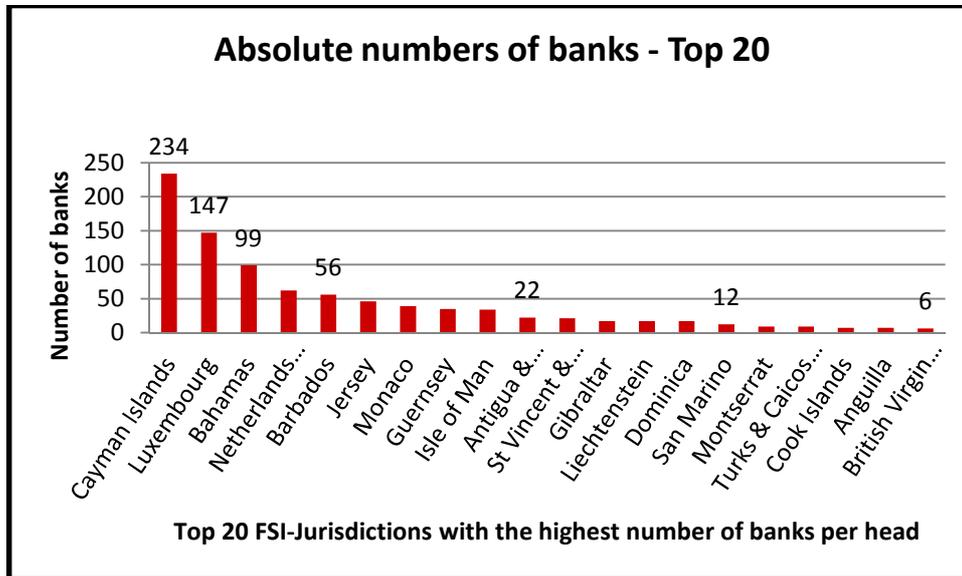
## Conclusions

Relying both on the case studies analysed in the first part and the statistical evidence presented in the second, it appears that designing commercial tax abuse schemes and turning a blind eye upon suspicious transactions have become an inherent part of the work of bankers and accountants. Their inclination to create exceptionally strong presence in more secretive jurisdictions helps them avoid strictly enforced laws and

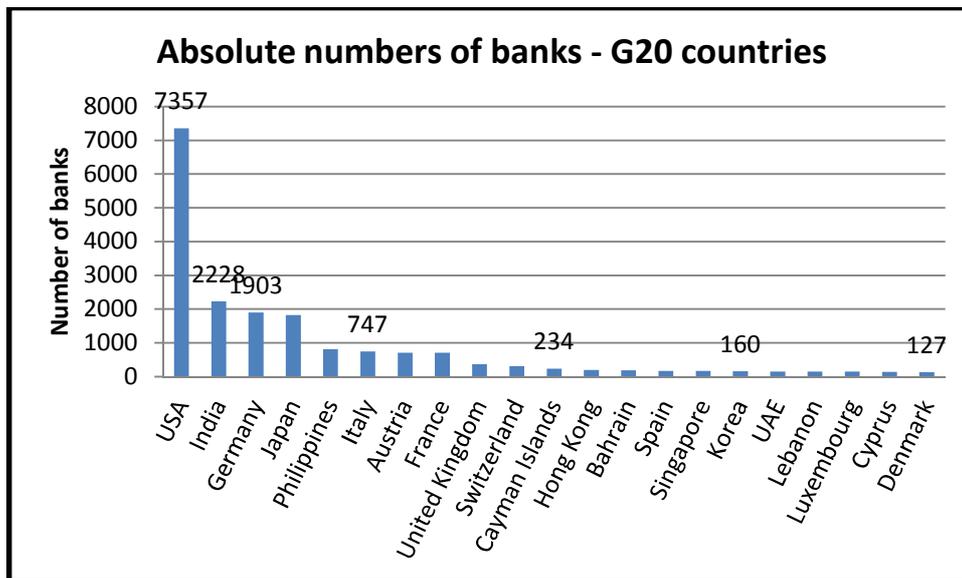
regulations and has led to a culture of non-compliance, thus increasing the volume of illicit financial flows and crime. At the same time, banks and Big 4 invest in lobbying for laws and regulations that reduce transparency. The statistical correlation identified in part two of this research supports both hypotheses.

## Appendix 1: Absolute numbers of banks

Graph a:



Graph b:



## Appendix 2: Number of Banks in 72 jurisdictions analysed in the FSI\*

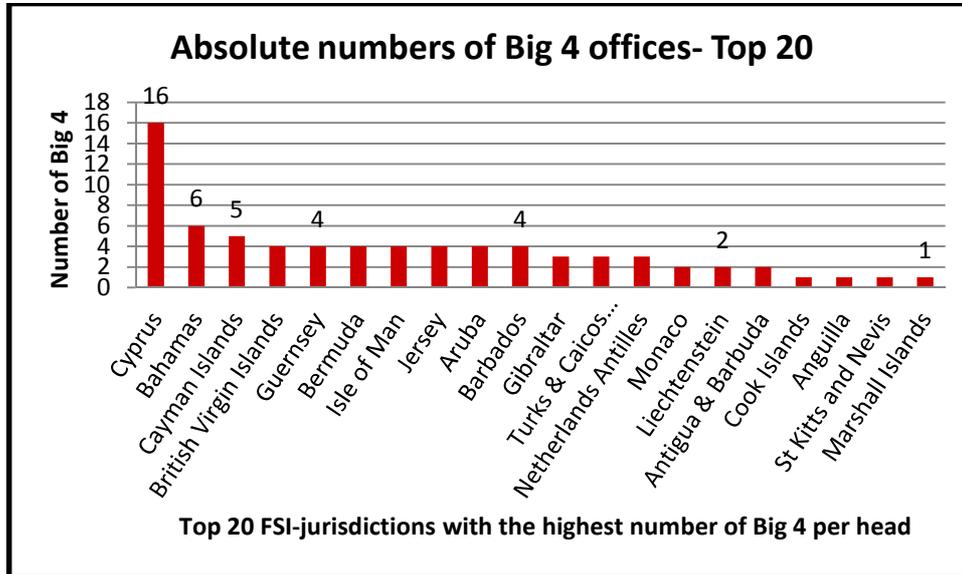
ID	Jurisdiction	Banks	Population	Banks per 1,000 head
1	Andorra	6	85,082	0.07
2	Anguilla	7	15,423	0.45
3	Antigua & Barbuda	22	89,018	0.25
4	Aruba	11	107,635	0.10
5	Austria	709	8,219,743	0.09
6	Bahamas	99	316,182	0.31
7	Bahrain	189	1,248,348	0.15
8	Barbados	56	287,733	0.19
9	Belgium	121	10,438,353	0.01
10	Belize	27	327,719	0.08
11	Bermuda	4	69,080	0.06
12	Botswana	8	2,098,018	0.00
13	British Virgin Islands	6	31,148	0.19
14	Brunei	13	408,786	0.03
15	Canada	74	34,300,083	0.00
16	Cayman Islands	234	52,560	4.45
17	Cook Islands	7	10,777	0.65
18	Costa Rica	18	4,636,348	0.00
19	Cyprus	142	1,138,071	0.12
20	Denmark	127	5,543,453	0.02
21	Dominica	17	73,126	0.23
22	France	706	65,630,692	0.01
23	Germany	1903	81,305,856	0.02
24	Ghana	29	25,241,998	0.00
25	Gibraltar	17	29,034	0.59
26	Grenada	20	109,011	0.18
27	Guatemala	25	14,099,032	0.00
28	Guernsey	35	65,345	0.54
29	Hong Kong	194	7,153,519	0.03
30	Hungary	35	9,958,453	0.00
31	India	2228	1,205,073,612	0.00
32	Ireland	76	4,722,028	0.02
33	Isle of Man	34	85,421	0.40
34	Israel	24	7,590,758	0.00
35	Italy	747	61,261,254	0.01
36	Japan	1820	127,368,088	0.01

ID	Jurisdiction	Banks	Population	Banks per 1,000 head
37	Jersey	46	94,949	0.48
38	Korea	160	48,860,500	0.00
39	Latvia	59	2,191,580	0.03
40	Lebanon	148	4,140,289	0.04
41	Liberia	9	3,887,886	0.00
42	Liechtenstein	17	36,713	0.46
43	Luxembourg	147	509,074	0.29
44	Macau	29	578,025	0.05
45	Malaysia (Labuan)	105	29,179,952	0.00
46	Maldives	6	394,451	0.02
47	Malta	25	409,836	0.06
48	Marshall Islands	2	68,480	0.03
49	Mauritius	28	1,313,095	0.02
50	Monaco	39	30,510	1.28
51	Montserrat	9	5,164	1.74
52	Nauru	0	9,378	0.00
53	Netherlands	125	16,730,632	0.01
54	Netherlands Antilles	62	178,609	0.35
55	Panama	88	3,510,045	0.03
56	Philippines	814	103,775,002	0.01
57	Portugal (Madeira)	35	10,781,459	0.00
58	Samoa	10	194,320	0.05
59	San Marino	12	32,140	0.37
60	Seychelles	7	90,024	0.08
61	Singapore	168	5,353,494	0.03
62	Spain	169	47,042,984	0.00
63	St Kitts and Nevis	9	50,726	0.18
64	St Lucia	7	162,178	0.04
65	St Vincent & Grenadines	21	103,537	0.20
66	Switzerland	312	7,655,628	0.04
67	Turks & Caicos Islands	9	46,335	0.19
68	United Arab Emirates	153	5,314,317	0.03
69	United Kingdom	370	63,047,162	0.01
70	Uruguay	31	3,316,328	0.01
71	USA	7357	313,847,465	0.02
72	Vanuatu	8	227,574	0.04

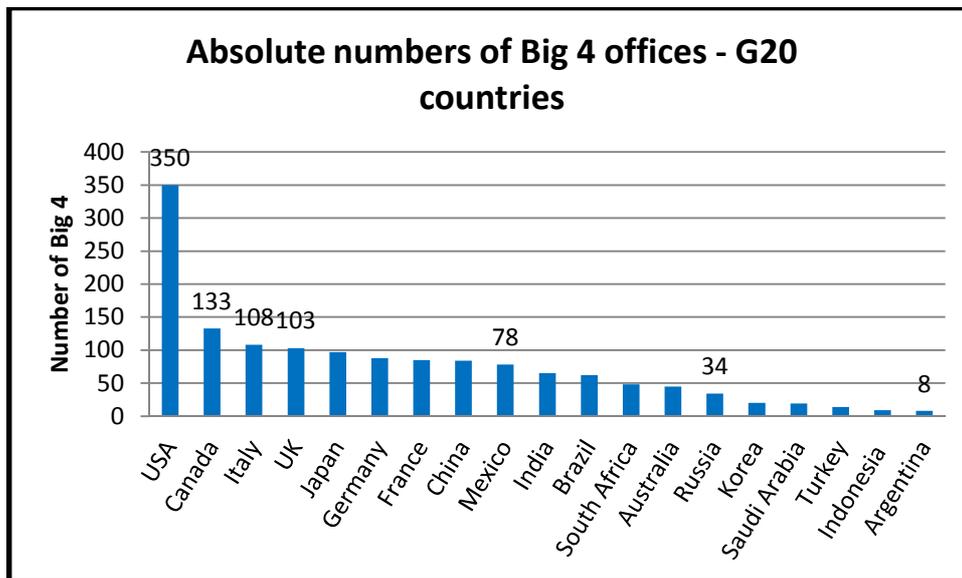
\*Data on France is included for our calculations regarding G20 countries

### Appendix 3: Absolute numbers of Big 4 offices

Graph c:



Graph d:



## Appendix 4: Number of Big 4 in 72 jurisdictions analysed in the FSI\*

ID	Jurisdiction	Big 4 offices	Population	Big 4 offices per 1,000 head
1	Andorra	1	85,082	0.012
2	Anguilla	1	15,423	0.065
3	Antigua & Barbuda	2	89,018	0.022
4	Aruba	4	107,635	0.037
5	Austria	28	8,219,743	0.003
6	Bahamas	6	316,182	0.019
7	Bahrain	4	1,248,348	0.003
8	Barbados	4	287,733	0.014
9	Belgium	36	10,438,353	0.003
10	Belize	0	327,719	0.000
11	Bermuda	4	69,080	0.058
12	Botswana	4	2,098,018	0.002
13	British Virgin Islands	4	31,148	0.128
14	Brunei	4	408,786	0.010
15	Canada	133	34,300,083	0.004
16	Cayman Islands	5	52,560	0.095
17	Cook Islands	1	10,777	0.093
18	Costa Rica	4	4,636,348	0.001
19	Cyprus	16	1,138,071	0.014
20	Denmark	49	5,543,453	0.009
21	Dominica	0	73,126	0.000
22	France	85	65,630,692	0.001
23	Germany	88	81,305,856	0.001
24	Ghana	4	25,241,998	0.000
25	Gibraltar	3	29,034	0.103
26	Grenada	0	109,011	0.000
27	Guatemala	4	14,099,032	0.000
28	Guernsey	4	65,345	0.061
29	Hong Kong	11	7,153,519	0.002
30	Hungary	5	9,958,453	0.001
31	India	65	1,205,073,612	0.000
32	Ireland	18	4,722,028	0.004
33	Isle of Man	4	85,421	0.047
34	Israel	16	7,590,758	0.002
35	Italy	108	61,261,254	0.002

ID	Jurisdiction	Banks	Population	Big 4 offices per 1,000 head
36	Japan	97	127,368,088	0.001
37	Jersey	4	94,949	0.042
38	Korea	20	48,860,500	0.000
39	Latvia	4	2,191,580	0.002
40	Lebanon	6	4,140,289	0.001
41	Liberia	0	3,887,886	0.000
42	Liechtenstein	2	36,713	0.054
43	Luxembourg	4	509,074	0.008
44	Macau	4	578,025	0.007
45	Malaysia (Labuan)	4	29,179,952	0.000
46	Maldives	3	394,451	0.008
47	Malta	5	409,836	0.012
48	Marshall Islands	1	68,480	0.015
49	Mauritius	5	1,313,095	0.004
50	Monaco	2	30,510	0.066
51	Montserrat	0	5,164	0.000
52	Nauru	0	9,378	0.000
53	Netherlands	64	16,730,632	0.004
54	Netherlands Antilles	3	178,609	0.017
55	Panama	5	3,510,045	0.001
56	Philippines	18	103,775,002	0.000
57	Portugal (Madeira)	0	10,781,459	0.000
58	Samoa	0	194,320	0.000
59	San Marino	0	32,140	0.000
60	Seychelles	1	90,024	0.011
61	Singapore	10	5,353,494	0.002
62	Spain	100	47,042,984	0.002
63	St Kitts and Nevis	1	50,726	0.020
64	St Lucia	2	162,178	0.012
65	St Vincent & Grenadines	1	103,537	0.010
66	Switzerland	42	7,655,628	0.005
67	Turks & Caicos Islands	3	46,335	0.065
68	United Arab Emirates	20	5,314,317	0.004
69	United Kingdom	103	63,047,162	0.002
70	Uruguay	10	3,316,328	0.003
71	USA	350	313,847,465	0.001
72	Vanuatu	0	227,574	0.000

\*Data on France is included for our calculations regarding G20 countries

## Appendix 5: Additional qualitative evidence regarding banks' involvement with PEPs

**A.** In 2009, Global Witness exposed how Teodorin Obiang, the son of the president of Equatorial Guinea, one of the world's current most emblematic kleptocracies, held a personal account in a branch of **Barclays** (a UK-based bank) in Paris<sup>62</sup>. Furthermore, according to the report, despite his official income of \$4,000 a month as a minister in his father's government, Teodorin owns a \$35 million mansion in Malibu, California, a \$6.3 million fleet of fast cars and a \$33 million private jet. In 2011, Global Witness revealed that Teodorin has commissioned the building of a super yacht for himself, worth \$380 million (almost three times his country's combined annual health and education budgets for its people)<sup>63</sup>. However, soon after Global Witness started its campaign against the purchase, the government of Equatorial Guinea stated that Teodorin decided not to buy that yacht<sup>64</sup>.

The Barclays accounts were found after three French NGOs filed a complaint in France alleging, inter alia, that the ruling families of Equatorial Guinea had acquired assets worth millions of Euros in France that could not be the fruits of their official salaries. An initial French police investigation in response to the complaint uncovered evidence of luxury properties in France, including a 5,000 square feet home in an affluent arrondissement of Paris and cars belonging, among others, to the ruler of Equatorial Guinea and his family relatives<sup>65</sup>. Following the investigations, in March 2012 it was published that France issued an international warrant for the arrest of Teodorin on money laundering charges in relation to purchases of real estate in France<sup>66</sup>.

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<sup>62</sup> See pp. 4, 40-45, 89-90 in Global Witness' report (2009): "Undue Diligence: How Banks Do Business with Corrupt Regimes" (hereinafter: "Undue Diligence") in: <http://www.financialtaskforce.org/2009/04/26/undue-diligence-how-banks-do-business-with-corrupt-regimes/>; 2.9.12.

<sup>63</sup> See <http://www.theghanaijournal.com/2011/03/02/presidents-son-buys-380m-superyacht/>; 21.7.12.

<sup>64</sup> See <http://www.guardian.co.uk/world/2011/feb/28/dictator-son-superyacht-teodorin-obiang>; 20.8.12.

<sup>65</sup> See <http://www.theghanaijournal.com/2011/03/02/presidents-son-buys-380m-superyacht/>; 21.7.12; and see pp. 40-45 in "Undue Diligence", found in: <http://www.financialtaskforce.org/2009/04/26/undue-diligence-how-banks-do-business-with-corrupt-regimes/>; 21.7.12.

<sup>66</sup> See <http://www.globalpost.com/dispatch/news/regions/europe/france/120327/teodorin-obiang-arrest-warrant-issued-french-judges-report>; 21.7.12.

**B. Deutsche Bank** was also involved in cooperating with PEPs of questionable reputation. The German bank held several accounts for President Niyazov of Turkmenistan, who died in 2006 and whose regime was known for human rights abuses, repression and impoverishment of the population. A report by Global Witness disclosed that Deutsche Bank held the central bank accounts for Turkmenistan for 15 years, and also managed Turkmen foreign currency assets, such as the Foreign Exchange Reserve Fund (FERF). The FERF did not appear under the national budget and was effectively solely controlled by Niyazov. Nevertheless, according to the report, approximately 50% of Turkmenistan's gas revenues - worth billions of dollars - were transferred to the FERF on a regular basis. By allowing Niyazov's regime to keep Turkmenistan's natural resource wealth out of the government's budget, Deutsche Bank was, in fact, helping Niyazov to stay in power and oppress his people<sup>67</sup>.

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<sup>67</sup> See pp.82-88 in "Undue Diligence", in: <http://www.financialtaskforce.org/2009/04/26/undue-diligence-how-banks-do-business-with-corrupt-regimes>; 2.9.12.

## Appendix 6: additional qualitative evidence regarding the role of banks in facilitating tax evasion

**A.** In February 2009, **UBS** was fined an extraordinary \$780 million by the US authorities for facilitating tax evasion. The fine was part of a deferred prosecution agreement (DPA) that UBS has signed with the U.S. in which it admitted to helping U.S. taxpayers hide accounts from the Internal Revenue Service (IRS)<sup>68</sup>. As part of the DPA the bank was forced to hand over names of its US customers who had knowingly concealed \$20 billion from the American tax authorities<sup>69</sup>. The hearings of the U.S. Senate permanent subcommittee on investigations disclose some interesting facts on the case:

*"Among other actions, UBS allowed U.S. clients to establish offshore structures to assume nominal ownership of their assets and allowed U.S. clients to continue to hold undisclosed accounts that were not reported to the IRS. **Such actions, while not per se violations of the QI Program<sup>70</sup>, were aimed at circumventing its intended purpose of increasing disclosure of U.S. client accounts, and led to the formation of offshore structures and undeclared accounts that could facilitate, and have resulted in, tax evasion by U.S. clients [...]. In addition... at least 250 of its U.S. clients with Swiss accounts opened new accounts in the names of offshore corporations, trusts, foundations [...] UBS treated the new accounts as held by non-U.S. persons whose identities did not have to be disclosed to the IRS even though UBS knew that the true beneficial owners were U.S. persons.**" (U.S. Senate Report 2008: 10-11, **TJN emphasis added**].*

The quotation above demonstrates the role UBS has taken in preserving financial secrecy and facilitating tax evasion amongst its clients. By helping its U.S. clients to reinvest their money in specific assets that did not entail tax reporting obligations, the bank has knowingly contributed to hide illicit financial flows.

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<sup>68</sup> See <http://www.justice.gov/opa/pr/2009/August/09-tax-831.html>; 21.7.12; and <http://www.reuters.com/article/2009/08/19/us-ubs-idUSLJ59987220090819>; 21.7.12.

<sup>69</sup> See p.16 in: <http://www.financialtaskforce.org/2009/04/26/undue-diligence-how-banks-do-business-with-corrupt-regimes/>; 21.7.12.

<sup>70</sup> Qualified Intermediary (QI) system is a programme, established by the U.S. Government in 2001, to encourage foreign financial institutions to report and withhold tax on U.S. source income paid to foreign bank accounts. For more information please see <http://www.irs.gov/Businesses/International-Businesses/Qualified-Intermediary-Frequently-Asked-Questions>; 10.10.12.

## Appendix 7: additional qualitative evidence regarding the development of a culture of non-compliance among banks

**A.** On 12 June 2012, the U.S. Treasury Department announced it has reached a settlement of \$619 million with **ING Group**, a Dutch financial institution. The bank was accused of moving \$1.6 billion through the U.S., possibly violating US sanctions<sup>71</sup>.

**B.** Similar accusations were directed in August 2012 at the British bank, **Standard Chartered**. The NY State Department of Financial Services, has accused the bank of using a NY branch to mask more than 60,000 transactions for Iranian corporations and banks, for which the bank has received millions of dollars in fees<sup>72</sup>.

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<sup>71</sup> See <http://www.nytimes.com/2012/06/13/business/ing-bank-to-pay-619-million-over-sanctions-violations.html>; 7.8.12.

<sup>72</sup> See <http://www.nytimes.com/2012/08/07/business/standard-chartered-bank-accused-of-hiding-transactions-with-iranians.html>; 7.8.12.