

# Financial Secrecy

*The Shadowy Underside of Global  
Money Flows*

by

Ingo Walter

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## Preface

Secrecy is a vital element in much of finance. At the household level, family members expect to be able to keep personal financial information to themselves, and can usually find ways to do so. Cash under the mattress is a classic, and creates value by avoiding things that might happen if the stash were disclosed – like “loans” to family members with a dubious track record of repayment. But mattresses are hard to lift, and the money can eventually be discovered, requiring a scramble for somewhere new in the house. Of course, families are different. Household financial confidentiality in one family could be worth a lot, and very little in another.

In the financial economy, plain old bank deposits provide a certain degree of protection from unwanted insight – whether it’s account-access by thieves, creditors, relatives, salespeople or the public in general. Some consider such everyday financial privacy to be a basic “human right” – although it’s not often thought of in that way.

Still, just about all governments impose banking regulatory requirements that limit unauthorized disclosure - usually with exceptions for suspected criminal activity, tax evasion and the like. The same is true of investment instruments like mutual funds and other capital market products where there are active buyers and sellers, where confidentiality is critical to market efficiency and fairness, but where information can sometimes be stolen and exploited.

The importance of confidentiality – and its corollary in well-designed rules of disclosure – carries through to the infrastructure of financial markets and how they compete globally. This includes the market for crypto-currencies, with blockchains and crypto-exchanges supposed to deliver transparency in *transactions* paired with non-disclosure of *transactors* on the exchanges. But only up to a point. Nobody likes to be cheated, and since cheating almost always depends on financial secrecy, transaction venues that are more transparent should gain at the expense of those that are more opaque and potentially vulnerable to crypto theft.

This study applies a consistent and logical framework for thinking about financial secrecy in the contours of the modern financial system including a rise in governments' use of trade and financial boycotts and sanctions and related tools of foreign policy which require financial secrecy and create profitable opportunities to evade and avoid. Adding them up today – including targets of sanctions like North Korea, Russia and Iran – suggests a vibrant global financial secrecy market for that reason alone.

Anecdotal and case-based evidence suggests that secret financial holdings and flows – along with efforts to control them – have grown in importance in recent years. Credible evidence on the dark economy is not normally available. It has to be patched together indirectly, either using disclosed transactions that just don't add up, or from periodic leaks that hint at the overall clandestine market size and some of its attributes. Survey and other observations can be drawn from the OECD, the lead international organization on this issue, from Transparency International as the best-known NGO in this area, and a few other active sources of evidence on size and scope of confidentiality-

driven funds flows and financial holdings. Much of the rest is anecdotal which spreads through the Internet almost instantaneously and accepted as fact by those down the line. Even the best available data has to be used with care. Reaching credible conclusions about financial secrecy is treacherous business.

In this short volume we consider financial secrecy as a “product” or “service” that has value and is transacted in organized and unorganized markets around the world. No surprise: Those markets center around demand and supply. Secrecy demand is based on the “disutility” – negative consequences - of financial disclosure. Secrecy supply is based on the effectiveness and availability of various instruments and techniques that can successfully impede financial disclosure. The “price” or “cost” of those techniques can then be identified in the fees, margins and additional risks that accompany financial secrecy compared to financial techniques and products lacking meaningful protection from disclosure.

There are also “agency” and enforcement problems in the presence of financial secrecy, with examples from tax evasion, smuggling, trade in controlled substances and weapons, evading currency controls, undermining trade and financial embargos, evading blacklists and more. This is a never-ending cat-and-mouse game, with serious economic consequences. But financial secrecy can also prevent a lot of harm under adverse conditions like political oppression and systemic corruption.

The intent here is to put forward a sensible and useful guide to thinking about confidentiality and transparency issues in global finance. We argue that this framework can be useful in explaining

the behavior of people active in the murky market for financial secrecy, and reflected in the behavior of individuals, business enterprises and countries active in the supply of financial secrecy, civil and criminal enforcement activities, and financial flows across sovereign and regulatory jurisdictions

This book is not a “how to” manual, although it may give some people ideas – the word has it that my much earlier book (1985) on the subject sold surprisingly well at Heathrow Airport in London. But it but also boosted the volume of discarded reading material upon landing at JFK Airport in New York – especially in First and Business Class. I repeat: This is not a “how to” manual.

Ingo Walter, New York City, 2025

# Chapter 1

## How to Think About Financial Secrecy

Modern finance thrives on transparency and efficiency. Both help minimize the gap between returns earned by ultimate savers (people who abstain from current consumption to provide for future consumption), and the all-in cost of funds that faces investors and current consumers in the real economy. Everyone is looking for a good deal. They have plenty of financial products and competitors to choose from. The many channels that perform this financial intermediation includes banks, nonbank financial institutions (shadow banks) specialized lenders of various stripes – even loan sharks. As a composite, this amalgam of financial intermediaries and their respective markets are usually called the “financial architecture.”

The greater the efficiency and the more innovative the financial architecture, the larger will be its contribution to real income and economic growth. These are often described as “static” and “dynamic” efficiency benefits, respectively. “Static efficiency” means getting funds from savers to investors in ways that drains as little in the way of intermediation costs as possible. “Dynamic efficiency” means the financial system is continuously innovative in getting new financial processes and products to market in ways that add value for the end-sources and end-users of finance. Static benefits boost an economy’s *level* of real output and income. Dynamic benefits accelerate its *rate* of growth.



All good. But high sustainable performance of the financial architecture needs one more thing – stability, or “robustness.” Shocks originating in the domestic or international financial system, or in the real economy, are an ever-present threat. Big ones include the 2008 Global Financial Crisis and the onset of the Covid pandemic in 2020. They can strike at any time, for all sorts of reasons.

When they do, the financial system may propagate and even amplify those shocks across the economy, sometimes justifying the overused term “financial crisis.” Systemic shocks, along with the daily exposure of ordinary people to the financial system, underlies “safety and soundness” as another key objective in the contours of the financial architecture. What’s ultimately needed is a financial design – one that balances efficiency, growth and stability.

There are tradeoffs. New financial instruments can destabilize financial systems in unforeseen ways. Regulatory buffers can impair efficiency in ways that reduce financial efficiency. So there are endless debates on the regulatory options among people with high stakes and strong opinions which echo in the halls of political power.

Put another way, regulation that is ultimately intended to serve the public interest by reducing financial instability invariably generates costs and benefits. It “subsidizes” the system by reducing contagion, systemic risk and disorderly markets. It “taxes” the system by imposing constraints and mandates that make it less efficient, and possibly less dynamic as well.

For example, financial regulation often requires tradeoffs and liquidity “buffers” to protect financial intermediaries and end-users against systemic shocks. Capital buffers mean less capital can be used productively to finance assets. Liquidity buffers mean that more of those assets have to be held in cash or highly liquid assets. Both put a drag a on the financial efficiency and profitability for investors. It may also subject financial intermediaries to onerous and expensive reporting requirements, require “stress testing” financial firms’ viability under adverse conditions, applying “fitness and properness” standards to board members, managers and employees, and prohibiting or limiting certain financial products or practices thought to carry excessive systemic risk - or violate fairness in financial practices.

There are many ways of de-risking the financial system, but there are no “free lunches” – measures promoting robustness and fairness tend to extract a cost in terms of the system’s efficiency and dynamic attributes. It’s not hard to over- or under-regulate – over-regulation imposes a drag on static and dynamic efficiency and an “opportunity cost” on the economy. Under-regulation allows the sources of future problems to grow in the shadows and surface only after it’s too late.

The trouble is that both sides of this balance are hard to measure in trying to come up with an “optimum” financial regime that is demonstrably and sustainably in the public interest. You can’t run the world twice. Lobbyists and other influence peddlers - many of them ex-bankers, lawyers, financiers and some regulators - usually push for deregulation, armed with charts showing measurable regulatory costs and downplaying the (unmeasurable) risks of financial failure that hasn’t happened yet. The opposition comes

up with potentially disastrous consequences of regulatory failure for the general public who will ultimately have to pick up the pieces – especially the disadvantaged, leaving nary a dry eye in the house.

## **Asymmetric Information and Interpretation**

Once in a while, there's an episode that refocuses on this balance and merits retelling such as the 2023 banking crisis, which centered on Silicon Valley Bank and First Republic Bank in California. No financial secrecy other than conventional banking confidentiality. Ordinary banks competing with ordinary rivals for ordinary business under ordinary banking regulations. All doing pretty much the same thing in the same attractive banking market, so that just about nobody suspected a Great White shark gliding just below the surface.

In retrospect, the local banks (and many others) had made a terrible mistake by loading-up on fixed-rate ("safe") long-term government bonds or high-quality "jumbo" fixed-rate mortgages to prosperous families, funded by low-rate deposits that largely exceeded the \$250,000 maximum covered by the Federal Deposit Insurance Corporation (FDIC) – founded in 1933 specifically to prevent bank runs.

The banks had a hidden-in-plain-sight problem that the Medicis might have recognized in 15<sup>th</sup> Century Florence, during their heyday. Short-term retail deposits were being used to fund higher-rate long-term assets like government bonds at a time US monetary policy was tightening to combat incipient inflation. Long-term asset prices would therefore soon be falling even as short-term

funding costs would have been rising. It took a while for depositors – many of which were represented on both sides of the banks' balance sheets - having mortgages outstanding alongside demand and savings deposits at the same or similar banks.

No immediate problem with the mortgages, but many of the local banks' retail and business clients had a lot more than the FDIC-insured \$250,000 on deposit with these same (mostly mid-size) banks. And so their deposit clients pulled out at the first sign of trouble – “run first, ask questions later.” They ran, sometimes physically but mostly electronically, with bank withdrawal transactions confirmed within minutes.

“Run first” is the golden rule of bank panics, after all. Time enough later on to see what the problem was. If it's a solvency problem (bank assets worth less than its liabilities) or a liquidity problem (not enough cash on hand to make good on withdrawals) is confirmed, the early runners are already out the door. If no problem, the transaction can always be reversed at no cost whenever it's convenient. But it's important to be among the first to smell a rat and beat the other guy to the bank.

It turned out there was indeed a problem in spring 2023. As just noted, the inflationary environment (initially described by the Federal Reserve and the US Treasury as “transitory”) was so serious as to require equally serious tightened monetary policy, with markedly higher “policy” interest rates set by the Federal Reserve. So the value of bank assets booked at the Fed's previously low policy rates plunged, threatening to exceed the banks' capital buffers, then exceeding deposit insurance limits, and ultimately threatening big losses for uninsured depositors.

Predictably, depositors holding more than the \$250,000 FDIC insurance limit ran for the hills, often with only a few clicks on their smartphones. The “run” was on. In the end, the Fed bailed-out the most heavily affected banks and the FDIC extended its insurance to all depositors, no matter how large.

Even at regional banks that had not previously been thought of as “systemic,” the power of contagion added a new systemic element. Everybody knew about the five or six “too big to fail” US banks. But the US had well over 5,000 commercial banks and savings and loan associations at the time. Next came withdrawal requests at regional bank as far away as Maine (catering to local mortgage lending and small businesses in the fishing, forestry and construction industries) because of a news flash about troubles at a regional bank in California catering to tech entrepreneurs and start-ups. This was not just a hypothetical example of the power of financial contagion including the omnipresence of “moral hazard” – privatization of returns and socialization of risks.

Key lessons from 2023? Re-learn the basics of interest rate risk and liquidity risks, and the dangers of the “carry trade.” If the same thing is trading at different prices that can’t be explained by transaction costs (in this case otherwise identical US government bonds valued at different prices on bank balance sheets, depending on whether the bank defined them as “available to trade” or “held to maturity,” something is definitely wrong and can lead to a world of hurt.

Another lesson? Systemic risk is not confined to whales - sardines like to move in huge shoals for self-protection. But they also create big mouthfuls for predators. Financial regulation is indispensable,

and it has to be done right in the face of complex economic and political pressures.

It's not often that financial crises crop up in national economies, and there are plenty of buffers to try to prevent them – internationally if needed. But they always exist, and those with significant wealth are always on the alert. Think of the bunny sitting bolt-upright in a field of clover, ears straight, trying to sense danger from all directions. There's a reason for the high fertility rate among rabbits - and for the design of rabbit holes - and for the need for secrecy they inherently reflect.

## **The Dark Side of Finance?**

Transparency as an objective in banking and finance is an important component of social welfare as the overarching objective. But it is not a sufficient condition, as the 2023 California banking crisis just demonstrated. And things get much more complex when there are limits to transparency, which introduces the role of confidentiality and financial secrecy.

Financial confidentiality -- involving intentional non-disclosure of financial information concerning individuals, firms, financial institutions and governments – is the polar opposite of transparency, yet it is an integral part of the market for all banking and financial services, fiduciary relationships, and regulatory structures. As such, confidentiality is also a "product" or "service" that has intrinsic value, and that can be bought and sold separately on its own or in conjunction with a range of other financial transactions.

But on the dark side of finance, non-disclosure is imbedded in an array of activities that cause damage to society. It is integral to property theft, bribery and corruption, extortion, tax evasion, money laundering, evading national currency policies, and host of other impacts that can generate social damage. This is not to ignore the possibility that financial secrecy may also help countervail bad public policy or intolerable social conditions by making them less damaging and less sustainable.

Like any commercial service in the economy, financial confidentiality operates in a distinctive “market.” There are those who think they need it and are willing to pay for it. The more they need it, the more they are willing to pay. There are also people and institutions as well as countries who are in a position to provide protection from disclosure both of financial flows and stashes of accumulated assets, and want to use this to sell services that impede financial disclosure. The tighter the secrecy, the higher the price. As always in economics, the roots are in demand and supply. And that spells “market.”

## Chapter 2

# The Demand for Financial Secrecy

Financial secrecy has no doubt existed since the dawn of “money” as a means of payment and a store of value. The risk of theft is reason enough to try to prevent disclosure and help deliver security, so primitive techniques to avoid disclosure gradually evolved into limits to financial insight built into all modern financial systems. They enable personal and commercial transactions that would be impossible between buyers and sellers in totally transparent markets. You bid. I ask. Maybe we meet somewhere in the middle and we both gain. Financial disclosure rules are anchored in custom, law and regulation of trade in merchandise, land, services, labor, capital and of course knowhow.

In finance, owning a deposit account in a commercial bank or other depository institution comes with protection from insight by others. unless specifically authorized. Same with brokerage accounts and in the details of financial transactions ranging from mortgages to foreign exchange. If lack of insight impedes public prosecution in the administration of justice, for example, court orders are usually required to force financial insight.

Here’s where the microeconomic concept of “utility” becomes relevant. People derive satisfaction from consuming across a broad spectrum of goods and services, or enabling others to do so like family and friends, religious and charitable organizations, or collective entities like political causes. This covers the “utility” of non-revelation of financial affairs. At the extreme, some would



argue that financial privacy should be considered an important element of human liberty.

There are many motivations for wanting financial confidentiality, so it's logical that different groups of people would be willing to pay for assured non-disclosure of financial information. Here are some examples:

Personal financial confidentiality usually stays in substantial compliance with applicable laws and regulations and in many places it has been well-served by long-standing traditions of banking confidentiality. Even within the confines of a family, damage from unwanted disclosure of financial matters may trigger tensions across generations, familial disputes and recriminations, acrimonious divorce settlements and the like. Think about what happens when spendthrift Gen-Z kids find out what their thrifty Gen-X parents are *really* worth – in some families, stand back and watch the sparks fly.

Business financial confidentiality involves withholding financial information from competitors, suppliers, employees, creditors and customers. Release of sensitive information is tightly controlled and, where possible, in a way that benefits the enterprise. Financial information is proprietary. It's capitalized in the value of a business to its shareholders. But it doesn't preclude internal conflicts among business partners or shareholder groups.

Tax evasion is a classic source of demand for financial confidentiality. Some people are exposed to high levels of income taxation. Others are hit by confiscatory wealth taxes or death taxes. Still others feel forced by high indirect taxes or quasi-taxes like price

controls to escape into the underground economy. And there are those who think the only "fair" tax is zero.

Tax evasion requires varying degrees of financial confidentiality to work, and needs to be distinguished from "tax avoidance" which remains in compliance with the tax code and is fully disclosed to the tax authorities – yet takes advantage of any loopholes or other legal tax wheezes. The gray areas have given rise to the term "avoision" and sent many a tax lawyer's kids through university.

Crooks and Criminals, such as drug traffickers, not only accumulate large amounts of cash, but regularly deal in a variety of financial instruments and foreign currencies. The same can be said for arms dealers, terrorists, and organized and unorganized crime - robbery, burglary, theft, prostitution, kidnapping, loan sharking, protection, extortion and other rackets. Some have now taken hold in cyberspace - like stealing from client accounts on crypto exchanges and a bewildering array of Internet scams. Some of the customer losses have been mind-boggling and heartbreaking when the victims are senior or handicapped. Plus "Club Fed" style of incarceration of miscreants has often been subject to ridicule. Crime invariably requires ways of laundering proceeds and eliminating paper trail with financial secrecy needed at every turn.

Capital flight normally refers to bad news involving risks and expected returns associated with portfolios of assets associated with a particular country. Often it's enough to trigger redeployment of assets abroad. Again, it may make sense to flee first and see what happens. That simply reflects conflicts between the objectives of asset holders (domestic or foreign) and

governments. Capital flight may or may not violate laws and regulations but is invariably considered dysfunctional by the authorities. So capital flight is sensitive to disclosure and usually worth keeping in the dark.

Graft and corruption invariably require financial secrecy. Public policy gets displaced, winners and losers are created outside the established political process, wealth is reallocated and - maybe most important - people's confidence in the political system is undermined. Think about elected Parliamentary or Congressional representatives trading in shares of companies their committees regulate – 2023 insider trading scandals in the US Congress and the EU Council of Ministers attracted only moderate outrage. Even in the best of circumstances, “where there's politics there's campaign finance,” which in turn opens the door to the need for secrecy. And in some places, everyday business, politics and life itself is virtually unthinkable without graft.

There are of course perfectly legitimate reasons to seek ways of avoiding financial disclosure. Examples include residency in multiple countries; the desire to diversify investment portfolios, ownership of a business that is itself international, concerns about home-country macro- and currency-stability, political risk, tax avoidance, concerns about kidnapping, and keeping assets out of the reach of family members, business partners and creditors making spurious claims. All of them are concerns that give rise to a demand for financial secrecy.

Alongside money flows motivated by everyday confidentiality considerations like these is the need for clandestine asset holdings and flows that generate sometimes serious social costs. This

includes the market for controlled substances, smuggling, human trafficking and kidnapping, trade in endangered species and human organs, global arms dealing, funding terrorists, hiding graft and corruption on both sides of the transaction -- plus arguably the largest of them all, tax evasion.

In short, avoidance of damage is what the confidentiality-seeker is after. Since damage usually is a matter of probabilities, the attitude toward the risk of exposure is a critical factor in how this benefit is valued. Conventional financial confidentiality imbedded in bank and securities accounts and other evidence of property ownership provides some degree of protection against unwanted insight, which may well be sufficient.

But when it comes to legal and enforcement matters it may not be enough, and higher (and probably more costly) secrecy levels may be needed for additional protection from disclosure. At the limit, corruption on the part of senior government officials can be publishable by death, a powerful motivator for seeking financial confidentiality.

Terrorist finance is another malevolent use of financial secrecy with potentially enormous negative spillovers. Even the most horrific terror strikes are not very expensive, so that the necessary financial flows are relatively easy to hide. It has been estimated that the most horrific terror strike in history, the World Trade Center attack of September 20, 2001, in New York City, cost only about \$100,000 to execute, including targeting costs, training, travel and other expenses. Of the 2,700 people killed in the attack. Financial secrecy was obviously at the center of this horrific crime, and its attributable follow-on costs in terms of the Middle East

“war on the terror.” If the \$100,000 estimate is correct, the cost of absolute secrecy must be considered infinitesimally small compared to the present value of the damage costs – and there must have been impossible search costs in looking for the financial needle in the haystack.

A less virulent need for financial secrecy is to support militancy and protest which has spread around the world in response to global events to be militant about. Chinese around the world worry as Beijing tightens its iron grip on Hong Kong and its Security Law leads to arrest and imprisonment (or exile) of protestors, expanding the range of protest over the fate of the Uyghurs in Xinjiang, Tibet.

Protests flare up regularly over Myanmar and its treatment of the Rohingya and other minorities conditions in their Bangladesh exile. Then comes the Russian invasion of Ukraine and its waves of refugees. Not least is the Israel-Gaza war with its diaspora on both sides spreading the conflicts in the United States, Canada and Western Europe. Add places like West Africa, Kashmir, Cuba, Haiti and Nicaragua and it sometimes seems like only authoritarian states like Russia, China and North Korea can keep the lid on the pot and add their own toxic ingredients to the brew. And none of these are countries that refugees from political and economic misery are clamoring to get into.

All such conflicts have their sympathizers around the world, some of which is transparent, such as support for Israel in the United States or Europe, and some is politically exposed and therefore requires “charities” and other less transparent structures or cash transfers that are best not revealed.

Cryptocurrencies have become another vehicle for conflict-related finance. Seizure orders issued by Israel designed to interdict monetary resources to Hamas, Palestinian Islamic Jihad and Hezbollah pulled several hundred million dollars from suspected crypto accounts. Given the volume of weaponry the Gaza-based forces were able to throw at Israel in the early days of the war – and the persistence of the effort against the Israeli Defense Forces (IDF) backed by massive US-supplied war materiel -- the secret money (including long-term financial flows to harden Gaza defenses) must have been both impressive and sustained. Some of the funds openly solicited donations from individuals and organizations directly deposited in bitcoin accounts, bypassing crypto exchanges' transaction safeguards.

The Israeli response included requests to crypto exchanges, notably Binance, the world's largest, to seize suspected account assets. The identifying real owner of crypto assets tends to be a show-stopper. Besides crypto, currency notes in the hundreds of millions of dollars (including Iranian cash support) reportedly were physically transported into Gaza from Egypt.

Consider at a narrower level the US case of political consultant, lobbyist and former Trump presidential campaign chairman Paul Manafort and his business associate Rick Gates. Both were indicted on multiple charges arising from their consulting work in Ukraine for the pro-Russian government of Viktor Yanukovich before his flight to Russia in 2014. Additional charges were filed in 2018 for obstruction of justice and witness tampering. Funds had been paid to accounts in Cyprus, a favorite offshore center for wealthy Russians, and from there transferred to offshore accounts in St. Vincent and the Grenadines in the Caribbean – ultimately destined

for Manafort's real estate transactions in New York and Virginia - as well as an array of luxury purchases.

Pardoned by President Trump in his first term, Manafort was newly charged with 16 counts related to mortgage fraud, conspiracy and falsifying business records. Manafort was eventually sentenced in Virginia to 47 months in prison on financial fraud convictions and ordered to pay \$24.8 million in restitution.<sup>1</sup> He was pardoned again during President Trump's second term.

That's nothing compared to the case of Jang Song-thaek, uncle of North Korea's dictator Kim Jong Un, who pushed to the limit his nephew's tolerance in various money-making projects without maintaining adequate layers of secrecy. He was last seen publicly bundled from a meeting of the Political Bureau of the Central Committee of the Workers' Party of Korea in Pyongyang - reportedly facing a firing squad of anti-aircraft guns the next day.<sup>2</sup>

Given the array of motivations underlying the demand for financial secrecy, is there a common thread that runs through many of them?

Market frictions like taxes, currency controls, interest-rate controls, price controls, tariffs and other trade barriers inevitably give rise to economic incentives to avoid or evade them. These "parallel"

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<sup>1</sup> Sharon la Franiere, *"Paul Manafort's Prison Sentence Is Nearly Doubled to 7½ Years," New York Times, March 13, 2019.*

<sup>2</sup> <https://www.nytimes.com/2016/03/13/world/asia/north-korea-executions-jang-song-thaek.html>

markets are often very narrow and inefficient. They can also be highly profitable for those on the inside.

The same is true of public procurement that is not open to competitive bidding, awarding permits to do business, and administration of health and safety standards. Parallel markets can even develop for police protection and other public services, as well as the enormous market for controlled substances. The symptoms are familiar enough - smuggling, thriving domestic and cross-border black markets, organized and unorganized crime, tax evasion, bribery and corruption of public officials. All are ultimately traceable to regulation-induced market inefficiencies, whether or not well intended, that can throw off enormous amounts of illicit cash.

Tapping into such market inefficiencies logically means finding the most heavily distorted economies or sectors and then ferreting-out viable ways to do illicit business in them. Among the obvious choices have been developing countries bent on pursuing what end up as misguided macroeconomic policies and reliance on direct economic and financial controls (often with heavily overvalued currencies) where public and private transactions can be undertaken far removed from transparent markets. Bribery and corruption have always thrived in such environments because market inefficiencies generate more than enough profits to cover high transactions costs and generate eye-watering profits.

Nor are market distortions confined to heavily controlled economies. They exist as well in economies organized along free-market lines. Taxation is rooted in the need to finance public expenditures. Specific products like cigarettes and alcoholic



beverages may be heavily taxed for revenue purposes and to discourage their use – although these two objectives are themselves in conflict. Regulation of other aspects of economic life ranges from pollution control and the number of taxis permitted on city streets all the way to assuring bank safety and soundness.

Regulatory constraints exist even in the most free-market economies to cope with market failures as well as moral hazard, adverse selection and social costs. Regulation exists, perhaps, to achieve greater equity among groups in society even at the cost of economic efficiency. Among them is a range of activities defined as criminal.

Still, banned or restricted activities continue to be carried out in organized and unorganized fashion as long as there is demand - even against the risk of arrest and punishment - through what are often highly sophisticated channels renowned for their market imperfections and extreme profitability. So the kind of financial confidentiality required to make underground transactions work in highly distorted economies can also be associated with distorted sectors of basically market-oriented economies.

In short, even a cursory scan of the state of play among the world's economies suggests a vigorous demand profile for avoiding financial disclosure and assuring financial secrecy. As with any product or service that is perceived to have value, this demand will be supplied by a range of financial services.

## Chapter 3

# The Supply of Financial Secrecy

As with the demand for financial secrecy, the supply of secrecy-oriented financial services stretches across a complex network of intermediaries, conduits, and asset classes that provide varying degrees of safety from unwanted disclosure. Supply dimensions can be classified into “onshore” and “offshore” financial or physical assets (held either onshore or offshore), as well as cryptocurrencies and associated “virtual” assets.

### **Onshore**

*Onshore financial assets* include bank deposits and certificates, cashier's checks, equity shares as well as bonds and notes of public or private issuers. All normally yield "market" rates of return, yet provide the asset holder with some degree of protection from unwanted insight.

Banks and institutional asset managers can often make use of clients' personal information internally and by their affiliates for business purposes, as well as externally for marketing their services. This use of personal information usually cannot be limited by the client – although in the US bank affiliates' use in clients' confidential creditworthiness information can be restricted.

Domestic financial confidentiality usually has its limits, even in the ordinary course of business. Holdings of physical assets is also popular – it is estimated that a significant slice of Manhattan

luxury residential floorspace is owned by non-residents, much of it unoccupied, often through shell companies.

Beyond regulatory and management insight, traditional practice in most countries provides for confidentiality in the case of “unauthorized” inquiries, which generally gives adequate shielding for most “personal” and “business” needs for confidentiality. Once the law gets involved however— either in civil, tax or criminal matters – much of that protection is lost.

Under proper legal procedures, the state can force disclosure in the event of divorce proceedings, creditor suits, inheritance issues and tax cases, and of course in criminal proceedings.

In addition to currency notes in secret hiding places, a certain amount of added domestic protection can sometimes be obtained through certificates of various types. These are IOUs payable to “bearer” and can circulate like cash as long as people trust the issuer and can cope with the risk of theft, loss and accidental destruction.

“Beneficial” ownership can be secured by placing assets in the name of friends, associates or family members, which may create an additional layer of secrecy assuming the collaborating “third parties” can be trusted and can tolerate the law enforcement spotlight when it comes to fall on them. Legitimate business “fronts” and “shell companies” may also be part of the process of rechanneling tainted funds into the financial mainstream.

## Offshore

Foreign financial or real assets may offer a good deal more confidentiality than is available at home. National sovereignty halts at the border. Extraterritorial investigation outside a secrecy-seeker's home country normally requires disclosure terms that are carefully and often reciprocally negotiated between governments.

Smuggling of cash internationally can be big business. In one reported case the problem was how to launder currency notes originating from illicit transactions – either the transactions themselves or the evasion of taxes on legitimate activities – accumulated in the UK to be sent to the UAE for laundering into a legitimate form of payment.<sup>1</sup> The UAE had no restrictions on imports of foreign currencies, and the UK had ineffective controls plus reporting requirements on currency exports that were easily ignored.

In one case seven densely packed, heavy suitcases of currency notes (probably mostly US dollars and euros) were checked-in as baggage on an Emirates flight from London Heathrow to Dubai by two young ladies. With Heathrow luggage X-ray calibrated to identify safely threats, not paper currency, the suitcases were loaded in the Emirates aircraft cargo hold. Their airfares (in Business Class to take advantage of higher baggage allowances) was paid by a UK “laundry broker” who in turn had charged his laundry customers a significant fee for the service - and who presumably had much to lose from disclosure.

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<sup>1</sup> Margot Patrick, *Dirty Money Flies Under the Radar At World's Busiest Airports*, *Wall Street Journal*, 22 April 2024.

At the other end, the luggage passed UAE customs in Dubai seamlessly and went on to the actual launderer who exchanged the foreign banknotes for local currency (AED) or other liquid assets that soon blended into UAE banking and other legitimate payments flows. Both ladies were provided with “document courier” identification papers, just in case, and were armed with a story that the bags contained a lot of fashionable outfits because “...I didn’t know what to wear” in Dubai.. They then returned to Heathrow the next day with the empty suitcases – this time in Economy Class.

Heathrow and Dubai are the world’s largest long-haul airports, providing plenty of cover, with few outbound checks at the UK origin or inbound checks at the UAE destination where currency inflows are perfectly acceptable. An estimate of such transactions worldwide comes in at roughly \$2 trillion.<sup>2</sup>

One of the characters in this story, the Dubai launderer, was later arrested with \$9 million in gold on the island of Zanzibar. The UK launderer had charged about 10% of the shipments’ value for his services and did about \$17 million of transaction in the four years prior to his arrest in 2021.

He later entered a guilty plea involving a seven-year jail sentence and around \$5 million in asset seizures. The ladies received suspended sentences. In their defense they argued that Emirates and Heathrow Airport were at fault because of inadequate anti-

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<sup>2</sup> Ibid.

money laundering defenses including CT luggage scanners - as well as “corruption and politics.”

Bank deposits may be held abroad, ideally in tax-haven jurisdictions. Foreign equities and debt instruments held in custodial accounts abroad can also provide security against disclosure, although the secret holdings may be subject to local tax - plus the risk of negotiated disclosure at the request of the home country.

Bearer certificates, beneficial ownership and foreign shell companies may provide added protection and can increase the complexity of any future paper-chase. The confidentiality features of foreign jurisdictions are of critical importance, best evidenced by the country’s history, traditions, economic condition and proneness to corruption.

Some of the foreign centers of confidentiality are “booking” centers ranging from Miami (notably for Latin Americans) to London, from Singapore to Panama, the Cayman Islands to Luxembourg. Some provide substantial exemption from domestic taxation as well.

A recent study found that American taxpayers hold around \$4 trillion in foreign accounts, almost half in jurisdictions usually considered tax havens. This represents a steep income gradient, with more than 60% of individuals listed in the top 0.01% of the US