What lies beneath: evidence from leaked account data on how elites use offshore banking

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Introduction

Governments around the world struggle to observe what wealth their citizens hold overseas. This creates problems both for tax enforcement (you can't tax what you can't see), but also corruption (you can't observe that your president is actually a lot richer than he/she appears).

This information asymmetry is amplified by the presence of tax havens: jurisdictions with low tax rates, high levels of financial secrecy and legal systems that make it easy to set up 'shell' companies - firms with little to no economic substances created for the purpose of holding assets.

These factors makes tax havens a popular destination for offshore wealth and recent research suggests that much of this wealth 'illicit' in nature: deposits in havens increase when developing countries receive large aid disbursements or petroleum-rents (Andersen et al 2017; Johannesen et al 2020), yet they fall whenever havens sign agreements to provide information to foreign tax authorities (Menkhoff and Miethe 2019).

Research question and contribution

Despite an explosion of research on the role of tax havens in both tax evasion and corruption, very little is known about the characteristics of clients of banks in tax havens.

This descriptive paper uses leaked data from an offshore bank to understand who stores their wealth in havens, how those with politically connects differ in their wealth and behavior, and how the use of shell companies affects our ability to accurately measure offshore wealth. It is the first paper to do so using micro data taken directly from a tax haven, making it possible to observe behavior that is normally partially hidden in aggregate statistics.

Data in detail

In late 2019, Phineas Fisher, a hacktivist, hacked into the Cayman National Bank, Isle of Man (CNBIOM) and copied several network hard drives and provided the information to Distributed Denial of Secrets, a Wikileaks-style journalist collective, who posted them online. Included in the leak was transaction data for every account spanning 2008-2019, the jurisdiction of residence for every client and estimates of their net worth as calculated by the bank. Importantly, the leak not only included the location of companies (and trusts), but it also included information on the where their ultimate owners were based.

In total, for the period 2008-2019, the bank opened accounts for approximately 2,400 active clients (those who maintained non-zero deposit balances) of which 50% were companies, 33% were trusts and 16% were individual clients. At its peak, the bank maintained roughly $200m in deposits. However, adding up the peak account balances of each of the clients over the 11 year period indicates that these 2,400 controlled up to $1.5b in assets over this period.
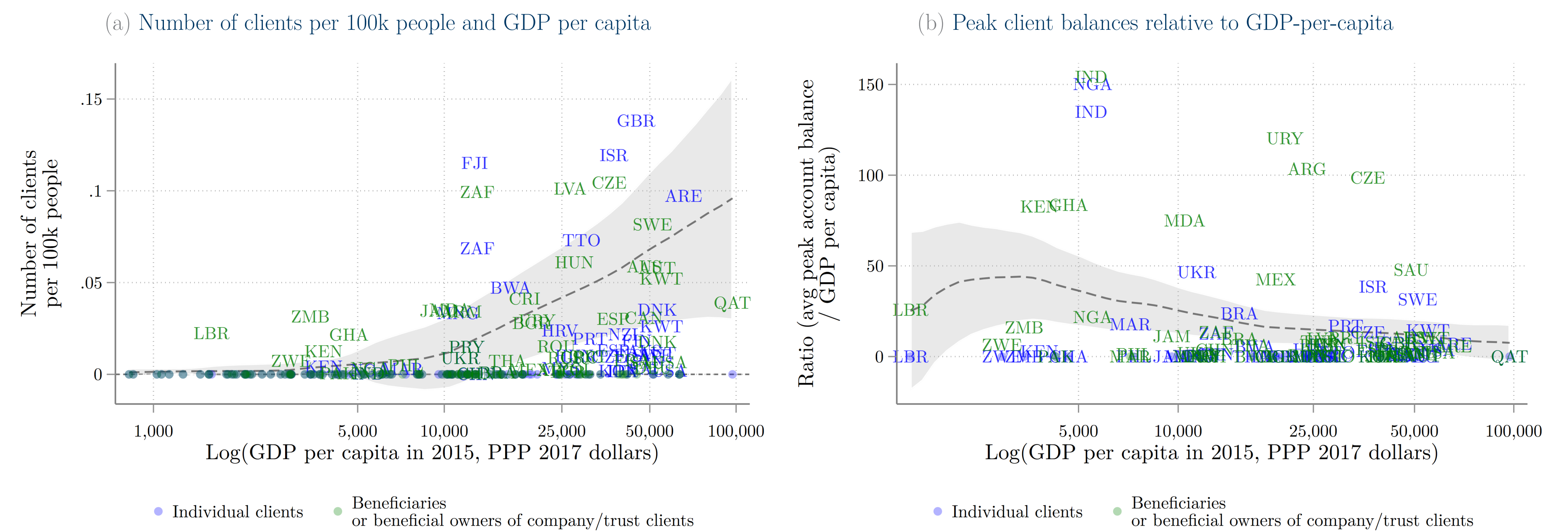
Also included in the leak were the bank's internal documents on 'politically-connected persons' (known as PEPs), individuals who were or had connections to people with politically power, which I merged with the client data in order to compare activity of those connected to PEPs to both ordinary offshore clients and other 'high profile' clients (mostly celebrities). Finally, the leak included quarterly submissions by the bank to the Bank of International Settlements (BIS), which are used by the research community to collate measures of offshore wealth, allowing me to observe precisely how the bank assigned ownership of its customers deposits to different jurisdictions.

Conclusion and Next Steps

- This paper highlights that the average offshore client is rich, and that a significant amount of deposits are controlled by political elites who engage in behavior consistent with hiding their ownership of wealth.
- It also shows the degree to which this behavior - in particular the use of shell companies - complicates our ability to correctly measure offshore wealth. Changes in BIS reporting requirements would help correct for this mismeasurement.
- Transparency policies, such as automatic-exchange-of-information (AEOI) on offshore deposits, as well as beneficial ownership (BO) registries, should help governments break through some of the information asymmetries that they face.
- **Next steps:** this project will examine the impact of information exchange and other cross-border tax policies on the behavior of offshore customers

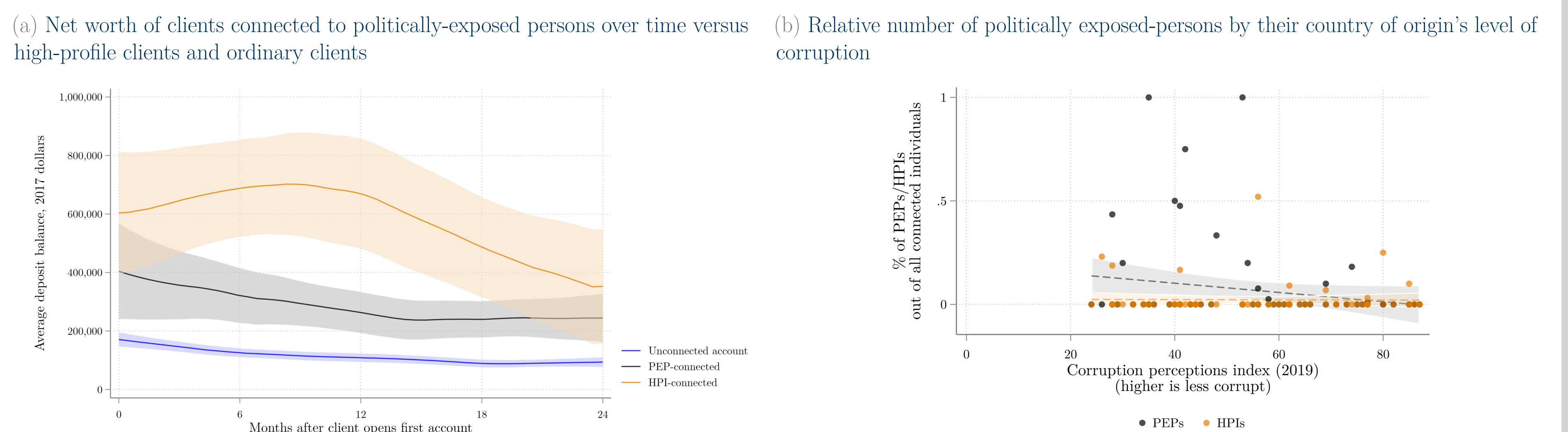## Result #1 - offshore banking remains an elite activity

The clients of offshore banks come predominantly from rich countries (Fig a), but those from poorer countries have higher levels of offshore wealth relative to GDP per capita (Fig b). Clients from poorer countries are more likely to hold wealth in the bank through a shell company or trust (those marked in green) than under their own names (marked in blue), highlighting the need for information exchange and other transparency policies that allow developing country governments to better observe hidden wealth.

(a) Number of clients per 100k people and GDP per capita

(b) Peak client balances relative to GDP-per-capita

Note: Author's estimates from account date. Figure (a) shows the total number of individual clients (in blue) or beneficial owners (in green) per 100,000 people per country, graphed against log GDP per capita. For Figure (b) I calculate the peak end-of-month deposit balance (excluding loan and investment accounts) per client in 2017 dollars, average them across jurisdictions, then divide it by GDP per capita to derive the average deposit-to-income ratio, which is shown on the y-axis. Both figures show the local polynomial estimate of this relationship, with 95% confidence intervals.

Result #2 - politically-connected clients control more wealth and use tax havens more intensely

Clients that the bank had identified as being politically connected (i) controlled roughly 100-200x more in wealth, (ii) were more likely to be based in tax havens, and (iii) were more likely to send/receive money from accounts in tax havens. More politically-connected people were identified from countries that had scored worse on measures of corruption perceptions. The 'political premium' that exists in other contexts appears to also exist in the offshore world. Systematic reporting on politically-connected accounts to regulators might limit the scope of abuse.
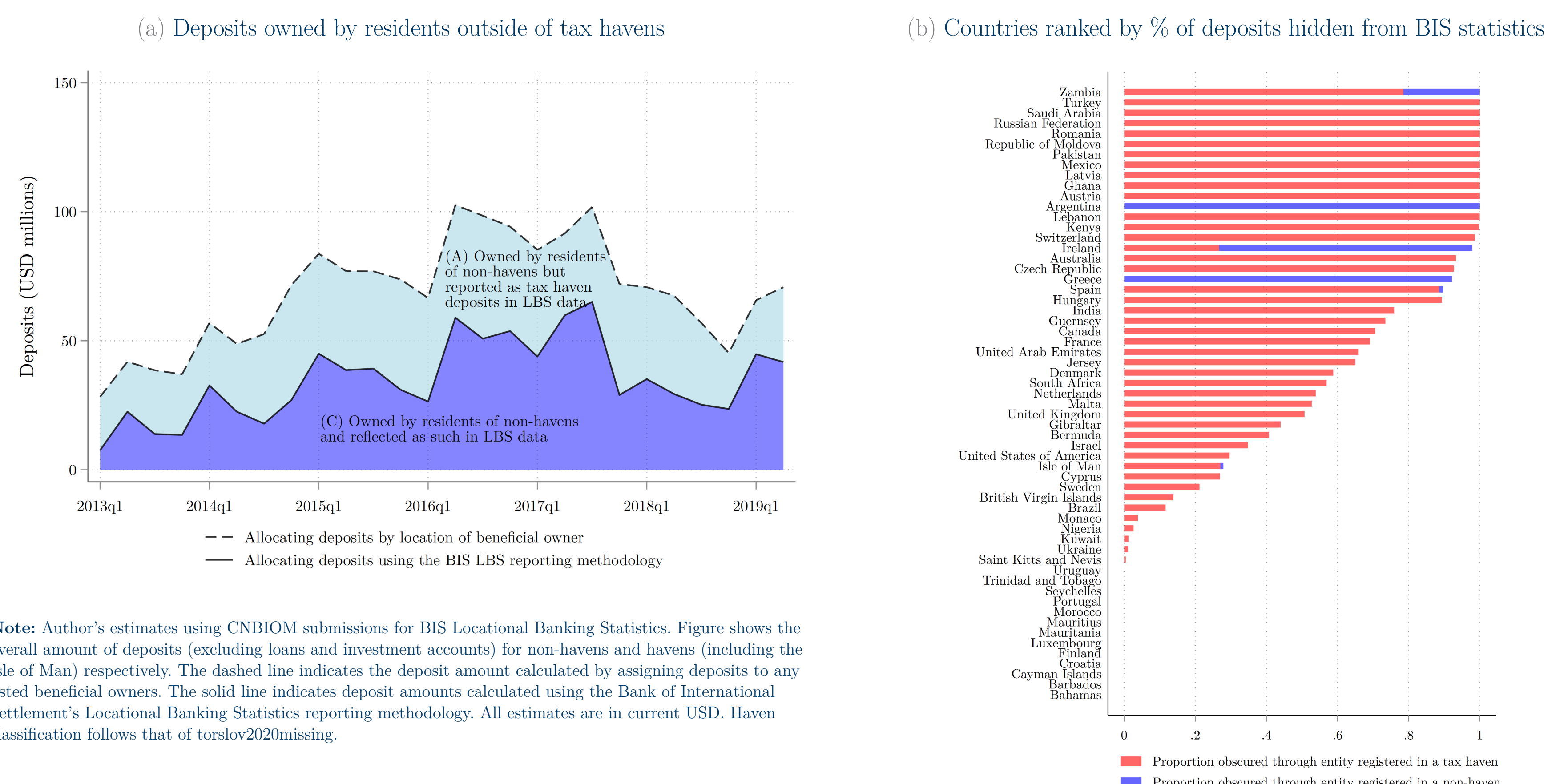

(a) Net worth of clients connected to politically-exposed persons over time versus high-profile clients and ordinary clients

(b) Relative number of politically exposed-persons by their country of origin's level of corruption

Note: Figure shows local polynomial estimate of the net worth of the bank's clients who are connected to a politically-exposed person (PEP), high profile individual (HPI) or not connected. 95% confidence intervals shown. The sample is restricted to clients who maintain accounts for at least 24 months, and is indexed relative to the month the account was first opened. All amounts are shown in 2017 USD.

Note: Author's estimates. Figure shows the relationship, by country, between the proportion of customers and PEPs or HPIs connected to the bank who are PEPs (or HPIs) and that country's Corruption Perceptions Index (CPI) score from 2019. Local polynomial estimates with 95% confidence intervals are also shown.

Result #3 - shell companies and trusts lead international statistics to undercount offshore wealth

Researchers often use data from the Bank of International Settlements (BIS) to measure offshore wealth. But the BIS's Locational Banking Statistics only aggregate ownership based on the location of the 'immediate counterparty." If a person from Zambia owns a bank account in their name, the deposits will be assigned to Zambia. But if they own it through an Isle of Man shell company, it will be assigned to the Isle of Man. When I re-assign the bank's deposits based on the ultimate 'beneficial owner' of the deposits, the reported deposits of those living outside of tax havens *doubles* (Fig a). Entire countries, including a number of developing countries (e.g. Zambia, Turkey and Lebanon) would be entirely hidden from the BIS data because of the way the wealth is reported (Fig b).

(a) Deposits owned by residents outside of tax havens

(b) Countries ranked by % of deposits hidden from BIS statistics

Note: Author's estimates using CNBIOM submissions for BIS Locational Banking Statistics. Figure shows the overall amount of deposits (excluding loans and investment accounts) for non-havens and havens (including the Isle of Man) respectively. The dashed line indicates the deposit amount calculated by assigning deposits to any listed beneficial owners. The solid line indicates deposit amounts calculated using the Bank of International Settlement's Locational Banking Statistics reporting methodology. All estimates are in current USD. Haven classification follows that of torslov2020missing.