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# Offshore Banking in the Bahamas -- A Growth Industry

*A Case Study by John S. Giaquinto*

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# International Banking and Trust Activities in The Bahamas



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OFFSHORE BANKING IN THE BAHAMAS: A GROWTH INDUSTRY

SUMMARY

The Commonwealth of the Bahamas is an island nation located in the Caribbean with direct proximity to Miami and South Florida. Independence was obtained from Great Britain in 1973 and continuing economic and political stability has been enjoyed.

The Bahamas and the United States (U.S.) are historically, culturally and economically aligned. Tourism is the largest industry, contributing 70% (\$770 million) towards the island's GNP. International banking is the second largest industry, contributing 15% (\$116 million).

Both tourism and banking have had a positive economic impact. The Bahamas, which has bank secrecy regulations, has evolved as the largest of the offshore centers and second largest Eurodollar center in the world following London.

Although bank secrecy has contributed to the growth of the industry it has also resulted in abuses. The most significant of the abuses is the utilization of offshore havens by narcotics traffickers, other criminals and tax evaders in order to launder and protect their assets from scrutiny. The islands are also plagued by unemployment, drug abuse, narcotics trafficking and the resultant corruption of its public officials. The significance of these problems was highlighted by the Bahamian Commission of Inquiry Report dated December, 1984.

These abuses were also highlighted by the U.S. Presidential Commission on Organized Crime Interim Report dated October, 1984. The significance of the Bahamas as a money laundering center for major narcotics cartels is reportedly not as great as is Panama for the Caribbean Basin and Hong Kong in the Far East. The Bahamas have been described in both reports as a significant trans-shipment and refueling point for narcotics entering the U.S. and proceeds exiting the U.S. in bulk cash enroute to Panama.

Bahamian officials and bankers have expressed concern for the integrity and perception of their banking industry. A Code of Ethics has recently been imposed and the Central Bank has assumed more control over the industry. Bahamian police & U.S. law enforcement are cooperating in joint efforts to stem the flow and abuses of narcotics trafficking and money laundering.

Continued cooperation and the mutual respect for the sovereignty of each nation will enhance the opportunity for future success in solving these significant problems.

John S. Giaquinto  
April 1985

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## I. Introduction

The purpose of this research project is to analyze International Banking and Trust Activities in the Caribbean basin, utilizing the Commonwealth of the Bahamas as a microcosm. The Bahamas was chosen as it is the second largest Eurodollar banking center in the world after London. It is also the largest international offshore banking center in terms of reported assets and liabilities.

The research was conducted in order to prepare an objective evaluation of several areas of interest and concern to include the following:

- Why do major banking institutions locate a branch or have some presence in an offshore location?
- What is the specific nature of their business?
- Why does a nation choose to develop an offshore banking industry?
- What abuses can result from such a banking arena?
- What remedies exist to stem such abuses?

## II. Scope of the Research

This particular topic was selected by the author given his personal experience with offshore banking and one of its resultant abuses, money laundering. In view of the world wide interest in narcotics trafficking, offshore havens and money laundering it was envisioned that such a project would enhance the author's and the reader's knowledge of this aspect of the banking industry.

The project was undertaken as an academic exercise in order to fulfill a requirement that each Member of the Executive Seminar in National and International Affairs of the Department of State complete a case study and submit a written report. A four week period was allowed for the author to conduct the appropriate research, travel, interviews and submission of the report.

The research necessitated extensive readings which are set forth in the bibliography. Interviews were conducted in Miami, Florida, Nassau, Bahamas and Washington, D.C. The interviews included officials of the Drug Enforcement Administration, Federal Bureau of Investigation, Federal Reserve Bank, United States Customs Service, United States Attorney (S.D. Florida), Bahamian Central Bank, Bahamian Foreign Ministry, Royal Bahamian Police as well as bankers in the U.S. and Nassau.

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### III. Background

In order to fully comprehend the intricacies of the worldwide financial arena one would need to undertake a comprehensive study of the subject well beyond the parameters of this project. This particular study will limit its scope to the areas previously articulated.

Since the 1930's and particularly since World War II, the stresses and turbulences of international trade and political affairs have led to the evolution of world financial centers sometimes referred to as "offshore" and or "secrecy havens." These havens have several characteristics in common. First, they are located outside the major industrial and commercial nations of Europe and North America. In Europe, there is of course Switzerland as well as Luxembourg and Liechtenstein. Worldwide, the most significant are the Bahamas, Bermuda, Cayman Islands, Hong Kong, Monaco, Netherland Antilles, Panama, and Singapore. Secondly, once money arrives in such a haven it is protected by the bank secrecy, anonymity. In addition to providing secrecy, these offshore havens impose little or no taxes. Therefore, in addition to being secrecy havens, these jurisdictions are generally tax havens as well.

A tax haven by definition imposes little or no taxes on certain income and offers a certain level of bank secrecy.<sup>1</sup>

The origin of Bank Secrecy laws can be traced to Switzerland. Swiss bank secrecy reinforced by strong criminal penalties, dates back to the early days of Hitler. The Swiss Banking Law was enacted in 1934 to bolster the security of the banking system after the Great Depression and to insure the safety and security of client's deposits, particularly Jewish refugees.

The provisions of the Banking Law and the Swiss Criminal Code were a safety net for those who escaped Nazi terror and other political refugees from Eastern Europe, after World War II. As indicated, a violation of this banking trust is a violation of the Swiss Code and subjects one to criminal prosecution. Bank secrecy is not absolute however. Under specific legal circumstances, such as the prosecution of criminals, access to private banking records may be granted.

The Swiss have entered into numerous bilateral and multilateral conventions for legal assistance with other countries including the United States. They are willing to assist foreign countries in criminal cases. To be prosecuted as a crime, however, the alleged offense must be a crime under Swiss law as well. Therefore violations of foreign political or monetary laws as well as tax and foreign exchange rules are not considered crimes under Swiss law.

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This particular distinction, mutual criminality, is important in understanding the philosophy and motivation of other secrecy and tax havens. The Swiss Banking Law serves as a model for other haven nations including the Bahamas.

In addition to the development of offshore havens since World War II, the expansion of world trade, particularly Euromarket expansion has been phenomenal. Today worldwide trade, banking and commerce takes place in an ever shrinking global arena. The banking industry has been responsive to the needs of the world market place as the U.S. dollar accounts for 80% of the currency utilized. In order to service this marketplace, U.S. and international banking institutions have chosen the Caribbean Basin, which consists of the area from Bermuda to Panama, to expand their banking operations.

U.S. bankers interviewed have indicated that the Bahamas are the principal country of choice given the nation's political stability, lack of Federal Reserve margin requirements, income tax advantages and of course bank secrecy laws. Several distinct types of banking activities take place including regular commercial banking, international bookings and trading in Eurodollars, foreign currency transactions and trust accounts.

Eurodollar assets of over \$140 billion, the administration of an estimated \$2-5 billion<sup>2</sup> in trust accounts as well as bank secrecy, provide the appropriate credentials for an analysis of the island nation of the Commonwealth of the Bahamas.

## IV. THE COMMONWEALTH OF THE BAHAMAS

### A) Historical Perspective:

The nation of the Bahamas is made up of over 700 islands and cays (keys), most of which are uninhabited. The island of Bimini is located just 50 miles from the coast of southern Florida. The Bahamas derives its name from the early Spanish settlers who gave it, BAJAMAR, or shallows.

The islands recorded history begins in 1492 when Christopher Columbus made his first sighting of the new world. The Spaniards who followed were looking for gold and the fountain of youth. When they found neither, they abandoned their interest in the islands but not before enslaving the entire Lucayan Indian population of 20,000 and shipping them back to Spain to work in the mines.

A century later, English settlers, fleeing religious conflict that had spread from England to Bermuda, settled on the island known as Eleuthera. Eventually the Bahamas were granted to absentee landlords in the Carolinas. Their lack of interest....and proximity to the islands allowed these islands to

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become havens, for pirates such as Henry Morgan and Blackbeard. The islands' hundreds of harbors, then as now, were ideal havens for smuggling and piracy.

In 1718 a British captain, Woodes Rogers, took control of the islands as the first royal governor. He drove out or hanged the pirates and restored law and order. In 1729 the Bahamas had its own fully-elected legislature with a governor appointed by the Crown in England.

The capital and principal center of commerce developed on New Providence island, the heart of which is Nassau. The second trade and commercial center developed at Freeport on Grand Bahama Island. The other islands including Bimini, San Salvador, Eleuthera, etc., are now known as the Family Islands.

During the American Revolution, the U.S. Navy raided the British garrison on New Providence in order to carry off gunpowder and disrupt British supply lines. During the Civil War the Bahamas were engaged in gun running to the Confederate forces and during prohibition rum-running became very profitable.

The Bahamas historical links to England and the United States have given it a unique cultural diversity. The native population is black, the language is English and the legal system is based on English common law.

One consistent theme in Bahamian history has been an absence of income taxation dating to the colonial period. Since the Bahamas have never enacted income taxation they have had no cause to enter into tax treaties with other nations.

The banking industry began to develop in 1906 with the Royal Bank of Canada. The Royal bank remained as the only bank doing business in the Bahamas until 1947. In 1936 however, trust company business began to be developed by the Bahamas General Trust Company.

In the 1950's and early 1960's the Bahamian domestic economy, including tourism, began to flourish. With the growth of the world economy, the banking industry grew by geometric progression. During this period, hundreds of banks, trust companies, management and finance companies opened their doors. In 1965 over 600 unregulated companies, some of questionable character and solvency were conducting financial business.

As a result, legislation was amended and new regulations were enacted in the 1960's. Enforcement was provided by the Ministry of Finance and the Bahamas Monetary Authority, now known as the Central Bank of the Bahamas. The regulations included capitalization requirements, licensing procedures and reporting regulations. Today, the number of active, licensed institutions is less than 300.



Politically, in 1964, the United Kingdom gave the Bahamas government complete power over its own affairs except in matters of defense and internal security. On July 10, 1973, complete independence was achieved and the Commonwealth of the Bahamas was formed. The first and still current Prime Minister is Sir Lynden Pindling, who is the leader of the Progressive Labor Party.

Ironically, Pindling came to power amid charges that the former government had been corrupt and allowed criminal elements to infiltrate the country. His own government faces these very same charges as a result of the Bahamian Commission of Inquiry.

Tourism remains as the islands most important industry, accounting for 70% of GNP which equates to \$770 million dollars. Banking is the second largest industry accounting for a \$116 million dollar contribution to GNP.<sup>3</sup>

Tourism and banking account for the close ties between the United States and the Bahamas. In 1983, 2.2 million tourists, 80% of whom came from the U.S., visited the islands. The majority of the 249 active licensed banks and trust companies in the Bahamas today are U.S. owned banks and subsidiary companies.<sup>4</sup>

#### B) Banking and Trusts

The banking industry in the Bahamas consists of three principal financial activities: domestic commercial banking, international banking and the international trust business. With the exception of one institution, the Bahamas Development Bank, all these activities could be considered international as the domestic banking functions are conducted by branches and subsidiaries of foreign global institutions.

The following table prepared by the Central Bank of the Bahamas provides for the geographic ownership distribution of the banks and trust companies.



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Table 2. Geographic Distribution of Bank and Trust Licensees

Domicile of Parent	Branches	Subsidiaries	Total	Notes on Ultimate Ownership
Belgium	0	1	1	
Bermuda	0	1	1	UK-owned
Brazil	4	1	5	
Canada	8	9	17	
Cayman Islands	2	1	3	Controlled by non-Caymanian owners
Colombia	0	5	5	One Spanish-owned
Ecuador	0	1	1	
France	0	2	2	French Government
Germany (West)	1	0	1	UK-owned
Hong Kong	4	2	6	
India	2	0	2	Indian Government
Israel	1	0	1	
Italy	0	5	5	
Liechtenstein	0	1	1	
Luxembourg	0	5	5	3 owned by international banking consortia; 1 by Mexican Government and international banking consortium; 1 by Italian interests
Mexico	2	0	2	Mexican Government
Pakistan	1	0	1	Pakistan Government
Panama	2	4	6	All controlled by non-Panamanian owners including one German, one Spanish
Peru	0	1	1	
Saudi Arabia	1	1	2	One consortium of Mid-East Government banks
Spain	2	0	2	
Switzerland	7	19	26	Including 1 Spanish, 1 German, 1 Singapore, 1 Italian, 1 UK, 1 Nordic bank consortium
United Kingdom	6	6	12	Including 1 Saudi controlled banking consortium
United States	92	15	107	Including 3 Japanese, 1 Israeli, 1 European banking consortium, 2 UK, 1 Hong Kong, 1 other foreign
Local	0	34	34	Including several joint ventures or consortia of major international banks and other foreign owners; 1 Bahamian owned
<b>TOTAL</b>	<b>135</b>	<b>114</b>	<b>249</b>	

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An analysis of the 249 public licenses granted by the Central Bank indicates that each separately licensed banking entity does not always represent a separate foreign bank. A foreign bank may obtain a separate license for each of its varied activities, that is commercial banking, trust business, etc. Therefore among the 249 licensees about 150 separate foreign banks are actually represented in the Bahamas.<sup>5</sup>

The 249 financial entities are further described as follows:

The Authorized Dealers include the seven "clearing banks" (four Canadian, two American, one British) that service the bulk of the domestic local currency banking needs of The Bahamas, with branches in Nassau and other islands of the country. However, these domestic offices also can and do attract a substantial volume of foreign currency deposits and thus play a significant role in the international side of Bahamian banking.

The eight Authorized Agents operate primarily as trust companies and, in the aggregate, provide a majority of the country's international fiduciary, corporate agency, and portfolio management services.

The 130 foreign bank branches are used mainly as offshore booking centers for Eurocurrency loans and deposits; most of them do not require their own separate staff and premises.

The 71 locally incorporated subsidiaries perform a variety of functions for their parents, ranging from primarily banking to primarily trust. Several are of substantial size, with assets of over \$1,000 million, and more than 100 in staff.

The 30 Bahamian based institutions have their head offices and usually their "mind and management" in Nassau. About two-thirds of them have been formed by foreign private-investor groups or companies to carry on international banking or trust business on behalf of their shareholders or affiliates. The other one-third have "resident" status under exchange control regulations and undertake considerable local business such as mortgage and savings banking; one of these banks is Bahamian-owned.

The Bahamas, despite the recent negative publicity and allegations regarding government corruption as well as the U.S. Government's continued pressure against offshore centers, continues to prosper. The following statistical breakdown is reflective of the relative financial position of the major offshore centers.

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Offshore Centers	Assets (Millions \$)	Sept. 84 (Millions \$)	Liabilities (Millions \$)
Bahamas	\$91,869		\$97,074
Bahrain	14,955		17,339
Cayman Islands	77,598		74,000
Hong Kong	61,011		63,311
Neth. Antilles	10,504		16,423
Panama	25,601		18,290
Singapore	59,978		55,113 7

Bahamian and U.S. bankers in Nassau are very optimistic about the future of the industry. They indicate that legitimate banking needs will continue to be served as taxes continue to increase in the industrialized world, as tax loopholes continue to close and banks become more active. As the above noted figures indicate, the Bahamas is the largest of the offshore centers in terms of total assets and liabilities. Additionally, the total dollar volume of the offshore sector, that is monies booked thru the systems is estimated to be \$140 billion U.S. dollars.<sup>8</sup>

The above data should enable the answering of the first question. Why do major banking institutions locate a branch or subsidiary in an offshore location?

In summary, the answer is as varied as the nature of their business and licensed function. Regardless of this function however, commercial, trust, etc., all the U.S. bankers advised that their reasons for locating in an offshore haven was to legally avoid Federal Reserve requirements, income tax advantages and confidentiality for their clients. They also selected the Bahamas for its relative political stability, adherence to prudent banking requirements, the formation of its Central Bank and its resolve to maintain the Bank Secrecy Laws.

Confidentiality and bank secrecy are primary considerations when considering the nature of Bahamian trust accounts. All the bankers interviewed described this segment of their business as related to wealthy clients, mostly European and Latin American businessmen who have legally derived income to protect. They wish to have the privacy, safety, security and confidentiality of having their funds secured and managed away from their own homelands. Political instability, corruption, high taxation, nationalization of industries, restrictive foreign exchange requirements and inflation require that many businessmen worldwide utilize offshore havens.

Additionally, U.S. bankers advised that they will not accept U.S. client trust business offshore without "knowing their client" and requiring that a waiver be signed authorizing the release of financial data to U.S. regulatory and enforcement agencies.

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C) Economic Impact

The economic impact of an international banking industry for the Bahamas appears to be very positive. As indicated, banking and its related services and infrastructure are the second largest contributor to Bahamian GNP following tourism; \$116 million and \$770 million respectively.

The presence of the significant number of banking institutions with their special requirements has had its most significant impact in terms of employment. Approximately three thousand individuals, mostly Bahamian citizens, are employed by the industry. Additionally, banking has given rise to a substantial accounting, legal and telecommunications infrastructure which could not be otherwise supported by commercial entities exclusive of banking.

The Bahamian Bar Association has approximately 200 members while the Bahamian Institute of Chartered Accountants has 120 members.<sup>9</sup> Telecommunications and related services required by the international banks have had a significant impact as well. There are approximately 50, IBM 34 computers in Nassau as well as 35-40 major WANG word processing systems. These significant companies as well as others are competing to provide state of the art services to the banking, legal and accounting professions.<sup>10</sup>

The following chart provided by the Central Bank, best illustrates the economic contributions of the banks and trust companies.

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## GROSS ECONOMIC CONTRIBUTION OF BANKS AND TRUST COMPANIES

(B\$ Millions)

	<u>1981</u>	<u>1982</u>	<u>1983P</u>
A. Total Employment	2,729	2,837	2,960
Bahamians	2,505	2,600	2,719
Non-Bahamians	224	237	241
B. Total Operational Costs (1+2+3+4)	87.2	92.1	103.3
1. Salaries	46.5	49.6	54.1
2. Government Fees	4.4	4.3	4.6
i) Licensing	1.7	1.8	2.2
ii) Company Registration	1.7	1.5	1.4
iii) Work Permits	1.0	1.0	1.0
3. Staff Training	n/a	1.4	1.0
4. Other Administrative Cost	36.3	36.8	43.6
C. Construction or Renovation Expenses	5.6	4.6	13.0
D. Total Expenditure (B + C)	92.8	96.7	116.3
E. Average Salary \$	17,039	17,483	18,277

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An analysis of the data indicates that in 1983, 2960 individuals were employed in the Bahamian banking industry. Of that total, 2719 were Bahamian citizens. This very high percentage of local employment is the result of a legal requirement that the industry seek qualified employees among the citizenry. If no individual meeting a specific position description is locally available then a non-Bahamian citizen may be employed. However, a penalty fee as high as \$10,000 may be imposed for this particular exemption.

The data further indicates that the industry's average salary in 1983 was \$18,277. This is indicative of the fact that the industry is providing a relatively high level of middle class employment opportunity which is of significant benefit to the economy and the citizenry.

The banks also pay annual licensing fees, which in total account for 2.2% of the total industry contribution. These fees are required as a matter of law by the Banks and Trust Companies Regulation Act of 1965. These fees range from a high of \$80,000 for Authorized Agents to \$450.00 for non-active banks and trusts.

In conclusion it appears that the presence of the banking industry has made a significant contribution to the Bahamian economy. In terms of total employment, annual incomes, contribution to GNP, developing infrastructure and a lessening dependence on tourism, the benefits to this island nation are readily apparent.

#### IV. BANK SECRECY

Both the United States and the Bahamas have Bank Secrecy Acts. These acts (laws) are quite diverse, however, and approach international banking and money flow from two distinct perspectives.

In the Bahamas, bank secrecy is provided for in Section 10 of the Bank and Trust Companies Regulation Act of 1965. At the request of the banking community the law was amended in 1979 to clarify the regulations and to insure that bank secrecy is enforced by the criminal law. The Bahamian Secrecy Law is modeled after the Swiss laws including the criminal sanctions.

The Bahamian regulations do provide for the lifting of bank secrecy when a Bahamian attorney petitions the Supreme Court. Bank secrecy will only be lifted if it is deemed that the nature and extent of the criminal activity is clearly spelled out in the documentation and there is, of course, mutuality of criminality.



U.S. law enforcement officials have indicated that this particular procedure is unacceptable as it is time consuming and counter-productive. Additionally, the documentation must be so complete as to present a prima facie case before the Bahamian court will grant access.

In 1970 the U.S. Congress passed the Bank Records and Foreign Transactions Act (Bank Secrecy Act) in order to curtail the flow of criminal cash from the United States to offshore havens such as The Bahamas. The Act was a reaction to the growing problem of bank secrecy jurisdictions.

Congress passed a series of record keeping statutes designed to assist government investigators track current transactions to foreign jurisdictions.

Early compliance with the act was non-existent as the Treasury Department required five years to implement the Act. Many banks therefore looked upon the regulations with disinterest and compliance was low.

In 1982 Congress reenacted the legislation, including the foreign and domestic transactions, as Title 31, and Title 12 United States Code bringing together those laws previously scattered throughout the Code.

Regulations under the Act issued by the U.S. Treasury Department are set forth as follows:

- 1) A Currency Transaction Report (CTR) must be filed by a bank or other financial institution whenever a currency transaction is more than \$10,000. The CTR's are filed with the IRS.
- 2) A Currency and Monetary Instruments Report (CMIR) must be filed by an individual whenever currency or other monetary instruments of more than \$10,000 are physically taken out of or into the United States. The CMIR's are filed with the U.S. Customs Service.
- 3) A Foreign Bank Account Report (FBAR) must be filed with the IRS whenever a person has an account in a foreign bank in excess of \$5,000.
- 4) Bank record paper trails must be maintained for up to five years.

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Compliance with the Act has improved as the volume of reports filed has continued to increase. In 1979, approximately 120,000 CTR's were filed with the IRS while in 1983, in excess of 500,000 were filed. Also, in 1979, approximately 75,000 CMIR's were filed while in 1983, 185,000 were filed with the Customs Service.

Certain significant loopholes exist in the current reporting requirements. Although a bank is required to report "cash" transactions in excess of \$10,000 the Act omits from the requirements such items as wire transfers and electronic fund transfers, bank checks, bank drafts or other written transfers.

Although an individual is required to declare cash or other monetary instrument of more than \$10,000 to U.S. Customs, cashiers checks and other bearer instruments are not covered by the Act.

These loopholes do provide an individual or institution intent on circumventing the reporting requirements with a significant degree of latitude in moving cash in and out of the country.

#### A) Criminal Abuse of Bank Secrecy

For the United States, its institutions and its people, the use of the international banking and business system for criminal purposes is an increasing problem. It undermines the integrity of American banks and other institutions of commerce. It threatens the integrity of our tax systems and deprives the Treasury of badly needed revenue. It feeds the coffers of criminal enterprise. It corrupts public and private morals.<sup>11</sup>

Of all the criminal uses for offshore havens, the most significant for our society and economy is the laundering of narcotics proceeds. These proceeds are generated by the operations of international cartels which include heroin networks operated by Southeast Asian and Italian Mafia organizations as well as the marijuana and cocaine networks controlled by Latin American cartels.

#### 1) Narcotics Trafficking

In 1983, heroin from Southeast Asia accounted for 41% of the heroin encountered in the Western United States. Hong Kong is the major financial center for Southeast Asia's drug trafficking. Hong Kong based trafficking organizations operate throughout the world. Large numbers of heroin traffickers obtain their product from Thailand and their financing from Hong Kong.<sup>12</sup>

Heroin has always been the drug commodity preferred by the Mafia. Heroin handled by U.S. Mafia families has been processed by their Mafia counterparts in Italy (Sicily). The total dollar volume of the heroin sales for the U.S. group is estimated to be \$2.5 billion.<sup>13</sup>



During one significant Mafia heroin investigation known as the "Pizza Connection," 38 individuals were charged by federal authorities in New York. The investigation indicated that approximately \$25 million was laundered by the New York group by utilizing banks and major stock brokerage houses to channel funds to Switzerland.

The Latin American cartels are identified by U.S. law enforcement as the most significant traffickers of marijuana and cocaine. The banking center utilized by these cartels is Panama and to a lesser extent the Cayman Islands and the Bahamas.

Total narcotics trafficking in the U.S. is estimated to be a \$50-75 billion dollar a year business. As one U.S. law enforcement official exclaimed, "You are talking petro-dollars here."

## 2) Money Laundering

Of the \$75 billion generated from drug sales in the U.S., some \$5-15 billion moves into international financial channels each year. More than two-thirds of this amount is laundered on behalf of foreign traffickers bringing drugs into the U.S. (the Cartels) as well as Columbia and Mexican distributors within the U.S. The remaining one-third is laundered by U.S. drug dealers operating throughout the fifty states.

It is estimated that 1/3 of this money is moved out of the country as bulk currency while the remainder is wired abroad after being deposited into financial institutions.<sup>14</sup>

It appears, therefore, that the international banking and financial community either unwittingly or willingly is playing a significant role in the movement of illicit drug money. It is the bank, brokerage house or currency dealer which accepts cash for export or will exchange it for a more transportable monetary instrument such as cashier's check or bearer bond, etc. The institution will also wire transfer the funds offshore or overseas to a second institution as directed. The money will often move through accounts of shell corporations whose true owners of record will never be divulged because of bank secrecy laws.

The funds may return to the U.S. as laundered money, that is their origin may not be traced, or may remain in offshore trust accounts to be managed by major international banking institutions. Those funds that do return may be disguised as income from a shell corporation or in the form of a loan from an offshore institution, complete with documentation showing the amount of interest to be paid. This feature is particularly distasteful to Treasury officials as the individual in reality has borrowed his own laundered money and is charging himself interest which is tax deductible.

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U.S. law enforcement became aware of the acute nature of the money flow aspect of narcotics trafficking during the late 1970's. Miami, Florida was beginning to evolve as the "Gateway of the Americas" in many diverse ways. A significant portion of the Latin American cocaine trafficking was facilitated through Miami. The city became the "Port of Entry" into the U.S. for drugs and the conduit for the proceeds leaving the country. As one federal official indicated "cocaine cowboys ruled the city, there were shoot outs in the streets and Miami became the Dodge City of the 20th Century."

Miami was a wide open city until law enforcement responded with a coordinated effort of undercover operations known as Operation Greenback and Bancoshares.

a) Operation Greenback:

The Treasury Department utilizing the reporting provisions of the Bank Secrecy Act developed this operation to identify and investigate individuals and financial institutions involved in laundering large amounts of currency. The operation was initiated in July 1980 by the U.S. Customs Service and IRS.

Federal Reserve Banks in Miami and Jacksonville were receiving a surplus of cash from banking institutions in Miami. In fact, the surplus of cash increased from \$921 million in 1974 to \$6 billion in 1980. Operation Greenback indentified attorneys, accountants, money brokers, couriers, banks and bankers facilitating the flow of drug money. There have been numerous arrests, indictments and convictions, however, the penalties are light compared to the profits involved.<sup>14</sup>

The most significant contribution of Operation Greenback was that it resulted in an increased awareness for both law enforcement and the financial community as to the scope of the problem and the resolve of the government to enforce compliance.

b) Bancoshares:

Coinciding with the initiation of Operation Greenback, the Federal Bureau of Investigation opened an undercover money laundering operation in Miami.

The purpose of the operation was to identify significant narcotics traffickers and money launderers by offering money changing services. Once its reputation for service and honesty (no short changing) had been established the drugers came in droves. The cash arrived in boxes, suitcases and other transportable means. Millions were counted and converted to cashable instruments.



Over \$170 million was laundered in the 2 years the operation was in business. Hundreds of videotapes were made of the transactions. When the operation was finally surfaced, numerous seizures and indictments resulted to include fifty-four bank accounts in Miami and New York, safe deposit boxes, cocaine and a cattle ranch.<sup>15</sup>

As with Operation Greenback, Bancoshares sent shockwaves throughout the community. The resolve of law enforcement was increased, the banking community was forced into compliance and the narcotics "Cocaine Cowboys" went underground. The City of Miami was returned to the rule of law, significant problems continue to exist.

Subsequent prosecutions and legal actions taken against banking institutions involved in money laundering such as South Florida's Sunshine State Bank and the Bank of Boston in Massachusetts are reflective of the continuing scope of the problem. Additionally, the contempt proceedings initiated by the United States Attorney in Miami against the Canadian owned Bank of Nova Scotia has served notice to the international banking community that the U.S. Government will rigorously enforce its laws.

South Florida law enforcement officials have indicated that the Miami banking community appears to be in reasonable compliance with the reporting requirements of the Bank Secrecy Act. However, due to enhanced law enforcement efforts in South Florida, some aspects of the trafficking and money laundering have moved to other U.S. cities.

Consider the following figures in Millions of Dollars. If the Federal Reserve Banks receive substantially more currency than they send out to commercial banks (shown by positive numbers) authorities suspect money laundering.

<u>City</u>	<u>Millions of dollars</u>	
	<u>1980</u>	<u>1984</u>
El Paso	\$-78	\$612
Jacksonville	1,157	1,394
Los Angeles	-136	374
Miami	4,676	5,263
Nashville	297	422
Philadelphia	-102	625
San Antonio	458	645
San Francisco	-166	1,172

DATA: Federal Reserve Board<sup>16</sup>

These figures indicate that such cities as El Paso, Los Angeles, Philadelphia and San Francisco have had substantial changes in this net cash flow with the Federal Reserve. They also are indicative of the fact that law enforcement officials suspect significant increases in money laundering activities away from the scrutiny of South Florida. The money is then moved from these cities out of the U.S.



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The movement of some aspects of money laundering away from Miami is the result of the mid level U.S. drug dealers. The major cartels appear to be circumventing the reporting requirements by flying the cash directly to Panama.

The mid level U.S. narcotics dealers are utilizing couriers known as "smurfs" who actually make the cash deposits. The Smurfs are unassuming individuals ranging from college students to senior citizens. They operate throughout the U.S. where bank teller awareness of money laundering is not as apparent as in Miami. In order to circumvent the \$10,000 CTR reporting requirements, the size of the deposits are limited to \$5,000 to \$7,000 dollars. The money, once accumulated in various accounts can be withdrawn in the form of a cashiers check or wire transferred out of the country. As indicated wire transfers and bank checks are not covered by the reporting requirements.

The utilization of Panama as a major banking center by the Latin American cartels has become a focal point for U.S. law enforcement. The amount of dollars that the Federal Reserve receives from Banco Nacional/de Panama, the Panamanian state bank, has increased substantially in recent years. Banco Nacional is a clearinghouse for cash in that it receives and distributes U.S. dollars. There has been a fourfold increase in the cash flow during the period 1980-1983. Additionally, more than \$2.2 billion in unreported cash is estimated to have been transported to Panama by the cartels.<sup>17</sup>

Once the currency reaches Panama, there are indications that the bulk shipments, sometimes exceeding \$1 million, are protected by corrupt officials as the cash moves from the airport to the banks.

Federal reserve figures indicate that the net flow of dollars, from other Caribbean basin havens, is insignificant compared to Panama. For example, the return flow of currency from the Bahamas is estimated at \$200 million as compared to Panama's \$1 billion. Considering the dollar volume of tourism in Nassau, \$770 million which is 80% U.S.; then a return flow of \$200 million is not considered to be excessive. Although the Bahamas have not been identified as a significant, initial laundering center for Latin cartel cash, it has evolved as a significant trans-shipping arena for drugs coming into the U.S. and cash destined for Panama.

A significant area of abuse by money launderers in the haven countries are the trustee/fiduciary accounts. The Bahamian trust accounts, estimated at \$2.5 billion in value, are described by the bankers as being primarily held for wealthy European and Latin American clients. The billions held in trust are cloaked in secrecy and are invested in stocks, bonds, real estate and commodities.

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U.S. bankers in Nassau advised that they either refuse U.S. citizen trust business or if they "know their customer," they will require that a waiver, authorizing the release of financial data, be executed. However, it is apparent that the utilization of shell corporations, unethical attorneys and other paper entities precludes the absence of significant abuse.

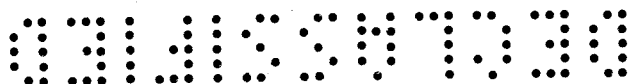
A second area of abuse by money launderers in haven countries is the willingness of foreign commercial banks to conduct significant cash business with U.S. citizens. Commercial banks in the Bahamas can and do attract a substantial volume of foreign currency deposits.

A U.S. citizen desirous of circumventing the Bank Secrecy Act reporting requirements, can simply make direct cash deposits in a Canadian or other foreign-owned bank located in Nassau or one of the lesser Family Islands. The U.S. citizens will not be in violation of Bahamian law and will be afforded the benefit of anonymity. The foreign bankers will argue that they are in compliance with Bahamian banking regulations and are practicing ethical business procedures. Additionally, the circumventing of another nation's, tax, currency and exchange regulations is not a criminal act in the Bahamas.

Although there is a requirement of the U.S. Bank Secrecy Act for a U.S. citizen to file a report (FBAR) relative to foreign bank accounts, this regulation is rarely enforced by the U.S. Treasury.

In conclusion, it appears that the most significant abuse of bank secrecy is the utilization of offshore havens by narcotics traffickers to facilitate the laundering of their proceeds. Although bank secrecy additionally undermines the integrity of the banking system and deprives the U.S. Treasury of revenue, the most debilitating effect is the eventual repatriation of billions of narco-dollars into the U.S.

Although the Bahamas are not immune to the abuses inherent with its evolution as a major offshore haven it does not appear that it is as significant a money laundering haven for the Latin cartels as Panama. However, given the secrecy surrounding its trust and commercial bank business there are no firm dollar estimates of their likely abuse by mid level U.S. narcotic dealers. Bahamian trust bankers indicate 1/2 of one percent of all their business which equates to \$25 million may be unknown to them and likely to be narcotics money. U.S. law enforcement estimates are in the \$50 million dollar range. Neither estimate is significant considering the billions of narco-dollars reportedly flowing through the banking system worldwide.



## V. STEMMING THE FLOW

Stemming the flow of narcotics into the U.S. as well as the resultant flow of proceeds out of the country requires that a multi-faceted approach be utilized. Increased utilization and prioritization of resources is paramount. However, unless the United States wins the support and cooperation of the foreign governments whose nations are the source of the narcotics or havens for the proceeds, all other efforts will be futile.

### 1) Initiatives

The U.S. has undertaken several initiatives in order to win the support of foreign governments and to penetrate bank secrecy.

#### a) The Caribbean Basin Initiative

In 1982 the Reagan Administration presented the Basin Initiative as one of its best hopes of winning the cooperation of haven countries in penetrating bank secrecy. The Initiative is an economic development plan which is multi-faceted. Caribbean nations may participate in the preliminary aspects of the plan, such as lifting of trade restrictions without accepting the most significant aspect, access to financial and tax records. Eligible nations, if full participants, would benefit from enhanced U.S. business investment and convention business. Tax credits and tax deductions would be extended to the U.S. businessman by the IRS in exchange for the release of the financial information.

To date, the Bahamas have agreed to the first segment of the proposal related to trade and are willing to discuss other aspects of the initiative with the exception of the tax data.

#### b) The U.S./Swiss Accords

In 1977 a bilateral Treaty of Mutual Assistance on Criminal Matters was signed and has successfully allowed the exchange of non-tax financial data.

In 1982 the U.S. and Switzerland additionally signed an accord relative to curbing abuses by corporate insiders in security transactions. The U.S. Department of Justice is the coordinating agency with the Swiss Government.

#### c) The Cayman/U.S. Agreement

The Cayman Islands, a British colony, recently signed an agreement relative to the release of narcotics-related financial information. It provides for the expeditious

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handling of requests for the information between the U.S. Attorney General and the Attorney General of the Bahamas. To date, compliance has been considered adequate and the agreement is serving as the basis for discussions with other haven nations including the Bahamas.

d) The Bank Secrecy Act

Several enhancements of the Act's reporting requirements have been implemented by the U.S. Treasury. The most significant is a result of the "Pizza Connection" case. Both stock brokerage firms and gambling casinos licensed to operate in the U.S. are now required to file CTR's for cash transactions of \$10,000 or more.

e) Legislative Proposals

In March of this year, legislation was introduced in order to strengthen our initiatives against money laundering and money launderers.

The first bill introduced provides for granting administrative subpoena power to the U.S. Treasury Department. The bill will enable the Treasury to issue a subpoena for the production of financial records without the convening of a Grand Jury.

The second bill amends Title 18 of the U.S. Code to create a criminal offense prohibiting the laundering of money in furtherance of criminal activity. The bill, which carries severe fines and penalties, is intended to curtail the activities of bankers and brokers who facilitate money laundering activities.

VI. WILLINGNESS TO COOPERATE

1) The Financial Institutions

The international banking community, although not known for its willingness to be supportive of efforts to penetrate bank secrecy, is concerned about ethical business practices, their reputations and the perceptions of the world community.

Bankers are generally law abiding, conservative businessmen who are primarily concerned with the profitability of their institutions. They are also desirous of preventing incursions by the criminal element into their operations and in minimizing losses from fraudulent operations.



As previously indicated, international banking transactions in the Bahamas account for \$140 billion in banking activity. Much of this activity is highly automated as it moves through the systems. Narcotics proceeds, which are a relatively small percentage of this total (\$50 million), are difficult to pinpoint beyond the initial cash entry as it is commingled with other bank funds.

The international banking community has also been responsive to the negative publicity generated by the increased pressure of U.S. law enforcement. The Bahamian bankers advised that they are concerned about the perceptions of their industry. They further advised that they are desirous of preserving and enhancing the integrity, reputation and profitability of the industry.

The Association for International Banks and Trust Companies points with pride at their recently enacted Code of Ethics. The Code sets forth specific standards for its members to follow in conducting their business, the most significant of which is the "Know Your Customer" and his business.

The bankers indicated that they are generally supportive of current U.S./Bahamian discussions regarding a Cayman Island type agreement. The discussions center around the exchange of narcotics and other criminally related financial data (non-tax). They are unanimous in their opposition to the second phase of the Caribbean Basin Initiative relative to the release of tax data, particularly when it relates to non-U.S. citizens. In their opinion, the Initiative would totally negate the effectiveness of the Bahamian Secrecy regulations and will have a debilitating effect on their industry and the economic well being of the Bahamas.

## 2) The Bahamian Government

The Commonwealth of the Bahamas is an emerging third world nation which, as indicated, has a long and stable political history. However, given its proximity to the U.S. and Latin America, the nation is not immune to the serious economic and social problems of its larger neighbors. Their problems include unemployment among youths, drug abuse, violent crime, and governmental corruption in support of narcotics trafficking.

To the credit of the Bahamians, faced with a "Watergate" crisis surrounding allegations of corruption leading to their Prime Minister, a Commission of Inquiry was empaneled to pursue the allegations. The Commission issued its report to the Governor General in December, 1984 which in effect confirmed many of the allegations.

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# CONCLUSIONS

Consider the following conclusions:

"During the 1970's and early 1980's a substantial number of non-Bahamians established transshipment points throughout The Bahamas. In order to carry out their operations it was necessary to obtain the cooperation, or at least to guarantee the non-interference, of a number of junior and middle level officials, and this unfortunately was achieved by the payment of substantial bribes. Many other local persons were recruited to assist the smugglers, some of them eventually running operations themselves."

"The evidence before the Commission indicates quite clearly that the widespread transshipment of illegal drugs through The Bahamas in recent times has adversely affected almost all strata of the Bahamian society."

"We were shocked to learn that the "spillover" from this transshipment trade has created a lucrative local drug culture that has permeated the society to an alarming degree."

"We were also alarmed by the extent to which persons in the public service have been corrupted by money derived from the illegal drug trade. We have given our reasons later in this report for concluding that corruption existed at the upper and lower levels of the Royal Bahamas Police Force and we have concluded that certain Immigration and Customs Officers accepted bribes. We were particularly concerned to discover that those corrupting influences made their presence felt at the levels of Permanent Secretary and Minister."

"We have also noted with some concern, the contribution made by some representatives of the private sector in facilitating the drug trade. In this regard we make special mention of the Legal profession and the Banking Industry (Commercial Banks and Trust Companies). It has become clear to us that some lawyers and bankers utilized the bank secrecy laws of The Bahamas to launder drug money. It is also plain to us that until fairly recent times, little or no consideration was given as to the source of funds entering the banking system. There is every reason to believe that the material benefits of the drug trade caused persons to "wink their eyes" or look the other way."

CONCLUSIONS

"The personal finances of the Prime Minister and Lady Pindling were examined by Inspector Richter of the investigating staff of the Commission who gave oral evidence and submitted a written report. This investigation covered the period from 1st January, 1977 up to 31st December, 1983 and was made with the object of ascertaining whether or not any funds received by the Prime Minister were drug related."

"In this period the Prime Minister's annual emoluments by virtue of his office increased from \$77,000 in 1977 to \$102,900 in 1982. Between 1st January, 1977 and 31st December, 1983, the Prime Minister and Lady Pindling made deposits into their bank accounts of \$3.5 million over and above his official income as Prime Minister."

It is apparent that the Prime Minister's expenditure over the years from 1977 has far exceeded his income. However, none of the known sources of funds made available to him appear to have been drug related. As to the unidentified deposits, the sources of which are still unknown, all that can be said is that there is no evidence before the Commission upon which we can form a conclusion as to whether or not these unidentified funds were drug related."

The Commission also considered the subject of U.S./ Bahamian relations which at the time were strained due to the absence of a U.S. Ambassador and the continued U.S. efforts to penetrate bank secrecy.

"Both the Prime Minister and the Attorney General admitted that the relationship between the United States and The Bahamas had fallen to a fairly low level. They apportioned a considerable amount of the responsibility on the former Charge d'Affaires, Mr. Antippas."

"We agree with the Leading Counsel to the Commission that the evidence before the Commission strongly suggests that the drug trafficking problem has contributed significantly to the deterioration in relations between The Bahamas and the United States. However, we do not believe that the problem is simply one of distrust between the Bahamian Minister of Foreign Affairs and certain officials in the Justice Department who are responsible on a day-to-day basis for the administration of various areas of criminal justice or drug trafficking in the United States. The fundamental problem, in our opinion, is and has been for some time, the absence of a working relationship between two sovereign States where the sovereignty and integrity of each is accepted and respected."



Since the filing of the Commission Report, relations between the two nations have improved considerably. An official of the Foreign Ministry indicated that much of the credit for re-opening the lines of communications between the two nations belongs to Ambassador Dobriansky and his staff.

Allegations of corruption within the Royal Bahamian Police is a matter of great concern to both rank and file and police officials. They are proud of their organization and are determined to rid the department of corrupt influences and practices. U.S. law enforcement officials advised that the Bahamian police have a most difficult task in maintaining the rule of law and internal discipline given the vast area (700 islands) of ocean to police.

They advised that they readily work with selected individuals and units of the Bahamian Police in joint narcotics operations and would continue to do so in the future. The corrupting influence of narcotics trafficking is not unique to the Bahamian Police.

The Foreign Ministry further indicated that discussions with U.S. officials relative to a "Cayman Island" agreement were progressing very well. It was fully expected that an agreement would be signed in the near future.

Bahamian officials generally advised that the U.S. and The Bahamas are closely aligned both historically and culturally. They indicated that the Bahamian people are pro-Western, pro-U.S. and pro-capitalist. Many Bahamian citizens and government officials have been educated in U.S. colleges and universities. It was further indicated that both nations share very serious economic and social problems that will take a joint effort to resolve.

In conclusion it was indicated that relations would continue to improve if U.S. officials in Washington and in certain instances Miami, respected the sovereignty of the Bahamas and did not consider it to be the 51st state.

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FOOTNOTES

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2. Euromoney; October, 1984, Euromoney Ltd., London.
3. Ibid. 2
4. Publication of the Central Bank of the Bahamas, January, 1983.
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Mr. Peter Page, Vice President,  
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Mr. George Steuart, Under Secretary,  
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