

# Bahamas Shadow Shopping



## *Public Report*

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# TABLE OF CONTENTS

- 01** Executive Summary
- 02** Introduction
- 03** Results
- 04** Broader Takeaways
- 05** Conclusions

# EXECUTIVE SUMMARY

**Overview:** In coordination with the Central Bank of The Bahamas (CBB), Evaluasi conducted a scientifically rigorous “shadow shopping” campaign to test the regulatory compliance of international banks and trusts supervised by the Central Bank of The Bahamas. Shadow shopping is a methodology whereby researchers simulate attempts to engage in illicit finance under natural conditions in order to observe the response of regulated firms. This assurance method provides a direct, accurate and scientifically rigorous augmentation of supervisory approaches to regulatory compliance with Anti-Money Laundering (AML) rules. Because the banks and trusts believed they were dealing with real potential customers, this direct approach gives much greater confidence that what we observe is real behaviour rather than simply regulated entities telling local regulators or international assessors what they want to hear.

**Approach:** This assurance study or “shadow shopping” exercise tested all Bahamian internationally active banks and trusts on their response to unsolicited approaches from potential clients. The test focused on Know Your Customer (KYC) performance and broader Anti-Money Laundering (AML) procedures via email solicitations from a group of 19 associates requesting bank accounts and trust services. The subject pool is the 50 licensee bank and trust companies supervised by the CBB. A total of 250 approaches were made. Researchers recorded the response of these firms and followed up as appropriate to probe their responses and determine the extent to which vulnerabilities to illicit financial activity exist in the Bahamian financial system.

This exercise follows on from a decade of research-focused shadow shopping, amounting to tens of thousands of inquiries, across a great many firms and jurisdictions. Of most note from the previous work was a finding in 2020 of perfect compliance by Bahamian firms within a multi-country study. This result is regrettably unusual, with the larger and more economically developed countries often featuring at the top of the non-compliance list.

The current exercise is the first to our knowledge where a regulator has shadow-shopped an entire national population for AML risk compliance.

**Overview:** This study generated three substantive findings:

1. First, Bahamian banks and trusts are not particularly receptive to unsolicited approaches from clients unknown to them. Only 33 of 238 (14%) of solicitations generated a response from the targeted institutions. Only 16 of 50 institutions responded to any of the inquiries.
2. Furthermore, none of the responses from the banks and trust companies supervised by the Central Bank of The Bahamas indicated any willingness to engage in illicit or dubious activities. No response offered anonymous or illegal access to financial services. All email conversations either ended with KYC-compliant demands from the financial institution or petered out such that the bank no longer pursued the client. No financial institution showed interest in dubious financial dealings.
3. There was no discernible pattern among responses, other than respondents tended to respond more often to trust enquiries than banking enquiries. This is consistent with the most common business model among the Bahamian institutions subject to shadow shopping.

**Implications and Recommendations:** Our results provide evidence that banks and trusts in The Bahamas are following the KYC and AML regulations in the context of unsolicited approaches by unknown customers. Our past work across many jurisdictions suggests that The Bahamas is among the leaders in managing the AML risks associated with previously unknown potential clients.

Banks and trust behaviour may be different with known or established customers, and we understand that this is a matter of ongoing Central Bank supervision. The CBB and other financial regulators may wish to explore how and why this resilience emerged and how they can replicate or build on successes to ensure the continuing robust and effective regulation of the financial sector.

dubious financial dealings either through explicit reference to KYC regulations, refusal to pursue the client, or by not entertaining the potential client in the first place (non-response).

**Implications and Recommendations:** Our results provide evidence that financial entities in the Bahamas are following the KYC and AML regulations in the context of unsolicited approaches by unknown customers. These results come with the caveats that bank behavior may be different with known or established customers, and that 34 of the 50 contacted institutions never responded to our enquiries. The apparent resilience of the Bahamian financial system to illicit finance warrants further examination, including shadow shopping that simulates known customers or that employs forms of initial contact other than email. The CBB and other financial regulators may wish to explore how and why this resilience emerged and how they can replicate or build on successes to ensure the continuing robust and effective regulation of the financial sector.

# INTRODUCTION

The fundamental problem of Anti-Money Laundering (AML) at the national and global scale involves the difficulty in measuring actual effectiveness, as the recent Empirical AML Research Conferences in The Bahamas have confirmed (Sharman IADB 2021, 2022). Though the FATF attempts to measure effectiveness in its 4th round reviews, this approach fails to address obvious problems. For example, it is not clear whether a small number of money-laundering convictions is evidence of success (little money laundering to prosecute) or failure (a lot of money laundering, but little enforcement). Similarly, although countries must now write National Risk Assessments, there is no solid evidentiary basis on which to ground such assessments. These assessments instead tend to rely on qualitative and subjective judgments.

To overcome these and other deficiencies of current attempts to assess the efficacy of AML and KYC efforts, Evaluasi partnered with the CBB to implement a “shadow shopping” campaign. Shadow shopping is a methodology whereby researchers simulate attempts to engage in illicit finance under natural conditions in order to observe the response of regulated firms. In the crucial related areas of Know Your Customer and customer risk assessment, our study provides far more valid and robust results by directly testing and observing the actual behaviour of financial institution personnel.

As an assurance study, we directly measure what banks and trusts do when they are dealing with what they think are real prospective customers. By doing so, we can answer questions about the compliance process in real time. When do banks screen out risky customers? When do they accept them? When do they apply or flout KYC rules? This study provides clearer and more accurate answers for The Bahamas.

As a result of the study, we feel confident that an unknown individual approaching a licensee within The Bahamas would either have to complete robust KYC checks or would be unsuccessful in their attempt to create a trust or bank account in The Bahamas. Furthermore, the character of the communications between institutions and prospective customers made it clear that Bahamian institutions have no detectible interest in facilitating illicit finance.

This study is not an exhaustive examination of compliance and regulatory processes in The Bahamas and should not be interpreted as a blanket determination that Bahamian financial institutions are compliant with the full range of their regulatory obligations. However, it does constitute rigorous evidence that there is broad-based compliance with important preliminary processes that would impede or prevent attempts at illicit financial activity.

# DETAILS OF THE STUDY

To test regulatory compliance with international and Bahamian AML rules, we sent multiple email requests on behalf of a roster of hired associates to each of the 50 internationally focused licensee bank and trust companies that the CBB supervises. The email solicitations enable us to measure compliance in several key outcomes areas. These are: 1) whether firms reply to associates' approaches; 2) whether they are willing to do business; and 3) whether they perform mandated KYC checks, due diligence, and risk assessments to establish the identity of the would-be customer and the source of funds. We first designed the email requests, recruited associates, and then sent email requests to the financial institutions.

No solicitations were sent to institutions which mainly operated in the Bahamian domestic market, such as retail banks and credit unions. Only Central Bank supervised banks and trusts were surveyed.

Each email requested information regarding how to set up a bank account or trust. The design of these email requests required a delicate balance between providing consistent information (to ensure the emails are closely similar in substance and thus providing comparable tests of AML compliance) and minimising detection. Given that we sent five emails (from five different associates) to each financial institution, we needed to ensure that bank personnel who received these emails took these solicitations as genuine, rather than as part of a test of compliance. Therefore, we developed the following two base texts.



**Bank:** *“My name is [NAME] from [CITY], [COUNTRY], and I’m writing to enquire about opening an account to handle my business expenses--I work with a multi-country consultancy conducting business in [LOCATION]. My work experience has been in [SECTOR]. Since I work internationally, I am hoping to find an institution with expertise handling transactions in multiple jurisdictions, and your website made that seem like something you could do. I’d love to maximize whatever tax savings I can without raising any red flags. I am projecting one or two transactions a month, perhaps totalling [AMOUNT] US per year, and would be looking for a credit card I can use for business expenses and some international wire transfers. Is this something you can help me set up? Can you give me an idea of what tax requirements would be for a citizen of [NATIONALITY] if I were to open an account in the Bahamas? And what documentation would be needed from me to set this up?”*

**Trust:** *“My name is [NAME] from [CITY], [COUNTRY], and I am looking into the requirements to set up a [AMOUNT] USD trust to manage my family’s international share portfolio and an International Business Company to hold some potential future real estate titles in the Bahamas. I would need a vehicle that would have the capacity to send and receive international wire transfers on behalf of the trustees, myself and two other family members who live in [NATIONALITY 2]. I’d also love to maximize whatever tax savings I can without raising any red flags. Can you send me some details about what this would involve, as well as the tax reporting requirements that would be involved for a citizen of [NATIONALITY]? And what documentation would you need from me to set this up?”*

We then varied the order in which we provided information in the email (e.g. location coming later in the text, discussing documentation at the outset, etc.), and we also varied the diction, syntax, and tone (formal to more casual) in order to create enough variation to minimise detection, or the likelihood that the banks and trust companies would discern that the enquiry came from a shadow-shopping study. In the first three email requests that each financial institution received, the email included some language that suggested the associate wanted to comply with rules and regulations but also wanted to avoid red tape. In the fourth and fifth emails we either deleted this phrase or added in more explicitly dubious phrases such as: “unfortunately my country has a lot of crime and corruption, so it’s important my business affairs/family wealth stay confidential” or “tax minimization and privacy are my top priorities, so I want to know if there are opportunities you can provide here.”

To minimise detection, we included details about each associate, including their city and country of origin, and the sector or sectors (e.g. hospitality, tourism, research and development, services, etc.) in which they have experience. These sector backgrounds reflected the actual experience of the associates. In the trust emails, we also randomly assigned a nationality to the associate’s family; this was included in the placeholder [Nationality 2] in the trust email above. We selected additional nationalities (those not included among the nationalities of our associates) from all regions of the world. We also varied the amount of funds that would be associated with the account or trust (between \$1-5 million; 15 unique values including values such as \$1-2 million, \$2-4 million, \$3 million, etc.). Thus, each item in “[ ]” in the above email texts provides information specific to the associate.

Our associates are actual people and each email provides genuine information about them (with the exception of the random assignment of family nationalities in the trust email). Further, we made no more than two additional follow-up emails; this allowed us to obtain more information and further test bank personnel without demanding too much of their time. Our research team sent all emails on behalf of the associates in order to maintain full researcher control over the exercise (from Gmail accounts created for this study).

We recruited associates through our team’s networks, with a particular focus on university graduate students, in order to maximise variation in nationalities and associate profiles. As reflected in Table 1, our associates represent 17 unique nationalities from 5 continents. To ensure associates clearly understood their role, we conducted an information session in which we provided the details of the study (without revealing client details or that this study focused on The Bahamas), the email texts, and the precise ways in which we would approach financial institutions on their behalf. We advertised this as a Research Assistant job working with the lead researchers, and we compensated associates accordingly.

**Table 1: Associate Details**

| <b>Region</b> | <b>Nationality</b> | <b>Number of Associates</b> |
|---------------|--------------------|-----------------------------|
| South America | Argentina          | 1                           |
|               | Brazil             | 6                           |
|               | Chile              | 2                           |
|               | Colombia           | 1                           |
|               | Peru               | 1                           |
| North America | USA                | 1                           |
| Europe        | Austria            | 1                           |
|               | Czechia            | 1                           |
|               | Greece             | 1                           |
|               | Romania            | 1                           |
|               | Slovakia           | 1                           |
|               | Spain              | 1                           |
|               | UK                 | 2                           |
| Asia          | China              | 2                           |
|               | India              | 1                           |
|               | Hong Kong          | 1                           |
| Africa        | Cameroon           | 1                           |

We contacted each bank and trust company/licensee five times via email approaches from five different associates. We sent one request to each licensee per week between 9 December and 25 January (excluding the holiday period). We provide exact dates of each round in Table 2. All approaches were made via email, providing a complete written record of all exchanges between associates and regulated firms, with no calling or in-person solicitations. As we obtained responses, we coded their responses using FATF and Bahamian KYC rules as a metric for compliance. We then followed up with further enquiries, particularly when the initial response was not easily or obviously sorted into a particular outcome category (compliant, non-compliant).

**Table 2: Schedule of Email Solicitations**

| <b>Email Round</b> | <b>Date</b> | <b>Number of Emails Sent</b> | <b>Number of Email Replies</b> |
|--------------------|-------------|------------------------------|--------------------------------|
| 1                  | 12 Dec 2022 | 44                           | 7                              |
| 2                  | 19 Dec 2022 | 44                           | 4                              |
| 3                  | 10 Jan 2023 | 50                           | 8                              |
| 4                  | 17 Jan 2023 | 50                           | 8                              |
| 5                  | 25 Jan 2023 | 50                           | 6                              |
| <b>TOTAL</b>       |             | <b>238</b>                   | <b>33</b>                      |

*Note: The first two rounds have fewer emails sent as six institution's email addresses were invalid.*

# RESULTS

## **Quantitative Trends**

We received 33 responses from our 238 initial inquiry emails (a response rate of 13.9%). We found no non-compliance. All email enquiries were coded into one of the following categories: direct reference to KYC regulations (5%), email conversation ends before we have all information (9%), or there is no response to our initial enquiry (86%). We consider all of these to illustrate a lack of non-compliance. When email conversations ended without explicit reference to KYC regulations, they almost always requested an in-person or zoom meeting or the conversations ended without the financial institution pursuing the client further. These are all clearly compliant as they suggest no willingness of these institutions to engage in illicit behaviour. Further, responses that did not request specific documents often stated that compliance with US Foreign Account Tax Compliance Act (FATCA) and global Common Reporting Standard (CRS) tax information exchange was required from their customers. It is important to note that these stipulations for CRS and FATCA in the emails actually exceed the current global standards in terms of required compliance.

We also consider non-response to signal compliance: our initial email requests were suggestive, although subtly, of potentially risky clients that were interested in minimizing or even avoiding regulations. Thus, it is likely the case that non-response is due to institutions seeing red flags in the initial email and thus choosing not to engage. While we cannot know that these are the motives behind non-response to our enquiries, a non-response does not provide any evidence of non-compliance.

**Table 4: Email Characteristics**

| <b>Email Responses</b>                      | <b>Number of Responses (%)</b> |
|---|--------------------------------|
| Referral to tax lawyer                      | 9<br>(27%)                     |
| Directly stated commitment to KYC reporting | 10<br>(37%)                    |
| Requested a meeting                         | 13<br>(39%)                    |
| Explicitly stated KYC requirements          | 13<br>(39%)                    |

  

| <b>Email Types</b>               | <b>Number of Responses (%)</b> |
|----------------------------------|--------------------------------|
| Response to “bank account” email | 9<br>(27%)                     |
| Response to “trust” email        | 24<br>(73%)                    |

Table 4 summarises a number of key elements of the responses we received: 10 responses explicitly stated their commitment to KYC regulations, 13 of the responses specifically referenced the need of certain information to meet KYC requirements, 13 requested an in-person or phone meeting, and 9 referred us to a tax lawyer. There is clear overlap in these elements; e.g. most responses that stated a commitment to KYC rules also requested information/documents to comply with these requirements.

## **Qualitative Insights**

Much of the value of this approach comes from the responses themselves. The correspondence between the licensees and our team could indicate whether particular banks are inappropriately enthusiastic about taking on potentially risky new customers or are consistently in line with KYC rules. As well as providing an assessment on a bank and trust basis, the results reveal patterns of compliance within the industry regarding KYC performance.

Our strategy for responding to emails was to keep the conversation over email, request information about the setup process until we received information about compliance, and provide reasonable and factual information to support our request whenever possible. We would abort the conversation or stop replying if it was beyond the realm of normal conversation to continue. Typically, this was if banks repeatedly requested meetings without providing additional information despite our attempts to rebuff them, or if their request for a meeting was so absolute there was no way for our associates to avoid it. Once we received information regarding compliance, we would either thank them and close or let the conversation naturally conclude via non-response.

In one or two cases, the organisation requested more detail about the trust formation than we could reasonably answer and we elected to terminate the conversation. When firms requested information as to the motivation for opening an account or a trust, we would claim to be fulfilling a request on behalf of a family member, or that we were trying to avoid corruption in the relevant origin country – if that was reasonable given the country context. The simulated prospective client was typically an individual relatively unfamiliar with the wealth management landscape and thus was asking for basic information, which once again accurately reflects our set of associates.

The most responsive licensee in the sample asked each time for the unknown email correspondent to fill out an extensive pre-vetting form before continuing the conversation at all. These responses were short and to the point: "Please complete the attached pre-vetting form, and advise how you hear about [...]"

Others gave lengthy, in-depth responses about the questions raised by the email approach. Responses included direct reference to KYC compliance information/requirements. Further, responses were notable for specifically tailoring their reply to the associated country of origin/background. As an excerpted example:

*“Dear Ms. Ionesco, We thank you for your email. We would be happy to assist you with your family trust. In order to determine the tax requirements / implications of contributing funds to a trust and holding same under an underlying limited company of the trust in the Bahamas would require advice from local Romanian counsel and tax expert as to the most efficient manner to contribute the assets to the trust and the subsequent capital contribution of the same to the trust’s underlying company. One point which may be relevant is the revocable/irrevocable nature of the trust and whether or not retained investment powers will be retained or full discretion will rest with the trustee.”*

In other cases, it took several rounds of engagement before they replied with a list of required KYC documents. This did not seem to be from a lack of compliance, but a preference for a conversation on the phone or perhaps a lack of these requests coming via email. One representative example is as follows:

*“Hello Marcelo, Thank you for your email and interest in us. Kindly advise a time and a contact number when you are available to have a conversation with you to discuss your email further.”*

*“Hi [bank official], I'll admit I don't have much to add--my family asked me to look into this for them and I'm not too familiar with trusts and such. Is there any chance you could give me background information on what's involved so I can get some context to share with my relatives? Thank you, Marcelo”*



*“Hello Marcelo, We will really need to have a chat with you or someone to get an appreciation of what you would like to do and why do you think you would require a trust. In the meanwhile, please review the attached which should give you a brief background of the Trust product. We await your further direction.”*

*“Hi [bank official], That's helpful--I'll take this to my family and try to nail down what they want so I can get on a call with you and make it productive. Last question before I head off to holiday plans (which will now be full of tax discussions): what documents would you need from them in order to set it up? Does it depend on every case, or is there a standard list I should tell them to compile if they want to get serious about this? Thanks again, Marcelo”*

*“Hello Marcelo, Below is a checklist which outlines the items which are standard requirements for opening of an account. Once you have decided which product that you would require we can then drill down to the specifics relative to that product. Hopes this helps. \*KYC for individuals listed above.*

*[a]Passport*

*[b]Secondary Identification – Other Government issued I.D.*

*[c]Proof of address – Government issued I.D. with address or utility bill (within 3 months)*

*[d]Name Screening*

*[e]Web Search*

*[f]Source of wealth/Source of Funding (Original Bank Reference letter for banking history and Source of funding and where applicable documentary proof of source of wealth.)*

*All Directors & All Signatories*

*[a]Passport*

*[b]Proof of Address”*

One trust responded by indicating that our associate's domicile of residence determined which office should handle the potential client. However, upon responding with domicile information, the trust did not respond. We code this as evidence of no non-compliance given that there is no willingness to avoid tax and other regulations even though the trust did not continue communication.

*“Dear Mr. Lau, Further to the below, can you confirm whether you are in Hong Kong or Guatemala. I can then refer you to the most relevant office in or near that jurisdiction for assistance. Please note however we are unable to provide tax advice. Many kind regards”*

*“I am in Guatemala, but am a citizen of Hong Kong. My family asked me to reach out to you because the Bahamas has a reputation for being a good place for wealth management, and they want to handle their funds discreetly.”*

Thus while response rates, responses, and conversations varied, the overall conclusion is that once licensees engage, not much progress toward setting up an account will be made until key identifying information and/or documentation is obtained. Thus, the licensees responding to our requests were fully compliant.

# BROADER TAKEAWAYS

From our engagement with the licensees, it seemed that they were invested in knowing and clearing their customers prior to opening business relationships with them. The study showed that banks are wary of unknown customers and prioritised a meeting or phone call. They are also reluctant to engage with areas outside of their expertise, as we learned from the low response to the commercial bank account request and from the consistent referrals to a tax lawyer. The low response to the bank account request may be a result of banks feeling suspicious of a potential customer and choosing to avoid the question of compliance by refusing to engage altogether, though this conclusion is speculative. There is also the consideration that Bahamian institutions as a group are more focused on cross border trust and funds management business than on cross border banking business.

What this approach does not show us is how banks would respond when asked for a compliance breach by a known and high-wealth customer, or when engaging with someone who presents themselves as a more knowledgeable and/or higher value customer.

# CONCLUSIONS

As a result of the study, we feel confident that an individual approaching a licensee within The Bahamas would either have to complete KYC checks or would be unsuccessful in their attempt to create a trust or bank account in the Bahamas. Of course, this study is not an exhaustive examination of compliance and regulatory processes in the Bahamas and should not be interpreted as a blanket determination that Bahamian financial institutions are compliant with the full range of their regulatory obligations. However, it does constitute rigorous evidence that there is broad-based compliance with important preliminary processes that would impede or prevent attempts at illicit financial activity.

The finding of no non-compliance in our sample of Bahamian licensees suggests a number of avenues for further investigation. First, are other similar country contexts as compliant or does The Bahamas stand out as a high performer? It would be valuable to implement the same shadow shopping exercise in other, similar contexts. Second, will this behaviour change over time? Can we expect Bahamian institutions to maintain this high level of compliance as economic, financial, institutional, international and other variables change? It would be especially interesting to investigate how the next MER (Mutual Evaluation Report) and CFATF (Caribbean Financial Action Task Force) may change compliance. Third, it would be useful to expand the study to corporate service providers (CSPs). CSPs may be engaging some of the banks that did not respond to our inquiries and may provide a back door to anonymous banking or trust formation. Fourth, changing the profile and/or depth of the approach to make the non-compliance more appealing for the banks could lead to crucial additional knowledge about compliance. In sum, the high compliance uncovered in this study offers helpful but narrow comfort about the state of AML compliance in The Bahamas.

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[evaluasi.io](https://evaluasi.io)

2028 E. Ben White Blvd. #240-3049

Austin, TX 78741