

# Cracking Switzerland's

**As solid and secure as the Alps: this was the reputation of Swiss banking secrecy. But even the toughest mountain can crack. Similarly, a banking secrecy law can be overturned. See how U.S. authorities shook the very foundations of Swiss bank UBS, alarmed and galvanised the Swiss government, shattered world-renowned Swiss confidentiality – and brought about the end of an era.**

By Sven Gallinelli | Try this stereotype on for size: Every time Hollywood's bad guys want to hide illegal money, they transfer it to numbered Swiss bank accounts.

Both inside and out of the movie theatre, Switzerland has quite a reputation as a safe haven for criminal money. However, the numbered bank account was actually abolished years ago, in 2004. And, criminals shouldn't bet on their money being too safe in Swiss accounts for another reason as well – the country has one of the toughest laws in the world against money laundering.

Until recently however, there was one aspect of Swiss banking that wasn't just an outmoded stereotype: Swiss banking secrecy. Invented 75 years ago to grant financial privacy to any individual, the law ensured authorities couldn't simply access someone's bank account for no reason. However, the banking secrecy law has increasingly become the target of global criticism in the last couple of months.

And this resulted in a dramatic step that stunned many Swiss: On March 13 (a Friday), Swiss Finance Minister Hans-Rudolf Merz announced Switzerland would abolish banking secrecy in order to assist other countries that are pursuing citizens believed to have hidden money from tax authorities in a Swiss bank account. Sacrificing Swiss banking secrecy – the unimaginable had happened. An era had ended.

## How we got here

The Swiss Federal Council took this extraordinary step after a build-up of events during the weeks prior to Merz's Friday the 13<sup>th</sup> press conference.

It started in February when UBS and the Swiss government did something that horrified many investors: it agreed to reveal account details of more than 250 UBS customers to the United States Internal Revenue Service (IRS), which was in direct violation of the Swiss banking secrecy law.

For nearly a year the IRS had been trying to obtain the data, but Swiss authorities were cautious, and proceeding slowly in an effort to adhere to their own laws as well. Too slowly, as far as the United States was concerned. The IRS lost its patience and threatened to cancel UBS' banking licence in the United States if the Swiss authorities failed to act.

The threat, made in February, came when UBS had already been hit badly by the ongoing financial crisis. Since U.S. business is an important and profitable part of UBS' balance sheet, Swiss authorities didn't want to risk harming the bank more.

Therefore, the Swiss banking regulatory body (Financial Market Supervisory Authority) decided to reveal the data. And with that decision, it overruled Swiss legislation.

## Caught red-handed

Naturally, the IRS was eager to get the data because the customers in question were under suspicion of tax evasion in the United States. And, they were very wealthy U.S. citizens. About a dozen have since filed suit in the Swiss federal court system, claiming both UBS and the Financial Market Supervisory Authority violated banking secrecy laws.

However, the real scandal starts here: UBS illegally acquired these customers in the United States by actively soliciting them with a scheme to deliberately hide their assets. The U.S. authorities first caught wind of this scheme after they arrested a UBS manager in April 2008 – one who blew the whistle about what was going on behind the scenes.

UBS' practices in the United States were regarded with much scepticism in the bank's home country. And for good reason: UBS was on the brink of ruin, and likely would have gone under were it not for the Swiss government loaning the bank 68 billion Swiss francs last October. That UBS was in dire need of government support, but was at the same time involved in an international crime was not well received by the Swiss political establishment.

## A matter of perspective

But did UBS really commit a crime? This depends on the point of view. In the United States tax evasion is a serious crime, whereas in Switzerland there is a clear distinction between tax evasion and tax fraud. The former is seen as a misdemeanour, the latter as a serious crime.

Where the line gets drawn exactly is constantly being disputed, but here is a general guideline: If you just happen to forget to mention some assets on your tax declaration – consciously or not – it's seen as tax evasion by Swiss law, and you would only be punished with a fine. But if you counterfeit any documents, e.g. a bank statement, then you've committed tax fraud and are open to prosecution.

The distinction really counts when it comes to Switzerland granting administrative assistance to foreign countries. It does so if there is evidence of a tax fraud, but it doesn't if it's only tax evasion, since misdemeanours do not qualify for international assistance. This distinction has not been happily received by the international community.

# best-kept secret



## Swiss financial scandals

Often, when Switzerland receives international attention, it is connected to some sort of scandal in the financial sector.

In the late 1980s and early '90s, it came to light that many dictators, like Robert Mugabe from Zimbabwe, Jean-Claude "Baby Doc" Duvalier from Haiti and Imelda and Ferdinand Marcos from the Philippines kept millions of dollars in Swiss bank accounts. The scandal grew as more and more similar accounts were revealed.

Politicians reacted late but tough: they introduced a law against money laundering that is known as one of the strictest internationally. Now, banks must be able to identify the source of all money in any account and make sure they know which assets belong to which customer.

The late '90s were marked by a debate about assets in Swiss banks that were not identifiable. It turned out Swiss banks hid, and were in possession of many of the assets belonging to Jews who were killed during World War II.

Once U.S. lawyers caught on, they threatened Swiss banks – including UBS – with lawsuits that could have cost fortunes. To avoid such lawsuits, the banks agreed to pay a couple of Jewish organisations 1.25 billion U.S. dollars.

Once again, the Swiss government acted late. However, once the machinery started, the government set up a task force and later on a commission whose job it was to untangle the history of the lost assets.

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The United States and European Union consider Switzerland a tax oasis. When even rich countries are running out of money because they're pumping billions into weak economies, citizens accused of hiding taxable money offshore are appreciated even less than usual. Thus, pressure on Switzerland – and banking secrecy sisters Austria and Luxemburg – is increasing.

## Just the beginning

Despite Switzerland's release of account details for over 250 UBS customers, the United States is still threatening to cut UBS off from U.S. business. It's demanding the data of 52,000 more UBS customers who, it is estimated, have sheltered \$15 billion in Swiss banks. So far, the Swiss government has denied the request.

At the same time, the EU was also attacking Swiss banking secrecy. Led by Germany, France and the UK, the Union threatened Switzerland with blacklisting should it not agree to additional information exchange with foreign tax authorities.

As a consequence for not immediately agreeing, the three EU countries teamed up with the 30-member Organisation for Economic Co-operation and Development (OECD) to tighten the screws. And on March 11, the OECD added Switzerland to a provisional black list of countries it considers uncooperative with respect to tax affair transparency.

Only after Finance Minister Merz announced two days later that Switzerland was ready to make concessions did the OECD conditionally remove Switzerland from that list, and British Prime Minister Gordon Brown congratulate Merz for sacrificing banking secrecy.

This is the same Merz who a couple of months ago stressed: "the Swiss bank secrecy will not be touched". Now it has been touched – and cracked – by the very government that claimed it would defend banking secrecy no matter what.

"The Swiss government knuckled under to the OECD and proved its lack of leadership," said House Representative and Swiss People's Party (SVP) member Hans Fehr, in response to Merz's announcement.

Yet as Merz pointed out at his March press conference: "We [are] only loosening up bank secrecy internationally; Swiss inhabitants therefore are still granted the same secrecy as ever."

## Black to grey

However, the OECD didn't entirely remove Switzerland from the black list. The final decision, made on April 2 at the G-20 conference in London, came as a surprise.

“Switzerland is not on the black list, but, I am sorry to say, on a grey list,” French President Nicolas Sarkozy announced at a press conference. And indeed – the OECD devised three lists: a black list for countries still considered tax oases; a white list for countries that stick to OECD regulations; and a grey list for countries that have declared they will accept OECD rules but still need to prove it.

They grey list revelation caused varied reactions within Switzerland.

“It would have been better if Switzerland would be on the black list but wouldn’t have sacrificed the banking secrecy,” said Ivan Perrin, vice-president of the SVP.

Christophe Darbellay, president of the Christian Democratic People’s Party (CVP), was “relieved that Switzerland jumped off the black list”.

And Social Democratic Party Vice-President Stéphane Rossini stated: “That Switzerland is on the grey list proves how isolated the country is internationally.”

### Getting off the list

It is now the Swiss government’s first priority to get off the grey list. However, Finance Minister Merz stated it’s doubtful if Switzerland will be ready by autumn, when the next G-20 summit is scheduled.

“We have to explain to the international community that we are willing to set up the new standards, but that political processes in Switzerland need their time. I am sure they will understand,” he said.

And the political process is just beginning. Because Switzerland has double tax agreements with about 70 countries, each agreement needs to be changed to implement the new rules when it comes to revealing information about bank customers. The Swiss government recently announced that the U.S. and Japan are the first countries it will start negotiations with.

Each agreement could also be subject to a referendum. The SVP already announced it would take the steps needed to bring about a referendum that allows Swiss voters to decide on these agreements for themselves. If that happens, it would prolong the process even more.

To fulfil OECD expectations and get onto the white list, at least 12 of these agreements must be settled. There is no deadline from the OECD; however, the G-20 is expected to take a close look at developments during their next summit in September.

### Back at the bank

While the politics of banking secrecy were playing out across the world’s stage, UBS had been spiralling down, as reflected by its share price, which dropped to a record low of SFr 10 in February, from SFr 80.40 in June 2007 – and kept falling to breach the psychological SFr 10 floor a few days later.

Furthermore, UBS had to pay a SFr 900 million fine to U.S. authorities for tax evasion charges. Whether or not UBS top management knew of the illegal practices at its U.S. branch remains unclear; the management has consistently denied such allegations. Regardless, it could be argued that recent events in the United States helped to bring about the sweeping changes in top-level management.

First, Chief Executive Officer Marcel Rohner was replaced. Many were surprised by his successor: Oswald Grübel, former CEO of Credit Suisse, which is the biggest competitor of UBS (and incidentally surviving the financial crisis much better). Grübel’s appointment was well received, since he proved his abilities by guiding Credit Suisse out of troubled waters after 2000 when the bank was suffering the aftermath of acquisitions not directly related to the bank’s business, such as the Winterthur insurance company.

Then, only a week after Rohner resigned, President of the Board Peter Kurer announced his decision to step down, after not quite one year on the job. The proposal of his successor was yet another surprise: former Federal Councillor and Finance Minister Kaspar Villiger, from the Free Democratic Party (FDP).

Critics point out Villiger has no knowledge of the banking business. But during a press conference in March, Villiger said CEO Grübel is the one who should lead the bank, whereas the Board makes strategic decisions. Insiders see one big advantage of Villiger: his political network is still impressive, and as UBS is now being run on government money, these connections may come in handy.

### Out from under the veil

Switzerland’s future without its banking secrecy law is still an open question. First, it is not yet clear how much money could potentially be withdrawn from Swiss banks as the result of investor fears about the loss of privacy. The Swiss Bankers Association estimates the country’s banks are home to an approximate 2,000 billion Swiss francs in foreign investments.

Thus far, investors have remained cool. This is also due to the fact that it remains unclear how much money in Swiss bank accounts is undeclared money.

Some experts claim abolishing banking secrecy would make Switzerland a much cleaner financial centre and that the Swiss reputation in financial matters is not really connected to the banking secrecy law.

“That Switzerland will stick to OECD standards in the future is a positive step,” criminal law expert Mark Peith said to the Swiss Broadcasting Corporation’s online news source *swissinfo*. He went on to stress that with this solution, Switzerland only has to reveal data when a foreign country has reasonable suspicion, and therefore does not have to exchange data on an automatic basis.

Other experts are more critical. Ivan Pictet, senior managing partner of private bank Pictet & Cie and president of the Geneva Financial Centre, claimed that private banks especially would have to search for new business models, as investors are likely to withdraw their assets. Pictet fears that half of today’s investment volume will vanish.

And, of course, there will be another consequence: bad guys in Hollywood movies will have to transfer their money to new places now, as Swiss bank accounts are no longer safe havens. Maybe they could try out the British islands of Jersey or Guernsey, or the U.S. state of Florida. Even though they belong to countries that have criticised Swiss practices, they still profit from being places in which to hide money ... for now.

