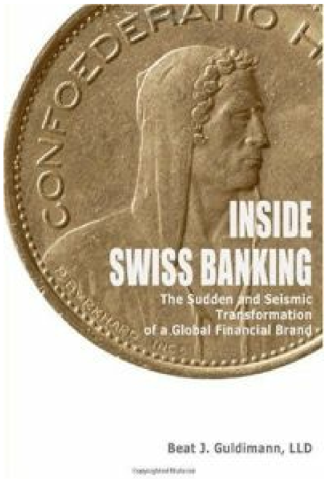

Book **Inside Swiss Banking**

The Sudden and Seismic Transformation of a Global Financial Brand

Beat J. Guldimann
LULU Publishing, 2010

Recommendation

A numbered Swiss bank account might rank high on your dream list, but don't count on it providing the same level of economic privacy that it once did. Now that financial transparency has become a weapon against global terrorism, tax fraud and political chicanery, Switzerland is no longer assured of its place as an island of banking privacy. Beat J. Guldimann's self-published, well-informed (but not well-proofread) book outlines the history of the Swiss banking industry and its overriding emphasis on client confidentiality. Guldimann, a former legal counsel and senior executive for major Swiss and Canadian financial institutions, says high-profile global investigations into tax evasion, political embezzlement and misappropriation killed Swiss banking secrecy. He acknowledges that some banking crimes took place, but posits that the Swiss financial establishment's complacency and its business-as-usual attitude helped bring about the nation's decline as an offshore banking haven. This dodges the question of where Swiss banks' competitive advantage now might lie. At times the book comes out swinging against Switzerland's perceived enemies, including the U.S., though Guldimann also offers their points of view. *BooksInShort* suggests this illuminating look at a secretive industry to students of financial history and to all those who hold numbered accounts (or who dream of them).

Take-Aways

- Switzerland is famous for neutrality, chocolate, watches and a propensity for individual privacy that gave birth to a banking system steeped in confidentiality.
- Numbered accounts do exist, but Swiss bankers are rigorous about knowing their clients.
- More wealthy people entrust their offshore funds to Swiss-based banks than to those in any other banking center.
- Until 2009, offshore account holders could escape their nations' tax authorities by shielding assets in Swiss accounts.
- People who are not Swiss also keep accounts in Swiss bank for perfectly legal reasons.
- Offshore clients seek preservation of inheritances and protection from sham litigation.
- "Politically exposed persons, or PEPs," such as the former Philippine dictator Ferdinand Marcos, subject Swiss banks to risk when authorities probe their accounts' legitimacy.
- Swiss banks weathered a major controversy over dormant Holocaust-era accounts.
- Recently, a discontented bank employee's whistle-blowing led to a tax evasion crisis.
- The Swatch watch resurrected the Swiss watch industry; Swiss private bankers will need to reinvent themselves in the same way.

Summary

A Safe Haven

In January 1997, Christoph Meili, a night watchman at a major Swiss bank in Zurich, discovered trash cans filled with banking records dating back to World War II. The files, about to be destroyed, were evidence in a case pitting the U.S. government against UBS, Switzerland's largest bank, for restitution of assets purportedly owned by Holocaust victims. This case and several other high-profile disputes placed Swiss banks and their vaunted confidentiality of client information on the hot seat globally. These banks are the world's largest money management firms and handle the biggest share of offshore funds owned by the world's richest people. Now, however, Swiss banks increasingly must defend practices that just a few decades ago constituted their raison d'être and their competitive advantage: protection of client information. Global terrorism, electronic funds transfers and political corruption threaten the cozy enclave that Swiss banks have always provided to the wealthy – and the famous or infamous. Indeed, some Swiss see new banking strictures as attacks against their sovereignty. After all, who should decide what practices are correct for

Swiss banks: Switzerland or the rest of the world?

> "It is commonly estimated that one-third of all offshore assets belonging to individuals around the globe are in the custody of Swiss banks."

Switzerland is famous for its banking confidentiality, along with its neutrality, chocolate and watches. But countless espionage stories and movie thrillers exaggerate that famous secrecy. Numbered accounts do exist, but each one is attached to an identifiable name, address and other data, albeit known only to a few bank employees. Such clients prefer to shelter assets in Switzerland because of taxes, litigation, political unrest, and the like. The Swiss follow strict "Know Your Client" (KYC) regulations in all financial dealings – as does the rest of the world, so how did Switzerland earn its reputation as a top-secret private banking refuge?

> "Because of its holes [Swiss cheese] became the perfect analogy to describe the many limitations of bank secrecy."

Switzerland has prioritized personal freedom and financial privacy in its regulations since the late 1800s. In 1934 it ratified the Bank Act, prohibiting its banks or their personnel from releasing client data. The Nazis had just passed laws forcing German banks to give financial data to the Third Reich so it could confiscate Jewish assets. The Swiss knew Jewish flight funds were flowing into Switzerland. To head off Nazi intimidation of its banks and citizens, Switzerland made revealing financial records a felony punishable by jail time. In 1937, it amended the Swiss Federal Criminal Code to include "economic espionage for foreign individuals, entities or governments." Given its situation – trying to keep the Nazis out of its land and out of its financial data – Switzerland was unique in legislating client confidentiality into its banking system.

> "While anonymous banking relationships can only be found in novels...numbered accounts do exist."

Switzerland's reputation as a reliable, safe banking center grew as generations of wealthy individuals and families from all over the world trusted its banks with their money, their business assets, their charitable trusts, their art collections and their children's college funds. Clients use Swiss accounts to protect their wealth from gratuitous legal threats and to build inheritances for their children. Private bankers support many customers out of their firm's special offices set up to address family banking needs. However, while banking secrecy allows reputable clients to enjoy Swiss service, it also shelters shadier characters with less than honest motives.

> "The banks could no longer go about their business following the ancient Roman axiom of 'pecunia non olet' (money does not smell)."

Over the years, as the financial world has evolved and society has changed, Swiss banking practices have preceded or reflected those shifts. In the 1980s, insider trading went from being an unavoidable part of high finance to a crime, and Switzerland amended its laws to criminalize it. Switzerland outlawed money laundering before the September 11, 2001, terrorist attacks and the enactment of the U.S. Patriot Act. But at the time, Switzerland's grip on client confidentiality, though loosening, remained firm.

Chiasso

In the late 1970s, Italy suffered political turmoil and the Italian Communist Party seemed poised to take over the government. Worried Italians of means flocked to the Swiss-border town of Chiasso, where willing bank executives aided in the illegal importation of Italian lira into Switzerland. They helped customers set up Liechtenstein-based holding companies that would secretly repatriate the funds. Regulators discovered these schemes when Swiss bankers had to pay guarantees on Italians' deposits due to the devaluation of the lira. Several Swiss bankers went to jail and the Swiss Bankers Association quickly responded with the "Code of Due Diligence," a self-policing guide to business behavior that sets out policies about customer classification, seeking to protect customer identities while forbidding illegal money transfers.

The Marcos Fiasco

When dictator Ferdinand Marcos fled the Philippines in 1986 after he was deposed, he left behind documents that revealed his massive bank deposits in, among other places, Switzerland's two then-leading banks, Swiss Bank Corporation and Credit Suisse. Investigators soon made it clear that the Marcos family did not legitimately own these funds – about $500 million. Rather, they were the misappropriated gains of decades of political corruption. The Philippine government and a U.S. class-action group instituted legal processes to reclaim the funds. The case led to many years of aggressive litigation, failed mediation and negative public scrutiny that shook Swiss private bankers. Until then, many political leaders, some beneficent, some thieving, had stashed their assets in Swiss banks to gain secrecy. This never overly concerned the bankers. But to repair the reputational damage of the Marcos affair and to prevent future debacles, Swiss banks began to screen "politically exposed persons, or PEPs," more carefully before taking them on as clients.

The Holocaust Claims

The Swiss banking community soon faced another public relations nightmare with roots in the early 1960s, when an order from the Swiss government forced the nation's banks to transfer the assets in all accounts held by known Holocaust victims to the Swiss National Bank. In turn, the bank passed the money to Israel. No one questioned this move until 1996, when the U.S. Senate examined claims from Holocaust victims' families for assets in dormant Swiss accounts. Banks in Switzerland hold unused accounts indefinitely, though in many other countries banks surrender stagnant accounts to a central bank after 10 years. During World War II, many Jewish account holders who were preparing for the worst set up powers of attorney for their assets. These remain in effect in Switzerland even after the grantors' deaths. The Swiss establishment was caught flat-footed when New York courts sued for the restitution of some $20 billion of assets.

> "The most important lesson learned from the Marcos case was that politicians were a client category that needed to be treated with heightened scrutiny and attention."

Night watchman Christoph Meili's 1997 discovery of the trash can filled with evidence created a firestorm of bad publicity for Swiss banks. The settlement, including $1.25 billion paid to Jewish groups, also resulted in the release of some 21,000 account names – the first time in history that Swiss banks publicized clients' identities.

Tax Evasion or Tax Fraud?

Until 2009, foreign depositors often stashed money in offshore Swiss bank accounts to reduce their tax bills in their home nations, giving those countries the long, often difficult task of prosecuting their tax avoiders. Unlike most sovereignties, Switzerland distinguished between tax evasion and tax fraud. Its laws did not deem tax evasion a crime – though tax fraud is illegal – so Swiss law did not require Swiss authorities to provide data to depositors' home jurisdictions unless the home countries showed proof of fraud. Swiss banks and Swiss taxing authorities do not share information on clients' holdings, as do banks in the U.S., Canada and the EU. The Swiss government has no central repository of investment income data. Lax taxation avoidance laws and the absence of central records drew many foreigners to Swiss banks. This has rankled other countries for years. Now and then, some try to repatriate taxation funds. For example, Italy holds periodic tax amnesties that have brought amounts totaling billions of dollars back to Italian banks.

> "Through the U.S. Senate investigation, the story of diamonds and toothpaste became the smoking gun of Swiss bankers acting like members of a spy agency rather than employees of a reputable bank."

In recent years, the OECD (Organisation for Economic Cooperation and Development) and the Group of Eight (G-8) countries prioritized pursuing tax cheaters more systematically and so began to pressure Switzerland. An unhappy technology worker at a bank in Liechtenstein helped in that chase when he sold confidential bank client data to the German authorities who promptly declared the information valid for their use in investigating German tax evaders. Even though the disgruntled worker may have obtained the information illegally, this emboldened other countries to press forward in their attempts to get client information on possible tax dodgers who held Swiss accounts. The U.S. Internal Revenue Service (IRS) came down hard on Igor Olenicoff, a wealthy real estate investor. Investigators who searched his home uncovered incriminating UBS bank records. Olenicoff's UBS banker, Bradley Birkenfeld, who took the concept of private banking to extremes, confessed to smuggling clients' diamonds overseas in his toothpaste.

> "The European Union and the United States have opened a unified front against Switzerland as a tax haven."

Information from Olenicoff and Birkenfeld, and the illegally sourced information from Liechtenstein, spurred the U.S. government to press the case that UBS had intentionally helped its American clients escape U.S. taxes. The investigation opened the door to the detention and indictment of other senior UBS officers and might have provoked criminal charges against UBS for defrauding the U.S., a move that would have threatened the bank's very existence. Its legal settlement forced UBS to reveal its documentation on 4,500 U.S. clients and to abandon serving U.S. customers offshore. The data U.S. investigators amassed also implicated other major Swiss banks, forcing Swiss authorities to react quickly to defuse the situation. Tensions grew between the two normally friendly countries. Swiss citizens resented the perceived threat to their country's sovereignty. Diplomats at the highest levels took public positions. The disagreement risked disruption in Switzerland's pivotal role as an intermediary for the U.S. with countries like Iran.

> "With UBS now playing a much more visible role in...domestic wealth management...the U.S. could no longer ignore the offshore business that the firm was engaged in with U.S. persons."

The UBS affair led Switzerland to renegotiate its tax treaties with several other countries, so it now permits foreign inquiry into alleged tax evasion. In 2009, Switzerland signed a new tax agreement with the U.S., extending that right to U.S. officials if they show sufficient cause.

The Aftermath

Switzerland wants to be accountable to the rest of the world in combating international tax evasion and monetary flight. A nation of just seven million people, with no natural resources with which to support a domestic economy, Switzerland relies greatly on its banks and the global marketplace for capital and employment. Surrounded by the EU, of which it is not a member, and a very reluctant participant in geopolitical groups – it didn't join the U.N. until 2002 – Switzerland must carve out its place in the modern world. Its history of neutrality has rightly magnified its position in diplomacy. While it has avoided fighting in wars, the nation has played undeniably important roles in mediating global disputes. In an increasingly connected world, Switzerland wants to create a more active place for itself in international affairs. Its foreign minister has even raised the possibility that Switzerland might join the Group of 20 (G-20).

> "Besides its neutrality Switzerland has little to offer that would give it legal or political clout in the global community."

What lies in the future for Swiss private banking, now that offshore clients can no longer use it to escape their tax collectors? Switzerland's smaller financial institutions may need to consolidate with larger Swiss or foreign banks to survive. Switzerland's larger banks, which are among the most modern, efficient and professional in the world, operate across the globe and compete successfully in all areas of banking with peers in the U.S., Asia and the EU. Optimizing their services, improving their products, assuring their security and risk management, and bolstering their onshore presence with offices worldwide will help guarantee their continued profitability.

> "Bank secrecy is no more a Swiss invention than...watches."

In the 1970s, inexpensive watches from Asia challenged the dominance of the Swiss watch industry. The Swiss lost many jobs to cheap imports, and many watchmakers closed. But the Swatch saved the Swiss industry from extinction. In the 1980s, ingenuity, strategy and fresh ideas put a Swatch on every chic wrist. Switzerland will have to bring the same skills to bear in financial services to retain its banks' global leadership.

About the Author

Beat J. Guldimann, LLD, was a senior executive and legal counsel for major Swiss and Canadian banks. His firm, Tribeca Consulting Group, specializes in consulting for private banks.