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Demystification of the Swiss Banking Secrecy and Illumination of the United States-Swiss Memorandum of Understanding

by Peter C. Honegger, Jr.*

I. Introduction

The "Memorandum of Understanding" between American and Swiss representatives was agreed upon to improve United States — Swiss law enforcement cooperation in the field of insider trading.¹ Repeated cases of insider transactions in the United States gave rise to the present "Memorandum of Understanding." Because these insider transactions were made through Swiss banks, the investigations of the United States' Securities and Exchange Commission (SEC) were repeatedly frustrated by Swiss banking secrecy laws. Therefore, an understanding of the legal background of the "Memorandum of Understanding" first requires insight into Swiss banking secrecy law.

Although banking secrecy is not without limitations under Swiss law, disclosure of the secrecy to foreign authorities can usually only be granted based on a judicial assistance treaty. Two recent cases² of insider trading in the United States through Swiss banks raised the question whether the banks can be compelled to reveal information to the SEC under the existing assistance treaty between the two nations. In the "Memorandum of Understanding" the countries ascertained the limited applicability of their treaty and agreed upon a new procedure of lifting the banking secrecy.

This article will discuss these facts and events, evaluate the new procedure, and point out a number of unsolved problems.

II. Provisions of the Swiss Banking Secrecy

"Banking secrecy" means that the banks must keep secret any information about their clients regarding privacy and property, which they

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¹ The negotiations took place in Bern, Switzerland on March 1 and 2, 1982, and in Washington, D.C. on August 30 and 31, 1982.

² SEC v. Certain Unknown Purchasers of the Common Stock, and Call Options for the Common Stock of Santa Fe Int'l Corp., [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,323 (S.D.N.Y. Oct. 26, 1981); SEC v. Banca Della Svizzera Italiana, 92 F.R.D. 111 (1981).

receive by practicing their business. This discretion applies to the banks' officers, employees and any other persons with a direct relation to the bank. The banker's discretion is based on three different legal concepts under Swiss law: (1) personality rights; (2) contractual duties; and (3) banking law that criminalizes secrecy violations.

Articles 27 and 28 of the Swiss Civil Code provide protection of personality rights.³ Article 28 permits a person who is illegally injured to sue for relief.⁴ Natural and legal persons (*i.e.* corporate bodies) are protected.⁵ The Swiss Federal Supreme Court has decided consistently that the invulnerability of privacy is both a moral principle and an attribute of personality protected by the law.⁶ Property is part of this privacy. The duty of discretion applies to all persons who are given insight into the privacy of others by their profession (*i.e.* clergymen, lawyers, notaries, physicians and bankers).

Even without express agreement, discretion is an implied contractual duty of the banker. This duty is a result of either the general law of contract or the law of agency. In most cases, the relation between bank and customer is governed by the law of agency. Here, the banker's discretion is part of his faithful and careful compliance with contractual duties.⁷ If the contract between the bank and the customer has no elements of agency, the banker's duty of discretion is a consequence of the good faith principle and of usage.⁸ Even absent a contract between bank and client, the beginning of negotiations between the parties creates factual relations that have legal consequences; the banker has a general duty of discretion based on the mentioned good faith principle of the Swiss Civil Code.⁹

Article 47 of the Banking Law¹⁰ criminalizes secrecy violations.¹¹ The Banking Law, however, does not specify what constitutes a violation of the banker's discretion. The notion of banking secrecy is defined solely by private law through the implications of the personality rights and by contractual duties.

³ Code Civil Suisse [C.C.] Arts. 27 and 28 (Switz.).

⁴ Article 28 of the Swiss Civil Code states: "Where anyone is being injured in his person or reputation by another's unlawful act, he can apply to the judge for an injunction to restrain the continuation of the act. An action for damages or for the payment of a sum of money by way of moral compensation can be brought only in special cases provided by the law." *Id.* at Art. 28.

⁵ See C.C. Arts. 11, 12, 52, 53, and 54.

⁶ See, *e.g.*, BG 97 II 97, 100, 102; BG 91 I 200, 204; BG 44 II 319, 320. See also Comment, *Swiss Banks and Their American Clients*, 3 CAL. U. INT'L L.J. 37, 42 (1954).

⁷ Code des Obligations [C.O.] Art. 398(2)(Switz.).

⁸ The good faith principle is laid down in C.C. Art. 2(1). See Mueller, *The Swiss Banking Secret*, 18 INT'L & COMP. L. Q. 360, 361 (1969).

⁹ See Mueller, *supra* note 8, at 361.

¹⁰ Bundesgesetz uber die Banken und Sparkassen of Nov. 8, 1934, as amended by Federal Law of Mar. 11, 1971.

¹¹ See *infra* note 24 for text of Art. 47. Under Swiss law, the Banking Law is part of the administrative law. Nevertheless it also has provisions of criminal law nature.

Violations of banking secrecy laws may result in civil liability under tort or contract law, or in criminal sanctions. The violation of the client's personality rights gives rise to a tort action.¹² The client must prove

- (a) the damages sustained by the banker's disclosure;
- (b) negligence or willfulness of the banker;
- (c) cause in fact and proximate cause, *i.e.* that the harm was caused (foreseeably) by the disclosure; and
- (d) the illegality of the disclosure, which is imminent absent either a legal provision or a client's waiver permitting the bank to give information to third persons or public authorities.¹³

If the particular seriousness of the injury and of the fault justify it, the client also has a claim to a payment of money as reparation.¹⁴ Action can be brought against the bank itself which is liable for the torts of its employees.¹⁵

Since the banker's discretion is an implied contractual duty, disclosure is an actionable breach of contract.¹⁶ To establish the banker's liability the client has to prove:

- (a) the damages sustained by the disclosure;
- (b) breach of contract by the banker, *i.e.* the disclosure; and
- (c) cause in fact and proximate cause, *i.e.* that the damages were caused (foreseeably) by the disclosed information.¹⁷

There is a rebuttable presumption of fault against the banker.¹⁸ As under tort law, an action can also be maintained against the bank itself which is liable for breach of contract by its employees.¹⁹ Since the beginning of negotiations imposes a duty of discretion on the banker,²⁰ he is liable under contract law even though no contract has yet been validly agreed upon.²¹ Moreover, even if the parties ended their contract, the

¹² Article 41 subsection 1 of the Swiss Obligation Code states: "Whoever unlawfully causes damage to another, whether willfully or negligently, shall be liable for damages." C.O. Art. 41(1).

¹³ See *infra* Section III.

¹⁴ C.O. Art. 49(1).

¹⁵ Article 55 subsection 1 of the Swiss Obligation Code reads: "The principal shall be liable for damages caused by its employees or other auxiliary persons in the course of their employment or official capacity, unless he proves that he has taken all precautions appropriate under the circumstances in order to prevent damage of that kind, or that the damage would have occurred in spite of the application of such precautions." C.O. Art. 55(1).

¹⁶ Article 97 subsection 1 of the Swiss Obligation Code provides: "If the performance of an obligation cannot at all or not duly be effected, the obligor shall compensate for damage arising therefrom, unless he proves that no fault at all is attributable to him." C.O. Art. 97(1).

¹⁷ C.O. Arts. 99(3), 42, 43, 44.

¹⁸ *Id.* at Art. 97(1).

¹⁹ Article 101 subsection 1 of the Swiss Obligation Code states: "If an obligor, even though authorized, has performed an obligation, or exercised a right arising out of a legal relationship, through an auxiliary person, such as a co-tenant or an employee, the obligor must compensate the other party for any damages caused by the acts of the auxiliary person." C.O. Art. 101(1).

²⁰ See *supra* note 9 and accompanying text.

²¹ See Meyer, *Swiss Banking Secrecy and Its Legal Implications in the United States*, 14 NEW ENG. L. REV. 18, 24 (1978).

duty of discretion continues as long as the interest of the client demands confidentiality.

Under Swiss law, personality rights are a fundamental principle of law.²² They are, therefore, protected by both private law actions and by criminal sanctions. Clergymen, lawyers, notaries, auditors and physicians who divulge a client's secrets face imprisonment for between three days and three years and/or a fine of up to 40,000.00 Swiss Francs.²³ Secrecy violations by bankers are criminalized by Article 47 of the Banking Law,²⁴ which does not provide undue sanctions. Intentional disclosure of the banking secrecy is punishable by imprisonment between three days and six months and/or a fine not exceeding 50,000.00 Swiss Francs.²⁵ Negligent failure of confidentiality is sanctioned by a fine of up to 30,000.00 Swiss Francs.²⁶ Bankers face a much lower penalty than the above mentioned professions.

The mystification of Swiss banking practices continues due to the erroneous assumption that numbered or coded accounts receive special treatment under Swiss law.²⁷ Numbered accounts are subject to the same legal provisions as all other kinds of accounts. The contents and

²² See *supra* notes 3-6 and accompanying text.

²³ Article 321 of the Swiss Penal Code states:

Violation of Vocational Secrets:

1. Clergymen, attorneys, defenders, notaries public, secrecybound auditors according to the Code of Obligations, doctors, dentists, pharmacists, midwives, and their assisting personnel, who divulge a secret entrusted to them, or of which they have become aware in their professional capacity, shall, on petition, be punished by imprisonment or by a fine. Students who divulge a secret they have become aware of during their study are punished as well. The violation of professional secrecy remains punishable even after termination of the exercise of the profession or after termination of the study.

2. The offender shall not be punished if he divulges the secret based on the protected person's consent or, on the offender's request, on written authorization by his superior or controlling authority.

3. Federal and Cantonal regulations concerning the obligation to testify and to furnish information to a government authority shall remain reserved.

Code penal Suisse [C.P.] Art. 321.

²⁴ Article 47 of the Swiss Banking Law reads as follows:

1. Whoever divulges a secret entrusted to him in his capacity as officer, employee, mandatory liquidator or commissioner of a bank, as a representative of the Banking Commission, officer or employee of a recognized auditing company, or who has become aware of such a secret in this capacity, and whoever tries to induce others to violate professional secrecy, shall be punished by a prison term not to exceed six months or by a fine not exceeding 50,000.00 francs.

2. If the act has been committed by negligence, the penalty shall be a fine not exceeding 30,000.00 francs.

3. The violation of professional secrecy remains punishable even after termination of the official or employment relationship or the exercise of the profession.

4. Federal and Cantonal regulations concerning the obligation to testify and to furnish information to a government authority shall remain reserved.

Banking Law, *supra* note 10, at Art. 47.

²⁵ *Id.* at Art. 47(1).

²⁶ *Id.* at Art. 47(2).

²⁷ See N. FAITH, SAFETY IN NUMBERS: THE MYSTERIOUS WORLD OF SWISS BANKING (1982).

limits²⁸ of the banking secrecy are exactly the same, whether the account bears the client's name or is numbered.

The goal of coded accounts is to entrust as few bank employees as possible with the holder's name by replacing a name with a number in all correspondence between the bank and its customer. Coded accounts are granted only if the depositor shows legitimate reasons for such protection, *e.g.* by his personage.²⁹ Thus, the percentage of coded accounts is small.³⁰ They are set up in the same manner as other bank accounts but the bank takes precautions that the identity of the client remains unknown to its employees. Generally, at a minimum, the management or the regarding department of the bank knows the account holder's name. Purely anonymous accounts do not exist in Switzerland. Numbered accounts are nothing but an internal technical device to help banks avoid secrecy violations by their employees.³¹

III. Limits of the Banking Secrecy Under Swiss Law

The Swiss banking secrecy is not without limitations; both the will of the client and legal limitations determine its scope. As a result of the private law nature of the banking secrecy, the client, and not the bank, is the master of the secret.³² Thus, the client can ask the bank for any information he may wish regarding his account, and he can authorize the bank to furnish such information to third parties, especially to governmental authorities.³³ As long as the customer does not act, however, his wish for confidentiality must be presumed.³⁴

The Banking Law, which generally prohibits disclosure of the secrecy, provides that the Federal and Cantonal regulations concerning the obligation to testify and to furnish information to a government authority shall remain reserved.³⁵ Such government authorities can only be domestic, not foreign.³⁶ The most important areas in which the banking secrecy may be divulged to Swiss authorities are: (1) criminal proceedings, (2) civil proceedings, (3) execution of debts and bankruptcy proceedings and (4) tax proceedings.

Switzerland is a confederation of twenty-six states, called "Cantons."³⁷ Criminal procedure is a field of chiefly Cantonal legislation.

²⁸ See *infra* Section III.

²⁹ See generally Meyer, *supra* note 21, at 28 n.55.

³⁰ *Id.*

³¹ See Mueller, *supra* note 8, at 362.

³² See Comment, *supra* note 6, at 42-43.

³³ See Mueller, *supra* note 8, at 367.

³⁴ *Id.* at 363.

³⁵ See Banking Law, *supra* note 24, at Art. 47(4). There are also some legal provisions of less importance restricting the banking secrecy between individuals. For a short overview, see Meyer, *supra* note 21, at 29-30.

³⁶ See Mueller, *supra* note 8, at 367.

³⁷ The Swiss Confederation now has 26 Cantons and Half-Cantons. Where there is ambiguity, "Canton" means Canton or Half-Canton. C. HUGHES, *THE FEDERAL CONSTITUTION OF SWITZERLAND* at 3-4 (1954).

The Federal Law of Criminal Procedure,³⁸ as well as the Cantonal codes of criminal procedure, settle the duty of third persons to testify and edit documents of interest in criminal cases. Clergymen, physicians, lawyers, and the accused are exempt.³⁹ Bankers are not.⁴⁰ Therefore, under Swiss law, the banking secrecy is entirely cancelled in the field of criminal procedure.

Like criminal procedure, civil procedure is a field of mainly Cantonal legislation. The Federal Law of Civil Procedure⁴¹ stipulates a public duty of testimony from which bankers are not exempt. Therefore, on the federal level, the banking secrecy is superseded. The Cantonal codes of civil procedure establish the duty of third persons to testify and to edit documents of interest in civil cases. As to the exemption of persons with a professional duty of discretion, the Cantons are split into three groups. Seven Cantons entitle all holders of professional secrets to refuse testimony;⁴² seven Cantons empower the judge to decide whether the banking secret should be superseded in the particular case;⁴³ and eleven Cantons enumerate the persons who are entitled to refuse testimony and edit documents because of their professional discretion.⁴⁴ Since bankers are not listed by any of these eleven Cantons, they have to divulge the banking secrecy.⁴⁵

The area of execution of debts and bankruptcy law is unified throughout Switzerland by the Federal Bankruptcy Law.⁴⁶ Under this code, a debtor cannot avoid paying his debts by concealing his banking accounts.⁴⁷ Thus, the debt collection agency has a right of information as far as is necessary to pay off the creditors.⁴⁸ In at least the later stages of the attachment proceedings, the creditor has the right to information about the nature and size of the attached property. Attachment is granted, even before the commencement of a debt collection, if the debtor, as the owner of a banking account, has no fixed place of residence in Switzerland or is likely to evade his legal obligations.⁴⁹ Finally, the banking secrecy is superseded in a bankruptcy proceeding of the bank itself. "The interest of a few persons in the secrecy has to give way to the interest of the creditors to divulge the bank's business

³⁸ Bundesgesetz über die Bundesstrafrechtspflege of June 15, 1934.

³⁹ See Mueller, *supra* note 8, at 366-68.

⁴⁰ *Id.* at 368.

⁴¹ Bundesgesetz über den Bundeszivilprozess of December 4, 1947.

⁴² The Cantons: Aargau, Berne, Geneva, Neuchatel, St. Gallen, Valais, Vaud. Meyer, *supra* note 21, at 32.

⁴³ The Cantons: Freiburg, Nidwalden, Schwyz, Ticino, Uri, Zug, Zurich. *Id.*

⁴⁴ The Cantons: Appenzell AR, Appenzell IR, Basel-Land, Basel-Stadt, Glarus, Grison, Lucerne, Obwalden, Shaffouse, Solothurn, Thurgau. *Id.* at 31.

⁴⁵ The regulation in the Canton Jura is not known to the author.

⁴⁶ Bundesgesetz über Schuldbetreibung und Konkurs of April 11, 1889.

⁴⁷ See Meyer, *supra* note 21, at 35.

⁴⁸ *Id.* at 35 n.108.

⁴⁹ See Bankruptcy Law, *supra* note 46, at Arts. 271-76.

connections."⁵⁰

Both the Federal state and the Cantons levy taxes. While fiscal charges are imposed chiefly by Federal taxes, the levy of income and capital taxes remains mainly in the province of the Cantons.⁵¹ Therefore, the latter taxes can differ substantially. The taxes are collected by the Cantons in accordance with their own procedural law.

None of the Cantonal tax laws stipulates a general duty of third persons to furnish tax authorities with information, nor do they impose such duty especially on bankers. Thus a banker can refuse to provide information to tax authorities.⁵² This is only true for minor tax offenses, however, usually called tax evasion by the tax laws.⁵³ Tax evasion is the non-reporting or the incomplete reporting of income or capital without any further manipulations.⁵⁴

If the taxpayer uses fraudulent practices or falsifies documents in order to mislead the Revenue authorities the situation changes. His tax offense becomes a tax fraud according to the language of the tax laws.⁵⁵ Some Cantons treat tax fraud as a matter of tax law and impose no duty of information on a third person. Others consider it a crime. The major banking centers of Switzerland (*i.e.* Zurich, Geneva, and Basel), join the latter group. Since these Cantons make tax fraud a crime, their respective codes of criminal procedure apply. As a result, the banking secrecy is annulled when tax fraud is at issue.⁵⁶

Under the Agreement between the Swiss Bankers' Association and the Swiss National Bank on the Observance of Care by the Banks in Accepting Funds, and on the Practice of Banking Secrecy,⁵⁷ the banks bind themselves not to open any account or deposit without prior clarification of the customer's identity,⁵⁸ and not to support flight of capital and tax evasion.⁵⁹ The duty to clarify thoroughly the customer's identity requires that the latter identify himself if the banker does not know him personally.⁶⁰ The identification must also be thoroughly examined where the client is granted a numbered account.⁶¹ If the customer is

⁵⁰ BG 86 III 114, 117. For a discussion of this decision see Mueller, *supra* note 8, at 369.

⁵¹ See WORLD TAX SERIES, TAXATION IN SWITZERLAND 133-137 (B. Boczek ed. 1976).

⁵² See Meyer, *supra* note 21, at 33.

⁵³ *Id.* at 33-34.

⁵⁴ *Id.* at 33.

⁵⁵ *Id.* at 34.

⁵⁶ *Id.*

⁵⁷ The agreement, hereinafter cited as "Know your Customer Agreement," was first enacted on July 1, 1977 and was renewed for an additional five years on October 1, 1982 with little change. It is accompanied by executive regulations of July 1, 1982, of the Swiss National Bank and the Swiss Bankers' Association. See Hawes, Lee & Robert, *Insider Trading Law Development: An International Analysis*, 14 LAW & POL'Y BUS. 335 (1982); Schultz, *Bankgeheimnis und internationale Rechtshilfe in Strafsachen*, Bankvereinheft 22, 9-10 (1982).

⁵⁸ Know your Customer Agreement, *supra* note 57, at Arts. 3-6.

⁵⁹ *Id.* at Arts. 8-9.

⁶⁰ *Id.* at Art. 3 and executive regulations.

⁶¹ *Id.*

represented by an agent, the latter must identify his principal unless the agent is a Swiss lawyer, notary, or member of a Swiss trust or auditing company.⁶² This exception had to be made because of the professional discretion of the referring agents. Even these agents, however, bound to professional discretion by criminal sanctions,⁶³ must confirm to the bank that they are not aware of any circumstances where the banking secrecy will be abused.⁶⁴

In its second version, the agreement no longer mentions money obviously gained by criminal acts. The reason is that such behavior is interdicted rigorously by the Swiss Criminal Code.⁶⁵ Under the agreement, a bank is not obliged to inform the authorities of a suspicious customer, but it has to abandon business relationships with the regarding client immediately.⁶⁶ A bank's infringement of the terms of the agreement is punished by a penalty of up to ten million Swiss Francs.⁶⁷

This agreement appears to be applicable without any infringement of banking secrecy laws.⁶⁸ In accordance with the legal duties of confidentiality, the agreement seems only to guarantee the ethics of the bankers' profession.⁶⁹ To the extent that the agreement does limit the scope of banking secrecy by empowering the banks to partially or wholly divulge the secrecy, it would be irrelevant.⁷⁰ The banks cannot neutralize the legal rights of their customers⁷¹ by a contract with a third party, here the other banks and the Swiss National Bank. The agreement, therefore, has no influence on the contents and scope of the Swiss banking secrecy.

IV. Disclosure of the Secrecy to Foreign Authorities

Swiss bankers are permitted to divulge the secrecy to Swiss, but not to foreign authorities.⁷² Foreign authorities have to request judicial assistance by their diplomatic missions unless there is a special agreement.⁷³ The request must be addressed to the Federal Department of Justice and Police. If permissible, the request is then forwarded to the competent Cantonal court which rules on the request.⁷⁴

Because annulment of the banking secrecy is a "compulsory meas-

⁶² *Id.* at Art. 6 and executive regulations.

⁶³ *See supra* note 23 and accompanying text.

⁶⁴ Know your Customer Agreement, *supra* note 57, at Art. 6 and executive regulations.

⁶⁵ Under article 144 of the Swiss Criminal Code (Schweizerisches Strafgesetzbuch [STGB]) the receiver of stolen goods generally "shall be confined in the penitentiary for not over five years or in the prison."

⁶⁶ Know your Customer Agreement, *supra* note 57, at Art. 11 and executive regulations.

⁶⁷ *Id.* at Art. 13 (3).

⁶⁸ M. AUBERT, J. KERNEN, H. SCHONLE, *LE SECRET BANCAIRE SUISSE* 193 (1982).

⁶⁹ *Id.*

⁷⁰ *Id.* at 188.

⁷¹ *See supra* notes 3-9 and accompanying text.

⁷² *See supra* note 36 and accompanying text.

⁷³ *See Miller, International Cooperation in Litigation Between the United States and Switzerland: Unilateral Procedural Accomodation in a Test Tube*, 49 MINN. L. REV. 1069, 1079-1083 (1965).

⁷⁴ *Id.*

ure," it can be ordered by a Cantonal court only if such measures are provided for by Swiss law or by a ratified treaty.⁷⁵ Switzerland enacted the Federal Law on International Judicial Assistance in Criminal Matters on January 1, 1983,⁷⁶ which provides compulsory measures.⁷⁷ Such measures are also provided for by the American-Swiss Treaty on Mutual Assistance in Criminal Matters,⁷⁸ and the European Convention on Judicial Assistance in Criminal Matters, the latter being enacted in Switzerland on March 20, 1967. Since the Federal Law on International Judicial Assistance in Criminal Matters applies to all states which have no special treaty with Switzerland, it is possible for all foreign authorities to ask for divulgence of the Swiss banking secrecy in the area of criminal matters.⁷⁹

There are, however, some important limitations. Traditionally, Switzerland has refused judicial assistance which may jeopardize its sovereignty, security, public order, or other of its essential interests.⁸⁰ Under exceptional circumstances, the disclosure of a professional secret may represent such an essential interest. In addition, assistance is refused if foreign military, political or fiscal offenses are prosecuted.⁸¹ The notion of "fiscal offense" is interpreted extensively, and covers not only evasion of public levy, but also violations of foreign exchange, trade, or economic public regulations.⁸² Such laws are often politically motivated.

V. Recent Insider Trading in America through Swiss Banks

American insiders, in possession of nonpublic information, may channel their stock market operations through Swiss banks. In so doing, they probably violate either Section 10(b) or Section 14(e) of the Securities Exchange Act of 1934,⁸³ and Rule 10b-5 or 14e-3⁸⁴ promulgated thereunder.⁸⁵ By adding a third party between themselves and their broker they can realize illegal profits without material risk of detection by

⁷⁵ AUBERT, KERNEN, SCHONLE, *supra* note 68, at 306.

⁷⁶ Bundesgesetz über internationale Rechtshilfe in Strafsachen of March 20, 1981; enacted January 1, 1983. For a discussion of the impact of the new law, especially in tax matters, see Friedli, *New Law Helps Lift Veil of Secrecy from Swiss Banking*, *Legal Times*, Dec. 5, 1983, at 11.

⁷⁷ Bundesgesetz über internationale Rechtshilfe in Strafsachen at Art. 64.

⁷⁸ 27 U.S.T. 2019, T.I.A.S. No. 8302. For a discussion of this Treaty see *infra* Section VI.

⁷⁹ Other fields are usually of less importance. Nonetheless it is pointed out that Switzerland is a member of the Hague Convention on Judicial Assistance in Civil Procedure. Convention Relating to Civil Procedure, done Mar. 1, 1954, 286 U.N.T.S. 4173. Despite the fact that the United States is not a party to this Convention, Switzerland grants United States requests according to that Convention. See Frei, *The Service of Process and the Taking of Evidence on Behalf of U.S. Proceedings — the Problem of Granting Assistance*, 35 *WUR* 196, 200 (1983).

⁸⁰ See Meyer, *supra* note 21, at 54.

⁸¹ *Id.* at 55.

⁸² *Id.*

⁸³ 15 U.S.C. § 78j(b) and § 78n(e) (Supp. 1980).

⁸⁴ 17 C.F.R. § 240.10b-5 and 14e-3 (1981).

⁸⁵ See Greene, *U.S., Switzerland Agree to Prosecute Inside Traders*, *Legal Times*, Oct. 4, 1982, 12, Col. 1, at 12, col. 2.

the Securities and Exchange Commission,⁸⁶ which is authorized by Section 21 of the Securities Exchange Act to make regarding investigations.⁸⁷ American authorities have studied this problem for many years.⁸⁸ Recently, however, two spectacular cases have renewed official interest in the problem and have attracted the public's attention.

In *SEC v. Unknown Purchasers of the Santa Fe Co.*,⁸⁹ the Securities and Exchange Commission filed a complaint against certain unknown purchasers of the common stock of, and call options for, the common stock of the Santa Fe International Corporation. The complaint alleged that the unknown purchasers had violated the antifraud provisions of the Exchange Act by effecting transactions while in possession of material non-public information, *i.e.* merger discussions between Santa Fe and Kuwait Petroleum Corp. The SEC's complaint further alleged that the unknown purchasers sold the shares and option contracts in the two week period following the announcement of the merger and that the value of such shares and option contracts increased in the aggregate, over five million dollars.⁹⁰ The complaint named as "nominal" defendants various financial institutions and broker-dealers with knowledge of the identity of the unknown purchasers and with custody of the proceeds of the allegedly violative transactions. Such nominal defendants included two of the most respected Swiss banks: Credit Suisse and Swiss Bank Corporation.⁹¹ The United States District Court for the Southern District of New York granted the Commission's application for a temporary restraining order against the nominal defendants to prevent disposal of the assets of the unknown purchasers relating to their transactions in Santa Fe options and common stock.⁹² The SEC's application for an order compelling the nominal defendants to identify the purchasers and for expedited discovery was denied, however.⁹³

In *SEC v. Banca Della Svizzera Italiana (BSI)*,⁹⁴ the District Court for the Southern District of New York granted a farther reaching order than was granted in *Santa Fe*. In this case, the SEC alleged insider trading on the part of the defendant and its principals in the purchase and sale of

⁸⁶ See *infra* Section VII.

⁸⁷ 15 U.S.C. § 78u (Supp. 1980).

⁸⁸ See *Swiss Banks and Secrecy Laws: Hearings Before the House Comm. on Banking and Currency on H.R. 15037*, 91st Cong., 1st and 2d Sess. 364 (1969-1970), at 12.

⁸⁹ *SEC v. Certain Unknown Purchasers of the Common Stock, and Call Options for the Common Stock of Santa Fe Int'l Corp.*, [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,323 (S.D.N.Y. Oct. 26, 1981).

⁹⁰ *Id.* at 92,026.

⁹¹ Other nominal defendants were: Swiss-American Securities, Inc., Citibank, N.A., Lombard Odier & Cie, Morgan Guaranty Trust Co. of New York, Drexel Burnham Lambert, Inc., the Chase Manhattan Bank, N.A., and Moseley, Hallgarten, Estabrook and Wedden, Inc. *Id.* at ¶ 92,025.

⁹² *Id.* at ¶ 92,026.

⁹³ The SEC also subsequently brought charges against the general counsel of a subsidiary of Santa Fe International Corp., his wife, other relatives, and a neighbor. See *SEC v. Feole*, 14 SEC. REG. & L. REP. (BNA) No. 39, at 1717 (C.D. Cal. filed Sept. 8, 1982).

⁹⁴ 92 F.R.D. 111 (1981).

call options for the common stock, as well as the common stock itself, of St. Joe Minerals Corporation.⁹⁵ On March 10, 1981 the defendant purchased through a New York subsidiary corporation 3,000 shares of St. Joe common stock and approximately 1,055 call options which carried the right to purchase 105,500 shares of common stock. The purchases in question were made immediately prior to the announcement on March 11, 1981 of a cash tender offer by a subsidiary of Joseph E. Seagram & Sons, Inc., an Indiana corporation. On the next day, BSI instructed its brokers to close out the purchases of the options and sell 2,000 of the 3,000 shares of common stock. The transactions resulted in an overnight profit of two million dollars.⁹⁶

The Securities and Exchange Commission brought suit alleging that the purchasers were unlawfully using material nonpublic information which could only have been obtained or misappropriated from sources charged with a confidential duty not to disclose information prior to the public announcement of the tender offer. The SEC obtained a temporary restraining order against Irving Trust Company which held the proceeds of the sales of the options, and of the common stock, in defendant's bank account with Irving Trust. The order also directed immediate discovery proceedings, including the requirement that "insofar as permitted by law" BSI should disclose within three business days the identity of its principals. BSI refused to furnish the requested information, adhering to its duties under Swiss banking secrecy law.⁹⁷

The court stated, that in line with other circuits and district courts, the Second Circuit had retreated from the position that the foreign law's prohibition of discovery is an absolute bar to compelling disclosure.⁹⁸ In support of its position, the court referred to the Supreme Court's last decision on the subject⁹⁹ and section 40 of the Restatement (Second), Foreign Relations Law of the United States (1965) (Restatement of Foreign Relations). In *Societe Internationale pour Participations Industrielles et Commerciales, S.A. v. Rogers*,¹⁰⁰ the Supreme Court held that a foreign law's prohibition of discovery is not decisive of the issue. The good faith of the party resisting discovery is a key factor in the decision whether to impose sanctions when a foreign law prohibits the requested disclosure. Section 40 of the Restatement of Foreign Relations provides that where

⁹⁵ The present case is sometimes also referred to as the St. Joe (Minerals) case.

⁹⁶ 92 F.R.D. at 113.

⁹⁷ The defendant had furnished some, but not all, of the answers to the demanded interrogatories after a waiver of Swiss banking confidentiality was secured from the customers concerned. The released information disclosed the names of three Panamanian corporations and one Swiss corporation for whom the St. Joe options had been purchased, as well as the name of the customer who had ordered the transactions on the corporations' behalf: Giuseppe Tomo, a close friend and advisor of the head of the Seagram Company. Siegel, *United States Insider Trading Prohibition in Conflict with Swiss Bank Secrecy*, 4 J. COMP. CORP. L. & SEC. REG. 353, 362 (1982).

⁹⁸ 92 F.R.D. at 116.

⁹⁹ See *infra* note 100 and accompanying text.

¹⁰⁰ 357 U.S. 197 (1958).

two states have jurisdiction to prescribe and enforce rules of law, and the rules they may prescribe require inconsistent conduct upon the part of a person, each state is required to consider primarily the vital national interests of each of the states and the hardship that inconsistent enforcement actions would impose upon the person.¹⁰¹

In *BSI*, the court emphasized the strength of the United States' interest in enforcing its securities laws to ensure the integrity of its financial markets. The court pointed out that secret foreign bank accounts and secret foreign financial institutions had permitted a proliferation of "white collar" crime and had allowed Americans and others to avoid the laws and regulations concerning securities and exchanges. It went on to emphasize the debilitating effects of the use of these secret institutions on Americans and on the American economy.¹⁰² The court also observed that, although expressly aware of the litigation, the Swiss government had expressed no opposition, and neither the United States nor the Swiss government had suggested that discovery be halted. The court stated that Swiss banking secrecy law had been enacted primarily to protect the right of privacy of clients,¹⁰³ not to protect the Swiss government itself or some other public interest.

The court examined the hardship factor of section 40 of the Restatement of Foreign Relations together with the good faith requirement stated by the Supreme Court in *Societe*.¹⁰⁴ Regarding the hardship that inconsistent enforcement actions would impose upon the party subject to both jurisdictions, it was admitted that *BSI* might be subject to fines and its officers to imprisonment under Swiss law.¹⁰⁵ The court emphasized,¹⁰⁶ however, that article 34 of the Swiss Penal Code¹⁰⁷ contains a "State of Necessity" exception that relieves a person of criminal liability for acts committed to protect one's own good, including one's fortune, from an immediate danger, if one is not responsible for the danger and

¹⁰¹ Section 40 of the Restatement of Foreign Relations reads as follows:

Limitations on Exercise of Enforcement Jurisdiction:

Where two states have jurisdiction to prescribe and enforce rules of law and the rules they may prescribe require inconsistent conduct upon the part of a person, each state is required by international law to consider, in good faith, moderating the exercise of its enforcement jurisdiction, in the light of such factors as

- (a) vital national interests of each of the states,
- (b) the extent and the nature of the hardship that inconsistent enforcement actions would impose upon the person,
- (c) the extent to which the required conduct is to take place in the territory of the other state,
- (d) the nationality of the person, and
- (e) the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule prescribed by that state.

RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 40 (1965).

¹⁰² 92 F.R.D. at 117.

¹⁰³ See Comment, *supra* note 6.

¹⁰⁴ 92 F.R.D. at 114-15.

¹⁰⁵ See Banking Law, *supra* note 24.

¹⁰⁶ 92 F.R.D. at 118.

¹⁰⁷ C.P. Art. 34.

one cannot be expected to give up one's good.¹⁰⁸

The court stated that should the Swiss government conclude that BSI is responsible for the conflict it is in, and therefore not apply the State of Necessity exception, this would be a result of BSI's bad faith.¹⁰⁹ The bad faith consisted in the deliberate use of Swiss nondisclosure law to evade, in a commercial transaction for profit, the strictures of American securities law against insider trading. The court went on to say that whether acting solely as agent, or also as principal, (something which could only be clarified through disclosure of the requested information), BSI invaded American securities markets and profited in some measure thereby.¹¹⁰ The defendant could not rely, therefore, on Swiss nondisclosure law to shield such activity.¹¹¹

The court summarized its position as follows: "It would be a travesty of justice to permit a foreign company to invade American markets, violate American laws if they were indeed violated, withdraw profits and resist accountability for itself and its principals for the illegality by claiming their anonymity under foreign law."¹¹²

VI. The Treaty between the United States and Switzerland on Mutual Assistance in Criminal Matters of May 25, 1973 (Treaty)¹¹³

A. Introduction

The negotiations between the United States and Switzerland lasted more than four years before the Treaty was finally signed by the parties on May 25, 1973 in Bern, Switzerland. The Treaty was enacted after another four years on January 23, 1977.¹¹⁴ The long discussions between the parties were primarily due to two circumstances. First, it was the first time that a judicial assistance treaty in criminal matters was settled by two countries with completely different systems of law, *i.e.* Anglo-Saxon common law as opposed to continental European civil law.¹¹⁵

¹⁰⁸ Article 34 of the Swiss Penal Code reads as follows:

Present Danger:

1. An act committed by a person to save his life, person, freedom, honor, or property from an immediate danger which cannot be averted otherwise, shall not be punishable if the danger was not caused by the offender and further if he could not be expected under the circumstances to make this sacrifice. If the danger was caused by the offender or if he could be expected to make this sacrifice, the court, in its discretion, may impose a less severe sentence (article 66 of this Code).

C.P. Art. 34. (Subparagraph 2. does not apply here. It deals with the case where a third person is in a present danger.)

¹⁰⁹ 92 F.R.D. at 118.

¹¹⁰ *Id.* at 117.

¹¹¹ *Id.* The court also referred to the remaining factors of section 40 of the Restatement of Foreign Relations, giving minor importance to them.

¹¹² *Id.* at 119.

¹¹³ Treaty on Mutual Assistance in Criminal Matters, May 25, 1973, United States-Switzerland, 27 U.S.T. 2019, T.I.A.S. No. 8302 [hereinafter cited as Treaty].

¹¹⁴ *Id.*

¹¹⁵ See Wicki, Der "Staatsvertrag Zwischen der Schweizerischen Eidgenossenschaft und

Second, the motives of the parties to enter into an assistance treaty in criminal matters differed widely. Switzerland wanted a comprehensive agreement covering all aspects of judicial assistance equivalent to the European Convention on Mutual Assistance in Criminal Matters. The United States wanted to lift the Swiss banking secrecy, especially where tax violations, securities law offenses and organized crime were prosecuted.¹¹⁶ The final formulation of the Treaty is a compromise of the parties' differing interests.¹¹⁷

B. Principles of the Treaty

Under the Treaty, mutual assistance is granted in investigations or court proceedings of offenses punishable within the jurisdiction of the requesting state.¹¹⁸ The Treaty does not apply, however, to investigations or proceedings concerning political or military offenses and proceedings for the purpose of enforcing cartel or antitrust law.¹¹⁹ Investigations or proceedings concerning violations of tax laws, customs duties, governmental monopoly charges or exchange control regulations also are exempt.¹²⁰ Moreover, assistance may be refused where the sovereignty, security or similar essential interests of the requested state are at stake.¹²¹

Under the "Principle of Specialty," information which is obtained pursuant to the Treaty generally must not be used by the requesting state in any other investigation or proceeding.¹²² Thus, information may not be requested and obtained under criminal charges and then used in a fiscal prosecution.

In the execution of a request, the state receiving the request may use only such compulsory measures as are provided for within its domestic jurisdiction. Compulsory measures will be applied only if the act described in the request contains the elements, other than intent or negligence, of an offense which would be punishable under the law of the state receiving the request. This is the so-called "Requirement of Mutual Penal Liability."¹²³ The Treaty comprises an appendix of offenses for which compulsory measures are available (Schedule).¹²⁴ The Treaty, moreover, states that "in the case of such an offense not listed in the

den Vereinigten Staaten von Amerika uber gegenseitige Rechtshilfe in Strafsachen" aus der Sicht eines Bankjuristen, 70 SJZ 341, 342 (1974).

¹¹⁶ See Meyer, *supra* note 21, at 64.

¹¹⁷ *Id.*

¹¹⁸ Treaty, *supra* note 113, at Art. 1(1)(a).

¹¹⁹ *Id.* at Art. 2(1)(c).

¹²⁰ Unless they equal an offense against the laws relating to bookmaking, lotteries and gambling when conducted as a business. *Id.* at Art. 2(1)(c)(5).

¹²¹ *Id.* at Art. 3(1)(a).

¹²² *Id.* at Art. 5(1).

¹²³ *Id.* at Art. 4(2).

¹²⁴ SCHEDULE OF OFFENSES FOR WHICH COMPULSORY MEASURES ARE AVAILABLE:

Schedule, the Central Authority of the requested State (here the Swiss Division of Police) shall determine whether the importance of the offense

1. Murder.
2. Voluntary manslaughter.
3. Involuntary manslaughter.
4. Malicious wounding; inflicting grievous bodily harm intentionally or through gross negligence.
5. Threat to commit murder; threat to inflict grievous bodily harm.
6. Unlawful throwing or application of any corrosive or injurious substances upon the person of another.
7. Kidnapping; false imprisonment or other unlawful deprivation of the freedom of an individual.
8. Willful nonsupport or willful abandonment of a minor or other dependent person when the life of that minor or other dependent person is or is likely to be injured or endangered.
9. Rape, indecent assault.
10. Unlawful sexual acts with or upon children under the age of sixteen years.
11. Illegal abortion.
12. Traffic in women and children.
13. Bigamy.
14. Robbery.
15. Larceny; burglary; house-breaking or shop-breaking.
16. Embezzlement; misapplication or misuse of funds.
17. Extortion, blackmail.
18. Receiving or transporting money, securities or other property, knowing the same to have been embezzled, stolen or fraudulently obtained.
19. Fraud, including:
 - a. obtaining property, services, money or securities by false pretenses or by defrauding by means of deceit, falsehood or any fraudulent means;
 - b. fraud against the requesting State, its states or cantons or municipalities thereof;
 - c. fraud or breach of trust committed by any person;
 - d. use of the mails or other means of communication with intent to defraud or deceive, as punishable under the laws of the requesting State.
20. Fraudulent bankruptcy.
21. False business declarations regarding companies and cooperative associations, inducing speculation, unfaithful management, suppression of documents.
22. Bribery, including soliciting, offering and accepting.
23. Forgery and counterfeiting, including:
 - a. the counterfeiting or forgery of public or private securities, obligations, instructions to make payment, invoices, instruments of credit or other instruments;
 - b. the counterfeiting or alteration of coin or money;
 - c. the counterfeiting or forgery of public seals, stamps or marks;
 - d. the fraudulent use of the foregoing counterfeited or forged articles;
 - e. knowingly and without lawful authority, making or having in possession any instrument, instrumentality, tool or machine adapted or intended for the counterfeiting of money whether coin or paper.
24. Knowingly and willfully making, directly or through another, a false, fictitious or fraudulent statement or representation in a matter within the jurisdiction of any department or agency in the requesting State, and relating to an offense mentioned in this Schedule or otherwise falling under this Treaty.
25. Perjury, subornation of perjury and other false statements under oath.
26. Offenses against the laws relating to bookmaking, lotteries and gambling when conducted as a business.
27. Arson.
28. Willful and unlawful destruction or obstruction of a railroad, aircraft, vessel or other means of transportation or any malicious act done with intent to endanger the safety of any person travelling upon a railroad, or in any aircraft, vessel or other means of transportation.

justifies the use of compulsory measures."¹²⁵ This provision does not mean that under special circumstances the banking secrecy may be superseded even if the pursued act is not a crime in Switzerland. It is only a general provision concerning new crimes which are punishable in both countries, but which are not listed in the Schedule.¹²⁶ This Schedule is generally authoritative.¹²⁷

Chapter Two of the Treaty deals with the prosecution of organized crime.¹²⁸ Here, Switzerland has abandoned its fundamental principles of judicial assistance and will grant assistance in investigations and proceedings concerning political offenses and violations of cartel law, tax law, customs duties, governmental monopoly charges or exchange con-

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29. Piracy; mutiny or revolt on board an aircraft or vessel against the authority of the captain or commander of such aircraft or vessel; any seizure or exercise of control, by force or violence or threat of force or violence, of an aircraft or vessel.
 30. Offenses against laws (whether in the form of tax laws or other laws) prohibiting, restricting or controlling the traffic in, importation or exportation, possession, concealment, manufacture, production or use of:
 - a. narcotic drugs, cannabis sativa-L, psychotropic drugs, cocaine and its derivatives;
 - b. poisonous chemicals and substances injurious to health;
 - c. firearms, other weapons, explosive and incendiary devices;
 when violation of such laws causes the violator to be liable to criminal prosecution and imprisonment.
 31. Unlawful obstruction of court proceedings or proceedings before governmental bodies or interference with an investigation of a violation of a criminal statute by the influencing, bribing, impeding, threatening, or injuring of any officer of the court, juror, witness, or duly authorized criminal investigator.
 32. Unlawful abuse of official authority which results in deprivation of the life, liberty or property of any person.
 33. Unlawful injury, intimidation or interference with voting or candidacy for public office, jury service, government employment, or the receipt or enjoyment of benefits provided by government agencies.
 34. Attempts to commit, conspiracy to commit, or participation in, any of the offenses enumerated in the preceding paragraphs of this Schedule; accessory after the fact to the commission of any of the offenses enumerated in this Schedule.
 35. Any offense of which one of the above listed offenses is a substantial element, even if, for purposes of jurisdiction of the United States Government, elements such as transporting, transportation, the use of the mails or interstate facilities are also included.

¹²⁵ *Id.* at 4(3).

¹²⁶ See Wicki, *supra* note 115, at 343.

¹²⁷ Treaty, *supra* note 113, at Art. 4(2)(a).

¹²⁸ Article 6(3) defines the term "organized criminal group" as an association or group of persons combined together for a substantial or indefinite period for the purposes of obtaining monetary or commercial gains or profits for itself or for others, wholly or in part by illegal means, and for protecting its illegal activities against criminal prosecution and which, in carrying out its purposes, in a methodical and systematic manner;

(a) at least in part of its activities, commits or threatens to commit acts of violence or other acts which are likely to intimidate and are punishable in both States; and

(b) either: (1) strives to obtain influence in politics or commerce, especially in political bodies or organizations, public administrations, the judiciary, in commercial enterprises, employers' associations or trade unions or other employees' associations; or (2) associates itself formally or informally with one or more similar associations or groups, at least one of which engages in the activities described under subparagraph (b) (1).

Id. at Art. 6(3).

control regulations¹²⁹ involving organized crime. The reason for this exception was that the heads of organized criminal groups can usually only be convicted of the above-mentioned crimes. Switzerland also agreed to forego the Principle of Speciality and the Requirement of Mutual Penal Liability where organized crime is prosecuted.¹³⁰

C. *Banking Secrecy Information under the Treaty*

Requests for disclosure of banking secrecy information have to be transmitted by the American Attorney General (or his designee) to the Swiss Division of Police in Bern.¹³¹ According to the Swiss Execution Law,¹³² the Federal Department of Justice and Police first examines whether the Swiss sovereignty or similar essential interests would be endangered by disclosure of the requested information.¹³³ Similar essential interests could be at stake, for example, if a bank were to disclose its relationship with a large number of its customers not involved in the crime, or if large transactions important to the whole Swiss economy would have to be revealed.¹³⁴ Refusal, however, must be a rare exception. Switzerland has appointed a special commission composed of five to seven members to decide such questions.¹³⁵

The Swiss Division of Police then examines whether the request is in accordance with the Treaty,¹³⁶ whether organized crime is prosecuted,¹³⁷ and whether the prosecuted act satisfies the "Requirement of Mutual Penal Liability."¹³⁸ Since the annulment of the banking secrecy is a compulsory measure, it cannot be ordered without this requirement.¹³⁹ If the request is in accordance with the Treaty, and especially if compulsory measures can be applied, the Federal Division of Police forwards the request to the competent Cantonal executive authority (Cantonal department of justice or district attorney) which then lifts the banking secrecy.

VII. Limited Judicial Assistance under the Treaty

In *Santa Fe* and *BSI*, the Securities and Exchange Commission's investigations regarding likely insider transactions were impaired by Swiss

¹²⁹ *Id.* at Art. 2(2).

¹³⁰ *Id.* at Arts. 5(2)(c) and 7(1).

¹³¹ *Id.* at Art. 28(1).

¹³² Bundesgesetz zum Staatsvertrag mit den Vereinigten Staaten von Amerika über gegenseitige Rechtshilfe in Strafsachen of Oct. 3, 1975 [hereinafter cited as Execution Law].

¹³³ *Id.* at Art. 4.

¹³⁴ Message from the President of the United States transmitting the Treaty between the United States of America and the Swiss Confederation on Mutual Assistance in Criminal Matters to the Senate, 12 WEEKLY COMP. PRES. DOC. 234 (Feb. 18, 1976).

¹³⁵ Execution Law, *supra* note 132, at Art. 6.

¹³⁶ *See* Treaty, *supra* note 113, at Art. 32(1) & (2); Swiss Execution Law, *supra* note 132, at Art. 5(2)(a).

¹³⁷ *See* Treaty, *supra* note 113, at Art. 8(2).

¹³⁸ *Id.*

¹³⁹ *Id.* at Art. 4(2)(a).

banking secrecy laws. Since the United States has a Treaty on Mutual Assistance in Criminal Matters with Switzerland,¹⁴⁰ the question arises whether the necessary information could be obtained through the channels of the Treaty in such cases. In both cases the SEC filed complaints in U.S. courts against Swiss banks without first calling for assistance under the Treaty. In *Santa Fe*, the Securities and Exchange Commission applied to the Swiss Division of Police for assistance in accordance with the Treaty in March 1982,¹⁴¹ only after the U.S. District Court for the Southern District of New York refused to issue an order compelling the banks to identify their customers.¹⁴²

There are two problems in applying the Treaty to situations as presented in *Santa Fe* and *BSI*. First, the purpose of the Treaty is to obtain evidence for criminal proceedings. The proceedings of the SEC, however, are of an administrative nature under Swiss law since the SEC is an administrative authority.¹⁴³ Few securities violations are prosecuted criminally in the United States. Most actions are brought before civil courts by the SEC.¹⁴⁴ If a bank refuses to comply, the SEC brings a motion under Rule 37 of the Federal Rules of Civil Procedure for an order compelling discovery and imposing sanctions upon the bank if it fails to identify the customer(s).¹⁴⁵ It is questionable, therefore, whether the Treaty can be invoked at all. Second, even if the Treaty is applicable, the Swiss banking secrecy can be superseded only if the prosecuted act is a crime in Switzerland as well.¹⁴⁶ But insider trading, *i.e.* securities transactions executed while in possession of material nonpublic information, is not prohibited explicitly under Swiss law.¹⁴⁷

In its landmark decision of January 26, 1983¹⁴⁸ the Swiss Federal Supreme Court decided these issues in the case of *X. v. Federal Office for Police Matters*.¹⁴⁹ The case has the following history: As previously mentioned¹⁵⁰ in the *Santa Fe* case, in March 1982, the SEC asked the Swiss Division of Police for judicial assistance, which was granted.¹⁵¹ A complaint against this decision was handed down in June 1982 by the same authority.¹⁵² The unknown appellant appealed directly to the Swiss Federal Supreme Court asking for a reversal of the decision of the Fed-

¹⁴⁰ See *supra* note 113.

¹⁴¹ BG 109 Ib 48, see *infra* notes 148-181.

¹⁴² See *supra* note 93 and accompanying text.

¹⁴³ See Frei, *supra* note 79, at 207.

¹⁴⁴ See Greene, *supra* note 85, at 14, col. 1.

¹⁴⁵ *Id.* at 14, col. 3.

¹⁴⁶ See *supra* note 123 and accompanying text.

¹⁴⁷ See, e.g., Briner, *Insider Trading in Switzerland*, 10 INT'L BUS. LAW. 348, 348 (1982).

¹⁴⁸ The decision was not officially published before the end of 1983.

¹⁴⁹ BG 109 Ib 47. The Swiss Division of Police is also called Federal Office for Police Matters.

¹⁵⁰ See *supra* note 141 and accompanying text.

¹⁵¹ BG 109 Ib 49.

¹⁵² *Id.*

eral Office for Police Matters.¹⁵³

The Swiss Supreme Court held that SEC investigations are criminal under the Treaty. Citing the Message from the President of the United States transmitting the Treaty to the Senate,¹⁵⁴ the court held that the SEC investigations are criminal proceedings as long as they might end up in a criminal court.¹⁵⁵ The court observed that insider trading may be prosecuted criminally in the United States, referring to Section 32 of the Securities Exchange Act of 1934.¹⁵⁶ The channels of the Treaty are thus open to SEC investigations.¹⁵⁷

The success of lifting the banking secrecy in SEC investigations further depends on whether insider trading is a crime under Swiss law.¹⁵⁸ In *X. v. Federal Office for Police Matters* the Swiss Supreme Court held that there is no proviso under Swiss law that explicitly prohibits insider trading.¹⁵⁹ The court then scrutinized whether insider trading is a violation of articles 159 (unfaithful management), 148 (fraud) or 162 (violation of business secrets) of the Swiss Penal Code.¹⁶⁰

The court first held that insider trading cannot be punished as unfaithful management under article 159 of the Penal Code.¹⁶¹ The unfaithful management provision¹⁶² requires that the offender injure property for which he has a legal or contractual duty of care. The Swiss Supreme Court also held that an officer of a corporation owes such a duty to the property of the corporation.¹⁶³ The corporation's property is not infringed, however, by an insider transaction of its manager.¹⁶⁴ In the present case, neither Santa Fe Int'l Corp. nor Kuwait Petroleum Corp. had sustained a loss.¹⁶⁵

The court in *X. v. Federal Office for Police Matters* also stated that insider trading cannot be punished as fraud according to article 148 of the Swiss Penal Code.¹⁶⁶ The fraud proviso¹⁶⁷ requires that the delinquent

¹⁵³ *Id.*

¹⁵⁴ See *supra* note 134, at 36.

¹⁵⁵ BG 109 Ib 51.

¹⁵⁶ 15 U.S.C. § 78a-78kk (1982).

¹⁵⁷ BG 109 Ib 51.

¹⁵⁸ See *supra* note 123 and accompanying text.

¹⁵⁹ BG 109 Ib 53.

¹⁶⁰ *Id.* at 53-58.

¹⁶¹ *Id.* at 53.

¹⁶² Article 159 of the Swiss Penal Code stipulates:

Unfaithful Management:

Whoever dissipates the resources of another person entrusted to him by law or contract shall be confined in the prison. If the offender acted from selfish motives, he shall be confined in the prison for not over five years and fined. Unfaithful management to the disadvantage of a relative or a member of the (same) family shall be prosecuted on petition only.

C.P. Art. 159.

¹⁶³ BG 109 Ib 53.

¹⁶⁴ *Id.*

¹⁶⁵ *Id.* at 54.

¹⁶⁶ *Id.* at 56.

¹⁶⁷ Article 148 of the Swiss Penal Code provides:

fraudulently mislead another or fraudulently use the error of another. The court stated that only the second alternative, *i.e.* use of an error, could be fulfilled by inside traders since there is no personal communication between buyer and seller on the stock exchange.¹⁶⁸ The court then rejected a fraudulent use of an error by the insider for four reasons: (a) the insider, not being personally at the stock exchange, does not support the outsider in his error, which would be indispensable;¹⁶⁹ (b) in the absence of personal contacts, the insider cannot protect the outsider, thus he has no disclosure duties;¹⁷⁰ (c) the absence of personal contacts between buyer and seller at the stock exchange precludes deceit on the part of the insider, and there is no fraud without deceit;¹⁷¹ and (d) the outsider would have traded on the stock exchange without the transactions of the insider, so that there is no cause in fact between the damage and the insider transaction.¹⁷²

The Federal Supreme Court of Switzerland finally examined whether insider trading is a violation of business secrets, punished by article 162 of the Penal Code. The mentioned provision¹⁷³ punishes not only those who, despite a legal or contractual duty of discretion, give a business secret away, but also those who profit by the information. The court held that the passing-on of inside information, *i.e.* tipping by persons with the above mentioned duty of discretion, is punishable under article 162 of the Swiss Penal Code.¹⁷⁴ Article 162, however, cannot be applied, the court continued, where the insider does not pass on his information, but acts on it for himself.¹⁷⁵

The Swiss Supreme Court concluded its decision in *X. v. Federal Office for Police Matters* as follows: Since the SEC's application for judicial assistance did not present any evidence as to whether inside information was passed on (which would be a violation of Swiss law), the Federal

Fraud:

Any person who, with intent to make an unlawful profit for himself or another, shall fraudulently mislead another person by falsely representing or concealing facts or shall fraudulently use the error of another and thus cause the deceived person to act detrimentally against his own or another's property, shall be confined in the penitentiary for not more than five years or in the prison.

The offender shall be punishable with a penitentiary term of not over ten years and fined if he makes a business of committing frauds.

Defrauding a relative or a member of (one's) own family shall be prosecuted on petition only.

C.P. Art. 148.

¹⁶⁸ BG 109 Id 54, 55.

¹⁶⁹ *Id.* at 55.

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.* at 56.

¹⁷³ Article 162 of the Swiss Penal Code reads:

Violation of Business Secrets:

Whoever, despite a legal or contractual duty of discretion, gives a business secret away, whoever utilizes the betrayal, shall, on petition, be confined to jail or fined.

C.P. Art. 162.

¹⁷⁴ BG 109 Ib 57.

¹⁷⁵ *Id.*

Office for Police Matters was wrong to grant judicial assistance.¹⁷⁶ In an *obiter dictum*,¹⁷⁷ the court indicated that violation of a business secret might not have a corresponding offense in the Schedule as required by article 4(2) of the Treaty.¹⁷⁷ The most similar counterpart of a violation or a business secret in the Schedule is a breach of trust,¹⁷⁸ but the court in its final remark showed its unwillingness to apply that offense to insider cases.¹⁷⁹ Nevertheless, the Swiss Supreme Court stated earlier in the same decision¹⁸⁰ that the Federal Office for Police Matters is free to grant assistance according to article 4(3) of the Treaty. This seems to be correct since the "Requirement of Mutual Penal Liability" is met in tipping cases.¹⁸¹

VIII. The "Memorandum of Understanding" between the United States and Switzerland of August 31, 1982 (Memorandum)¹⁸²

A. Background

The Treaty between the United States and Switzerland on Mutual Assistance in Criminal Matters of May 25, 1973,¹⁸³ provides limited help to the Securities and Exchange Commission. The recent decision of the Swiss Federal Supreme Court, *X. v. Federal Office for Police Matters*, shows that assistance is confined to tipping cases which could be a violation of business secrets under Swiss law.¹⁸⁴

If the SEC files a civil complaint and seeks an order compelling the bank to identify its client without calling on judicial assistance according to the Treaty, the route the SEC chose to take in *BSI*, jurisdiction over the bank is first required,¹⁸⁵ and American courts do not automatically compel Swiss banks to divulge the secrecy, as was illustrated in *Sante Fe*. According to the Supreme Court's opinion in *Societe*, such compulsion is appropriate only where the bank acted in bad faith.¹⁸⁶ Moreover, an order compelling discovery is granted only where the vital national interests of the United States prevail over those of Switzerland.¹⁸⁷ Therefore,

¹⁷⁶ *Id.* at 57-58.

¹⁷⁷ See *supra* notes 124-127 and accompanying text.

¹⁷⁸ Treaty, *supra* note 113, at app. Sched. § 19c. For the text of § 19c, see *supra* note 124.

¹⁷⁹ BG 109 Ib 58.

¹⁸⁰ *Id.* at 52-53.

¹⁸¹ See *supra* notes 123-127 and accompanying text.

¹⁸² The complete text of the Memorandum of Understanding is enclosed as Appendix A of this issue [hereinafter cited as Memorandum].

¹⁸³ Treaty, *supra* note 113.

¹⁸⁴ See *supra* notes 148-181 and accompanying text.

¹⁸⁵ In *BSI*, jurisdiction existed because the defendant had a subsidiary in New York. 92 F.R.D. 111, 112 (1981). Swiss banks could avoid U.S. jurisdiction by doing no more than instructing U.S. broker dealers to purchase securities on U.S. markets upon the order of foreign customers. Another way to avoid U.S. jurisdiction would be to purchase the securities on the stock exchanges of London or Zurich, Switzerland. See Siegel, *supra* note 97, at 364-65.

¹⁸⁶ 357 U.S. 197 (1958).

¹⁸⁷ See *supra* notes 101 and accompanying text.

neither requesting judicial assistance under the Treaty, nor seeking an order compelling the bank to identify its customer in a U.S. court, are efficient ways to provide the SEC with the necessary information.

In *BSI* the court ordered disclosure, with severe contempt sanctions for noncompliance.¹⁸⁸ The sanctions, a fine of up to \$50,000 per day and the possible exclusion of BSI from the American securities markets, alarmed the Swiss banking industry.¹⁸⁹ Shortly before, the Swiss "Banque Populaire" (Volksbank) had been barred by the Commodity Futures Trading Commission from trading on United States contract markets for ninety days,¹⁹⁰ and other Swiss banks were still under a temporary restraining order preventing the disposal of assets involved in the *Santa Fe* case.¹⁹¹ In addition, the Securities and Exchange Commission's attempts to acquire more information on BSI than was originally decreed by the court resulted in an official "demarche" of the Swiss Embassy at the State Department in Washington, D.C.¹⁹²

These incidents caused great concern in Switzerland because the American securities market is essential to Swiss banks in conducting international business. In the United States, around forty percent of the securities transactions carried out by foreign banks are put through by Swiss banks.¹⁹³ In addition, these events made it much more difficult for Swiss banking lawyers to predict the outcome of future conflicts with the SEC before U.S. courts.

At the invitation of Switzerland, the arising legal problems were first discussed in Bern, Switzerland on March 1 and 2, 1982.¹⁹⁴ The discussions continued in Montreal, Canada in June 1982,¹⁹⁵ and terminated in Washington, D.C. on August 30 and 31, 1982.¹⁹⁶ After two days of negotiations the parties came to an understanding regarding the future handling of insider trading on U.S. stock exchanges through Swiss banks. The result was the "Memorandum of Understanding," signed on August 31, 1982.

¹⁸⁸ See Greene, *supra* note 85, at 14, col. 1, n. 21.

¹⁸⁹ See Jost, *Insidergeschäfte*, TAGES ANZEIGER MAGAZIN, Nov. 20, 1982, at 6, 10.

¹⁹⁰ In *The Matter of Banque Populaire*, § 21,255 NO. 80-8 25,299; 25,257 (1981).

¹⁹¹ See *supra* note 92 and accompanying text.

¹⁹² See *Gesprache mit SEC: Keine Konkreten Ergebnisse*, DER BUND, Mar. 4, 1982, at 2.

¹⁹³ See Jost, *supra* note 189, at 10.

¹⁹⁴ The Swiss delegation was headed by Minister Jean Zwahlen, head of the Economic and Financial Section of the Federal Department of Foreign Affairs, while the American delegation was headed by the American Ambassador in Switzerland, Faith Ryan Whittlesey. Considering the complexity of the legal problems, the parties agreed to adjourn their negotiations.

¹⁹⁵ See Greene, *supra* note 85, at 15, col. 2.

¹⁹⁶ In Washington, D.C., the Swiss delegation was headed again by Minister Jean Zwahlen and included other representatives of the Federal government and representatives of the Federal Banking Commission and the Swiss National Bank. The delegation of the United States included John M. Fedders, Director of the Division of Enforcement of the SEC; Edward F. Greene, General Counsel of the SEC; Roger M. Olsen, Deputy Assistant Attorney General, Criminal Division, Department of Justice; John R. Crook, Assistant Legal Advisor for Economic Business Affairs, Department of State; and other representatives of the Department of State and Department of Justice. See Memorandum, *supra* note 182, at I.1.

B. Contents of the Memorandum of Understanding

Readers of the text of the Memorandum will be disappointed. It does not contain any procedural rules for handling future cases of insider trading by American and Swiss authorities. Instead, rules are contained in a private Agreement of the Swiss Bankers' Association that was referred to in the Memorandum.

The Memorandum is divided into five parts: (1) Introduction; (2) Exchange of Opinions Regarding the Treaty between the United States and Switzerland on Mutual Assistance in Criminal Matters; (3) Discussion of the Proposed Private Agreement Among Members of the Swiss Bankers' Association; (4) Further Consultations; and (5) Other Understandings.

The introduction states that both nations recognize that there is a conflict of interest between the SEC's investigative role and the Swiss banking secrecy law, and realize that the recent cases involving insider trading are detrimental to the interests of both nations.¹⁹⁷ The introduction also mentions that a discussion of the Private Agreement Among Members of the Swiss Bankers' Association is part of the two nations' final understanding.

In part two of the Memorandum, the parties affirmed the importance of the Treaty and noted that it should be used to the extent feasible.¹⁹⁸ The parties observed that, pursuant to article 1, paragraph 1 of the Treaty, assistance could be furnished as long as the investigation: (1) relates to criminal conduct, and (2) the prosecuted offense is a crime under the laws of each nation.¹⁹⁹ The parties also acknowledged that insider trading could be a violation of articles 148 (fraud), 159 (unfaithful management) or 162 (violation of business secrets) of the Swiss Penal Code, and that compulsory measures, such as lifting the banking secrecy, will often be possible.²⁰⁰ In addition, they agreed to exchange diplomatic notes to facilitate ancillary administrative proceedings in cases of offenses covered by the Treaty.

In part three of the Memorandum the parties noted that compulsory measures are not available under the Treaty if the available information fails to indicate the existence of an offense under the Swiss Penal Code. It appeared, however, that this gap could be filled by a proposed Agreement of the Swiss Bankers' Association (Agreement), which would permit participating banks to disclose the identity of a customer and certain other relevant information, under certain specified circumstances. The parties observed that the said Agreement would be submitted for signature to those banks located in Switzerland which might trade in the

¹⁹⁷ *Id.* at I. 4.

¹⁹⁸ *Id.* at II. 1. & 2.

¹⁹⁹ *Id.* at II. 3a & b.

²⁰⁰ *Id.* at II. 3b. Despite what the Memorandum says, compulsory measures will be limited to tipping cases. See *supra* notes 148-181 and accompanying text.

United States securities markets, and that the Agreement would also govern the relationship between signatory banks and clients. The parties subsequently discussed specific points of the Swiss Banker's Association Agreement.²⁰¹

Part four of the Memorandum provides for further contacts and consultations in the future regarding the SEC's best efforts to inform Swiss authorities about investigations and the Swiss Government's best efforts to handle such information with appropriate care.²⁰²

In part five, the two nations stated that the Memorandum does not modify or supersede any laws or regulations in either country. They agreed that no rights are conferred to bank customers in the United States court proceedings by the terms of the Agreement of the Swiss Bankers' Association. At the close of the Memorandum, the parties ascertained that the Swiss Bankers' Association will use its best efforts to promptly obtain the signatures of the banks concerned.²⁰³

IX. Agreement of the Swiss Bankers' Association with Regard to the Handling of Requests for Information from the SEC on the Subject of Misuse of Inside Information (Agreement)²⁰⁴

The key element of the "Memorandum of Understanding" was the proposed Agreement between the Swiss Bankers' Association and its members.²⁰⁵ After the Memorandum was adopted, the Swiss Bankers' Association asked its members and all other banks trading in U.S. securities markets to join the Agreement, which became effective on January 1, 1983.²⁰⁶

The Agreement states the formal procedure for disclosing information in connection with an investigation concerning possible violation of U.S. insider trading laws. The U.S. Department of Justice, either on its own behalf or on behalf of the SEC, must send a written application to the Swiss Federal Office for Police Matters,²⁰⁷ which transmits the inquiry to a specially created Commission.²⁰⁸ Under certain conditions, the Commission calls for an appropriate report from the bank(s) on the

²⁰¹ See *infra* Section IX.

²⁰² See Memorandum, *supra* note 182, at IV.

²⁰³ *Id.* at V.

²⁰⁴ The complete text of this Agreement — better known in Switzerland as Agreement XVI or Convention XVI — is enclosed as Appendix B of this issue [hereinafter cited as Agreement].

²⁰⁵ *International Agreements: United States-Switzerland Investigation of Insider Trading Through Swiss Banks*, 23 HARV. INT'L L. J. 437, 439 (1982-1983).

²⁰⁶ All major banks joined the Agreement in order to profit from the special proceedings guaranteed by the Memorandum and the Agreement, and to avoid being subject to the more severe sanctions of United States courts.

²⁰⁷ Unfortunately the name of this Swiss authority was translated differently in the Treaty on Mutual Assistance in Criminal Matters. There it was named Swiss Division of Police. See *supra* note 131 and accompanying text.

²⁰⁸ See Agreement, *supra* note 204, at Art. 3(1).

transactions concerned and furnishes the report to the Federal Office for Police Matters, to be forwarded to the SEC.²⁰⁹

The Agreement has a preamble and twelve articles. It can best be subdivided into five parts: (1) the definition of what is considered insider trading, and who is regarded as an insider (articles 1 and 5, subsection 2); (2) the Commission and the preconditions of its inquiries (articles 2 and 3); (3) the procurement and transmission of information by the Commission (articles 4, 5, 7 and 8); (4) the blocking of the customer's account (article 9); and (5) various other provisions (articles 6, 10, 11 and 12).

According to the Agreement, a bank shall disclose information only where a customer has given the bank an order to be executed in the U.S. securities markets within twenty-five days prior to a public announcement of a business combination²¹⁰ or acquisition.²¹¹ The banks cannot disclose information concerning forms of insider trading that are not included in the Agreement. Under the Agreement, insiders are:

- (a) Members of the board, officers, auditors or mandated persons of the company in question or assistants of any of them;
- (b) Members of public authorities or public officers who, in the execution of their public duty, received information about an acquisition or a business combination; or
- (c) Persons who, on the basis of information about an acquisition or business combination received from a person described in the preceding two groups, have been able to act for the latter or to benefit themselves from inside information.²¹²

A. The Commission and its Powers and Duties

The Board of Directors of the Swiss Bankers' Association shall appoint a Commission of Inquiry composed of three members and three deputies.²¹³ They may not be executives of either a bank or a company subject to the Swiss Banking Law.²¹⁴ Furthermore, the members of the Commission, their deputies, and staff are bound by the rule of banking secrecy.²¹⁵

The Commission handles a request only if all of the following requirements are met:

- (a) The U.S. Department of Justice must submit a written application to be transmitted to the Commission by the Swiss Federal

²⁰⁹ *Id.* at Arts. 4(1) and 5.

²¹⁰ A proposed merger, consolidation, sale of substantially all of the issuer's assets or other similar business combination. *Id.* at Art. 1.

²¹¹ The proposed acquisition of at least 10% of the securities of an issuer by open market purchase, tender offer or otherwise. *Id.* at Art. 1.

²¹² *Id.* at Art. 5(2).

²¹³ *Id.* at Art. 2(1).

²¹⁴ *Id.*

²¹⁵ *Id.* at Art. 2(2).

Office for Police Matters;²¹⁶

- (b) The request must be accompanied by documentation that offers evidence materially relevant to the inquiry;²¹⁷
- (c) The request must specify the securities transaction in question;²¹⁸
- (d) The SEC must satisfactorily show that these transactions were made in violation of American insider trading laws and that material price and volume movements have occurred;²¹⁹ and
- (e) The request must be accompanied by an assurance by the SEC not to disclose the information to any person except in connection with its investigations.²²⁰

If the preceding conditions are met, the Commission must promptly call upon the bank(s) concerned for an appropriate report on the transaction in question.²²¹ The bank must immediately inform the customer and invite him to give evidence and information to the bank within thirty days.²²² The bank then must file its report, including the necessary evidence, with the Commission, not more than forty-five days after the request was made.²²³ The report must contain the name, address and nationality of the customer, and his securities transactions during the forty trading days prior to the announcement of the business acquisi-

²¹⁶ *Id.* at Art. 3(1).

²¹⁷ *Id.* at Art. 3(2).

²¹⁸ *Id.* at Art. 3(3).

²¹⁹ Article 3(4):

The Commission will be satisfied in all cases where the daily trading volume of such securities increased 50% or more at any time during the 25 trading days prior to the announcement of an acquisition or a business combination above the average daily trading volume of such securities during the period from the 90th trading day to the 30th trading day prior to such announcement. The Commission will also be satisfied in cases where the price of such securities varied at least 50% or more during the 25 trading days prior to the announcement of an acquisition or a business combination above the average daily trading volume of such securities during the period from the 90th trading day to the 30th trading day prior to such announcement. The Commission will also be satisfied in cases where the price of such securities varied at least 50% or more during the 25 trading days prior to such announcement.

Id. at Art. 3(4).

In III. 3. of the "Memorandum of Understanding," the two countries agreed that the failure by the SEC to meet the threshold criteria would not result in any presumption that the SEC did not have reasonable grounds to make the request for assistance. *See* Memorandum *supra* note 182, at III. 3.

²²⁰ *See* Agreement, *supra* note 204, at Art. 3(5). In the "Memorandum of Understanding" the parties reaffirmed that such information obtained by way of the Memorandum and the Agreement may not be used in any other proceeding than those for which the information is granted. The information must not be given to any other administrative body in the United States, or made public. Switzerland's representatives set a high value on the Principle of Specificity, as expressed in the Treaty. *See supra* text accompanying note 122.

²²¹ *See* Agreement, *supra* note 204, at Art. 4(1).

²²² *Id.* at Art. 4(2). In III. 3. of the "Memorandum of Understanding" the nations agreed that the failure of a bank customer to provide such material shall not result in any presumption of guilt. *See* Memorandum, *supra* note 182, at III. 3.

²²³ *See* Agreement, *supra* note 204, at Art. 4(3).

tion or business combination in question.²²⁴ Any materials exonerating the customer are also furnished to the Commission.²²⁵ In case of doubt as to the accuracy of the bank's report, the Commission (or later the SEC) may request the Swiss Federal Banking Commission to scrutinize the bank's report and, if need be, to correct it.²²⁶

The Commission will furnish a report containing the requested evidence to the Swiss Federal Office for Police Matters, which will forward it to the SEC, unless the bank's report or the customer's material establishes to the reasonable satisfaction of the Commission that the customer's securities transactions do not constitute insider trading as defined by the Agreement,²²⁷ or that the customer is not an insider as provided for by the Agreement.²²⁸ If the Commission decides not to release the material, it must explain its reasons in a report to the Swiss Federal Office for Police Matters and then to the SEC.²²⁹

In the Memorandum of Understanding, an additional proviso concerning the transmission of information was made by Switzerland.²³⁰ As an exception to the general rule, the Commission can refuse to transmit a report to the SEC if the transmission would cause considerable harm to third persons, or to essential interests of Switzerland.²³¹ The report will be adapted to exclude such harm and the SEC will accept such judgment and use moderation when considering alternative measures.

B. Blocking of the Customer's Account

If the preconditions for the Commission's inquiries are met²³² the Commission must ask the bank(s) to block the customer's account immediately to the extent of the suspected profit. The bank must place such amounts in an interest bearing account at the disposal of the Commission until disposition of the matter by the SEC or U.S. courts.²³³ The Commission will remit the blocked amounts (plus accrued interest) to the SEC on request if the amount demanded is not higher than the unlawful

²²⁴ *Id.*

²²⁵ *Id.* at Art. 4(4).

²²⁶ *Id.* at Art. 8.

²²⁷ *Id.* at Art. 5(1). This subsection refers to article 3 of the Agreement. It would be more sensible to refer to article 1 of the Agreement since the latter defines insider trading while the former regulates the preconditions of the Commission's inquiries.

²²⁸ *Id.* at Art. 5(2). The location of the definition of who is regarded as an insider is unfortunate. It would have been more reasonable to locate this definition in the very beginning of the agreement.

In III. 3. of the "Memorandum of Understanding" the countries agreed that if the Commission judges the client not to be an insider as defined by the Agreement, the SEC will accept the decision and use moderation when considering alternative measures. *See* Memorandum, *supra* note 182, at III. 3.

²²⁹ *See* Agreement, *supra* note 204, at Art. 7.

²³⁰ *See* Memorandum, *supra* note 182, at III. 3.

²³¹ Such information would also be withheld under the Treaty. *See supra* note 121 and accompanying text.

²³² *See supra* notes 216-20 and accompanying text.

²³³ *See* Agreement, *supra* note 204, at Art. 9(1), 9(2).

profit, and either the customer consents in writing or the proceedings in U.S. courts have terminated in a final judgment adverse to the customer.²³⁴

The sums blocked will be unblocked in the following cases:

- (a) If the SEC consents in writing;²³⁵
- (b) If the proceedings in a U.S. court have terminated in a final judgment in favor of the customer;²³⁶
- (c) If, after the Commission considers the conditions for supplying the information not to be fulfilled,²³⁷ the SEC does not request that the Swiss Federal Banking Commission scrutinize the bank's report²³⁸ within thirty days;²³⁹ or
- (d) If the SEC requests the examination of the bank's report but the Federal Banking Commission does not correct the report within sixty days, or on the tenth day after a repeated²⁴⁰ statement refusing to supply the information, is forwarded to the SEC, whichever is earlier.²⁴¹

C. Various Provisions

The Agreement includes various provisions regarding who the bank's customers are, the sanctions of the Swiss Bankers' Association against noncomplying banks, the duration of the Agreement, and the bank's duty to inform its clients. Under the Agreement, customers include the beneficial owners of the assets identified in accordance with the Agreement on the Observance of Care by the Banks in Accepting Funds and on the Practice of Banking Secrecy.²⁴² If a signatory bank violates the Agreement, the Swiss Bankers' Association will either warn the bank concerned or, in serious or repeated cases, exclude the bank from the Agreement.²⁴³ The Agreement is in force for a fixed three-year period from January 1, 1983 to December 31, 1985 and will be renewed on a year to year basis if not terminated by a bank with notice at least six months in advance.²⁴⁴ The Agreement will be repealed if Switzerland

²³⁴ *Id.* at Art. 9(2). A consent in a United States court equals such final judgment.

²³⁵ *Id.* at Art. 9(3)(c).

²³⁶ *Id.* at Art. 9(3)(b). Again a consent in a U.S. court equals such final judgment.

²³⁷ See *supra* note 229 and accompanying text.

²³⁸ See *supra* note 226 and accompanying text.

²³⁹ See Agreement, *supra* note 204, at Art. 9(3)(a)(i).

²⁴⁰ The language of the Agreement is confusing on this point. The provision makes sense only if the word "repeated" is inserted, since the SEC can only learn of the bank's report by a first statement (of the Federal Office for Police Matters).

²⁴¹ See Agreement, *supra* note 204, at Art. 9(3)(a)(ii).

²⁴² *Id.* at Art. 6. For a discussion on the Agreement on the Observance of Care by the Banks in Accepting Funds and on the Practice of Banking Secrecy, see *supra* notes 57-71 and accompanying text.

²⁴³ *Id.* at Art. 10. Notice hereof will be given to the Swiss Federal Banking Commission and to the SEC.

²⁴⁴ *Id.* at Art. 11. In such case the other banks will be free to join such termination.

enacts legislation declaring insider trading a crime.²⁴⁵ Finally, the Agreement states that the banks must inform their clients in due form about the contents of the Agreement.²⁴⁶

X. Waiver of Confidentiality by the Bank Customers

The Agreement states that "the banks must inform their clients in due form about the contents of the Agreement."²⁴⁷ The Memorandum provides that "the Agreement will also govern the relationship between the signatory banks and the clients."²⁴⁸ Both statements are incomplete, however, because they do not emphasize or mention that the customers' waivers are absolutely indispensable for the proceedings provided for by the Agreement and approved in the Memorandum.²⁴⁹ Under Swiss banking secrecy laws, the client, and not the bank, is the master of the secret²⁵⁰ and the secrecy can only be limited either by the will of the client or by legal regulations.²⁵¹

The proceedings provided for by the Agreement conflict with the principles of banking secrecy. Under the Agreement, the bank must file a report concerning its customer, whom the SEC suspects of insider trading, to the Commission, which furnishes the report to the Swiss Federal Office for Police Matters, to be forwarded to the SEC.²⁵² These proceedings violate the bank's duty of confidentiality. Because the Agreement is not a legal limitation of the banking secrecy, but a mere private agreement between the members of the Swiss Bankers' Association, the customers' consent to the Agreement, waiving the right of confidentiality to the necessary extent, must be obtained in advance to guarantee the applicability of the Agreement in all future cases.²⁵³

The banks used three methods to procure the customers' consent to the Agreement in order to waive the latter's right of confidentiality. First, the banks asked the customers to consent formally to the Agreement by signature. Second, an implied consent to the Agreement was presumed if the customer did not react to two successive invitations to submit to the terms of the Agreement. Third, a client's order to be executed on the U.S. securities markets will be considered an implied consent to the Agreement in all cases. The Swiss Bankers' Association

²⁴⁵ *Id.* The Agreement is not precise enough in declaring any legislation on the misuse of inside information as generally sufficient to apply the Treaty to future insider transactions, thereby making the Agreement superfluous.

²⁴⁶ *Id.* at Art. 12.

²⁴⁷ *Id.*

²⁴⁸ See *supra* note 201 and accompanying text. See Memorandum, *supra* note 182, at III. 2.

²⁴⁹ See *supra* note 201 and accompanying text.

²⁵⁰ See *supra* note 32 and accompanying text.

²⁵¹ See *supra* Section III.

²⁵² See *supra* notes 221-31 and accompanying text.

²⁵³ To ask a customer for a waiver in a pending case was already common practice before the Agreement and the Memorandum. See *SEC v. Banca Della Svizzera Italiana*, 92 F.R.D. 111 (1981).

ensured that all banks, including nonmembers of the Bankers' Association, used the following proceedings to obtain the customers' consent.²⁵⁴

In general, all clients in possession of securities not issued by the bank were asked for a waiver, and all future customers who wish to open a securities deposit will be asked to submit to the Agreement. The banks sent all customers the text of the Agreement together with a cover letter containing the following, which was prescribed by the Bankers' Association:

In connection with an investigation of the SEC concerning misuse of inside information, the bank may reveal to the SEC the name of the customer as well as details of the customer's transactions on U.S. securities markets under certain conditions. Furthermore, the profits resulting from such transactions may be blocked and remitted to the SEC under certain conditions. In any case, however, the customer will be enabled to demonstrate that his transactions were not made in violation of U.S. inside trading law or that the requirements set forth in the Agreement are not met. The materials furnished by the client will be examined in Switzerland by a Commission appointed by the Swiss Bankers' Association which is bound by the rule of banking secrecy.²⁵⁵

In addition, the clients were furnished a form under which they either had to accept or reject the Agreement within a specified time.²⁵⁶ After lapse of the time fixed in the first letter, the banks sent a second invitation²⁵⁷ to all nonresponding clients, together with another Declaration of

²⁵⁴ The following explanations are based on Circular No. 5970 of the Swiss Bankers' Assoc. of Oct. 19, 1982.

²⁵⁵ See *id.* at enclosure No. 1.

²⁵⁶ This form had the following text:

Declaration of Acceptance or Rejection of Convention XVI of the Swiss Bankers' Association:
I, the undersigned, have taken due note of Convention XVI of the Swiss Bankers' Association.

I agree to my name and details of my transactions on the U.S. markets being revealed to the responsible bodies in any investigation under the terms of this Convention. I also consent to any balances in my favour which are attributable to profits made (or losses avoided) through such stock exchange transactions being temporarily blocked by the bank and being surrendered, if the situation warrants it, to the Securities and Exchange Commission in the United States.

I decline explicitly to submit to the terms of Convention XVI. I acknowledge the fact that no further orders can be executed on my behalf on the U.S. securities markets. If, after receipt of these documents, I continue to give the bank orders to be executed on the U.S. securities markets, such instructions may in all cases be understood to imply that I am in agreement with the regulations contained in Convention XVI of the Swiss Bankers' Association.

Name:

Address:

Place, date:

Signature:

²⁵⁷ The following is a sample of the second (invitation) sent to all non-responding clients:

Re: Exposure of insider transactions on the U.S. stock exchanges

Ladies and gentlemen,

In a circular letter mailed at the end of October 1982 we informed you about the "Agreement XVI of the Swiss Bankers' Association with regard to the handling of requests for information from the Securities and Exchange Commission of the United States on the subject of misuse of inside information." A number of our clients have not yet returned the form "Declaration of acceptance or rejection" and we therefore take the liberty to revert to the matter.

Acceptance or Rejection form. The second invitation stressed that silence on the part of the client would be regarded as an implied consent.²⁵⁸ The banks will refuse orders to be executed on U.S. securities markets if given by customers who did not submit to the terms of the Agreement. If such an order should be executed erroneously, the Declaration of Acceptance or Rejection form provides that the customer's instruction may in all cases (*i.e.* whether the client expressly rejected to submit to the terms of the Agreement or remained silent) be understood as an implied consent to the Agreement.²⁵⁹

XI. Assessment of the Value of the Memorandum

The practical value of the Memorandum of Understanding is speculative. The involved authorities agreed to keep all proceedings under the Memorandum secret. Nevertheless, there are some significant factors determining the Memorandum's value that can be inferred from the preceding explanations.

The first prerequisite for the success of the Memorandum is that the SEC will profit by it. Instead of seeking an order for disclosure in U.S. courts,²⁶⁰ the SEC must request the information concerned (through the U.S. Department of Justice) from the Swiss Federal Office for Police Matters.²⁶¹ Since attempts to obtain information in the way used in *BSI* are not always successful,²⁶² the SEC will use the new mechanism in the future.

Under the Memorandum, information will be furnished to the SEC according to the terms of the Agreement of the Swiss Bankers' Association.²⁶³ The Agreement provides assistance only with respect to insider trading before the announcement of a significant acquisition or disposition,²⁶⁴ such as the acquisitions that gave rise to *Santa Fe* and *BSI*. Thus, in exceptional cases, the requested information might not be available by way of the Memorandum, though the transactions are considered insider

Please note that the bank will assume, in the absence of either a positive or negative reaction on the part of the customer by December 31, 1982, that the customer agrees to the stipulations of "Agreement XVI" of the Swiss Bankers' Association. Your decision, if negative, is not irrevocable: if you oppose the convention now you may come back on your decision at a later date. Any orders to be executed on the American stock markets will be understood to mean that you are willing forthwith to submit to the terms of the convention.

If you were kind enough in the meantime to forward your reply, we apologize for having bothered you once more and thank you for your understanding.

Yours sincerely,
CREDIT SUISSE

²⁵⁸ See note 257. Since the Agreement became effective on January 1, 1983, *see supra* text accompanying note 206, most banks asked their customers to reply by December 31, 1982.

²⁵⁹ See Declaration of Acceptance or Rejection Form, *supra* note 256.

²⁶⁰ See *supra* Section V. for recent SEC procedures.

²⁶¹ See Memorandum, *supra* note 182, at III. 1.

²⁶² According to *BSI* a bank will only be required to reveal information after a careful evaluation of various factors. See *supra* notes 98-112 and accompanying text.

²⁶³ See Memorandum, *supra* note 182, at III. 1.

²⁶⁴ See *supra* note 211 and accompanying text.

trading in the United States. In addition, it will be possible to find smaller banks located in Switzerland which did not sign the Agreement. If those banks decide to trade in United States stock markets the channels of the Memorandum will not be open to the SEC.

According to the mechanism established by the Memorandum and the Agreement, a request for information will be delivered by the Federal Office for Police Matters of Switzerland to the specially created Commission of Inquiry which will call for an appropriate report from the bank involved.²⁶⁵ The Commission must then furnish the report concerned to the Federal Office for Police Matters, to be forwarded to the SEC. The Commission, however, may refuse to transmit the information if it does not consider the securities transaction to be insider trading, or the bank customer to be an insider, as provided for by the Agreement.²⁶⁶ According to the Memorandum, the SEC must accept the Commission's decision as one made in good faith.²⁶⁷

Because the Commission's power to withhold information is thus unimpeachable, this could theoretically neutralize the value of the Memorandum. Similar doubts also arise because the Commission is not bound by any rules of procedure and does not have to obey any directions of Swiss or American authorities.²⁶⁸

As previously mentioned,²⁶⁹ information will be transmitted under the Treaty only in criminal proceedings and where the prosecuted act would be an offense under Swiss criminal law. Since insider trading is not sufficiently punishable under Swiss law,²⁷⁰ it can be assumed that the SEC will prefer to use the mechanism of the Memorandum and the Agreement, even where the information might be made available under the United States-Swiss Treaty on Mutual Assistance in Criminal Matters.

If Switzerland enacts legislation declaring insider trading a crime, the required information will be available through the channels of the Treaty.²⁷¹ In case of such insider trading legislation, the Agreement, ac-

²⁶⁵ See *supra* notes 207-09 and accompanying text.

²⁶⁶ See *supra* notes 227 & 228 and accompanying text.

²⁶⁷ See Memorandum, *supra* note 182, at III. 3. Since article 5 of the Agreement is not very well drafted the Memorandum refers only to the Commission's judgment regarding the second question; *i.e.* whether or not the customer is an insider as defined by the Agreement.

²⁶⁸ Because the Commission's current president, Peter Forstmoser (corporations and securities professor of the University of Zurich Law School) is one of the strongest and best known defenders of the criminalization of insider trading in Switzerland, such fears of abuse should be unwarranted.

²⁶⁹ See *supra* Section VII.

²⁷⁰ See *supra* notes 158-75 and accompanying text.

²⁷¹ In October 1983 the Federal Council of Switzerland presented its drafted bill on the misuse of inside information to the public. The draft provides:

C.P. Art. 161 (new)

Taking Advantage of Confidential Information:

1. Whoever, as a member of the board, an officer, an auditor or an assistant of a company or of an affiliated company, as a member of a public authority or as a public officer, or as an assistant of any of them, receives a confidential informa-

ording to its own provisions, will be abrogated.²⁷² The Memorandum, however, will not automatically be superseded, but will be valid until the two countries agree on its termination.²⁷³

The Memorandum should benefit both the United States and Switzerland in most cases. The SEC will use the new mechanism to obtain the needed information, and the Commission will handle the cases with the care required. In most cases, information of insider trading on U.S. stock exchanges through Swiss banks will be transmitted. A problem exists, however, if non-signatory smaller banks start trading in United States stock exchanges. Insiders will be able to neutralize the effects of the Memorandum by choosing those banks which do not require clients to sign the waiver of confidentiality.

XII. Unsolved Problems

The customer's consent to the Agreement, waiving the right of confidentiality, was procured by banks in different forms, (*e.g.* an express consent, a consent implied by silence and a consent implied by conduct).²⁷⁴ Each form of the customer's consent to the Agreement could be challenged before Swiss courts.

If the customer expressly consented to the Agreement he or she signed the following text: "I agree to my name and details of my transactions on the U.S. markets being revealed to the responsible bodies in any investigation under the terms of this Convention."²⁷⁵ Such a waiver of confidentiality may be contrary to the Swiss public order and to article 27 subsection 2 of the Swiss Civil Code, which provides that no person can alienate his personal liberty nor impose any restrictions on his own enjoyment thereof which are contrary to law or morality.²⁷⁶ Because of the general nature of the customer's waiver, such an argument could possibly succeed.

The second letter forwarded to the bank customers contained the following sentence: "Please note that the bank will assume, in the absence of either a positive or negative reaction on the part of the customer by . . . (December 31, 1982), that the customer agrees to the stipulations

tion which upon publication is apt to influence materially the stock or outside market quotation of shares, non-voting-shares or other securities of the company, and makes a profit by using this information, shall be confined to jail or fined. If an acquisition of one company is sought by another, sub-paragraphs (1) and (2) shall be applied to shares, non-voting-shares and other securities of both companies.

2. Paragraph (1) shall be applied analogously if the confidential information is used to make a profit with shares, non-voting-shares or other securities of a cooperative.

²⁷² See *supra* note 245 and accompanying text.

²⁷³ See Memorandum, *supra* note 182, at IV. 2.b.

²⁷⁴ See *supra* Section X.

²⁷⁵ See *supra* note 256.

²⁷⁶ C.C. Art. 27(2).

of Agreement XVI of the Swiss Bankers' Association."²⁷⁷ Under Swiss law, silence to an offer usually does not constitute acceptance. Only where the "particular nature" of a transaction or the "circumstances" justify it, can an acceptance be inferred from silence.²⁷⁸ Neither exception fits the problem involved. The bank's letter, which in effect seeks to change the contract by releasing the bank from its duty of confidentiality, is not in the interest of the customer. Therefore, the transaction is not of a "particular nature" to justify the inference of an acceptance by silence.²⁷⁹ Arguably, the continuing contractual relationship between bank and customer constitutes a "circumstance" that justifies the inference of acceptance by silence.²⁸⁰ The bank customer, however, should prevail by arguing that the bank's proposal to change the contract was not within the range of prior negotiations, and that his silence is therefore not an acceptance.²⁸¹

The Declaration of Acceptance or Rejection form that was sent to the bank's clients contained the following sentence: "If, after receipt of these documents, I continue to give the bank orders to be executed on the U.S. securities markets, such instruction may in all cases be understood to imply that I am in agreement with the regulations contained in Convention XVI of the Swiss Bankers' Association."²⁸² Article 1 subsection 2 of the Swiss Obligation Code provides that a consent can be either express or implied.²⁸³ In contrast to silence, affirmative conduct is generally considered as consent.²⁸⁴ A client's order to his bank, to be executed on the U.S. stock markets, will probably be regarded as consent, implied by conduct, to the bank's letter. A client's argument asserting special circumstances, however, remains reserved. For example, a client may claim lack of knowledge of the bank's letters because they remained in the bank to be picked up by the client.

An additional question is what can be done if a signatory bank fails to comply with the Agreement, either by refusing to furnish the required information to the Commission²⁸⁵ or by not blocking the customer's account as requested by the Commission.²⁸⁶ The SEC, the United States

²⁷⁷ See *supra* note 257.

²⁷⁸ Article 6 of the Swiss Code of Obligations provides:

Where, due to the particular nature of the transaction, or due to the circumstances, express acceptance is not to be expected, the contract is deemed to be concluded if the offer is not declined within a reasonable time.

C.O. Art. 6.

²⁷⁹ See *Kommentar zum Schweizerischen Zivilgesetzbuch. Vol. V. 1a, Comment 28 to Article 6* (1973).

²⁸⁰ *Id.* at Comment 22 to Article 6.

²⁸¹ See, e.g., T. GUHL, H. MERZ & M. KUMMER, *DAS SCHWEIZERISCHE OBLIGATIONENRECHT* 98 (1980) [hereinafter cited as *GUHL, MERZ & KUMMER*].

²⁸² See *supra* note 256.

²⁸³ C.O. Art. 1(2).

²⁸⁴ See *GUHL, MERZ & KUMMER, supra* note 281, at 88.

²⁸⁵ As provided for by article 4 of the Agreement. See *Agreement, supra* note 204, at Art. 4.

²⁸⁶ As provided for by article 9 of the Agreement. *Id.* at Art. 9.

Department of Justice, the Swiss Federal Office for Police Matters, the Swiss National Bank, the Swiss Banking Commission and the Commission created by the Agreement all have an interest in obtaining compliance by the bank. None of the mentioned authorities, however, has a claim that the bank fulfill its duties under the Agreement, since they are not all parties of the Agreement. The Agreement is rather a multilateral contract of the signatory banks, endowing the contracting parties with the remedies as provided for by Swiss contract law and by the Agreement itself.

Swiss contract law does not supply the parties with an adequate remedy. The Swiss Obligation Code states, in its chapter on the consequences of nonperformance, that the breaching party shall compensate the affected party for the damages arising therefrom.²⁸⁷ Since the remaining signatory banks will not suffer any damages if a bank refuses to give the Commission information or fails to block a customer's account, the Code's remedy is meaningless. Article 10 of the Agreement, however, provides that in case of violation of the provisions of the Agreement, the Board of Directors of the Swiss Bankers' Association (a) shall issue a warning to the bank responsible; and (b) in serious cases, or where there is a repetition of a violation, it shall exclude the bank from the Agreement and shall inform the Federal Banking Commission and the SEC accordingly.²⁸⁸ Nevertheless, none of the previously listed authorities has any power to force a bank to comply with the Agreement's procedure. A bank cannot be forced to furnish information or block a customer's account.

Another issue is whether the Swiss Federal Office for Police Matters is bound by the procedure established by the Memorandum and the Agreement; *i.e.*, whether the Swiss authority can be required to forward information to the U.S. Department of Justice and to the SEC. The Agreement cannot require that the Federal Office for Police Matters furnish information to U.S. authorities since a private agreement cannot oblige third parties. The Memorandum, however, does not expressly state a general duty of the Swiss authority to pass on to U.S. authorities the report received by the Commission. Nor does the Memorandum expressly incorporate the Agreement and its mechanism of transmitting the information. The Memorandum merely states that the countries entered into certain understandings with respect to the Agreement²⁸⁹ and reproduces the parties' comment to specific points of the Agreement.²⁹⁰ Regarding the duty of the Federal Office for Police Matters to transmit the bank's report, the Memorandum states that the Swiss authority can withhold information if essential interests, either of Switzerland or of a

²⁸⁷ For the text of Art. 97(1) of the Swiss Obligation Code, see *supra* note 16.

²⁸⁸ See Agreement, *supra* note 204, at Art. 10.

²⁸⁹ See Memorandum, *supra* note 182, at I. 7.

²⁹⁰ *Id.* at III.

third person, are at stake, and that the SEC will regard this opinion as one made in good faith.²⁹¹ If the Swiss authority refuses to pass on the information for different reasons than those mentioned in the Memorandum, the Federal Office for Police Matters might argue that in the Memorandum there is no specific duty according to which the Swiss authority must transmit the information.

Apart from such objection, the enforceability of the Memorandum is problematical. It was not signed on behalf of the President of the United States and the Swiss Federal Council, but rather on behalf of the governments of the respective countries. Therefore, the Memorandum is not a binding treaty to be ratified by both the United States President and the Swiss Federal Council.²⁹² An interview with Edward F. Greene, General Counsel of the SEC and member of the American delegation in the regarding negotiations, affirms this argument. According to Mr. Greene, "A memorandum of understanding is a statement of intent between two governments, not a binding agreement."²⁹³ The Swiss Federal Office for Police Matters could thus refuse to transmit to the U.S. Department of Justice a bank's report, basing its refusal on two arguments: (1) that the Memorandum does not state such a duty; and (2) even if it did, the Memorandum is not a binding treaty.

Apart from the unsolved legal problems arising from the Memorandum of Understanding with Switzerland, the United States faces a more serious future problem. Once insider transactions are made more difficult through Swiss banks, they will be conducted by way of other foreign banks, such as those of Liechtenstein, Panama or the Caribbean.²⁹⁴ The United States should therefore prepare statements similar to the Memorandum with other countries having bank secrecy laws.

XIII. Conclusion

Because of the Memorandum of Understanding, the Swiss banking

²⁹¹ Section III. 3 of the Memorandum states:

The parties understand that there may be instances in which the Federal Office for Police Matters may determine that a report submitted by a bank pursuant to the terms of the private Agreement may not be transmitted to the SEC without considerable harm either to the essential interests of Switzerland or to third persons who appear to have no relationship to the offense which gave rise to the request for assistance. In such cases, it is understood that the Federal Office for Police Matters will use its best efforts to adapt the report so that useful information may be provided to the SEC without causing such harm to the interests of third persons or to Switzerland. In the same spirit, it is understood that the SEC will judge this opinion as one made in good faith and use moderation when considering alternative measures.

Id. at III. 3.

²⁹² See *International Agreements*, *supra* note 205, at 442.

²⁹³ Greene, *supra* note 85, at 12, col. 1, n.1.

²⁹⁴ See *Peeking into those Vaults*, TIME, Sept. 13, 1982, at 78. Luxembourg and Austria are other countries the banks of which are used for insider trading in the first place. Translations of many foreign secrecy laws can be found in: CRIME AND SECRECY: THE USE OF OFFSHORE BANKS AND COMPANIES, PERMANENT SUBCOMMITTEE ON INVESTIGATIONS, COMMITTEE ON GOVERNMENTAL AFFAIRS, 98th Cong., 1st Sess., Appendix (Comm. Print 1983).

secrecy can be superseded in most investigations concerning insider trading in United States securities markets, and the required information will be furnished to the SEC. The potential impact of the Memorandum of Understanding is so promising that similar arrangements are being prepared between the United States and other countries.²⁹⁵ The Memorandum, however, is not a cure-all for stopping illegal insider trading since the legal framework of the Memorandum could be challenged in many respects. In addition, insider trading will still be possible in America by interposing other foreign banks and smaller Swiss banks which did not join the Agreement of the Swiss Bankers' Association.

²⁹⁵ See, e.g., Hill, *Caymans Case Shows How Courts in U.S. are Cracking the Secrecy of Foreign Banks*, Wall St. J., Oct. 14, 1982, § 2, 33, col. 4, at 40; Thomas, *Securities Regulators Grapple with Extraterritoriality*, Legal Times, Jan. 17, 1983, 20, col. 1, at 24, col. 4.

APPENDIX A**THE GOVERNMENT OF THE UNITED STATES OF
AMERICA****THE GOVERNMENT OF SWITZERLAND
MEMORANDUM OF UNDERSTANDING****I. Introduction**

1. This MOU is a statement of intent setting forth the understandings reached by the delegations of Switzerland and the United States acting on behalf of their respective governments ("the parties") to establish mutually acceptable means for improving international law enforcement cooperation in the field of insider trading. These understandings continue a long tradition of law enforcement cooperation between Switzerland and the United States and were reached in the course of consultations between representatives of Switzerland and the United States in Bern on March 1 and 2, 1982, and in Washington, D.C. on August 30 and 31, 1982. The Swiss delegation was headed by Minister Jean Zwahlen, head of the Economic and Financial Section of the Federal Department of Foreign Affairs, and included other representatives of the said department, Lutz Krauskopf, Deputy Chief of Division, and Lionel Frei, Chief of Section, in the Federal Department of Justice and Police, and representatives of the Federal Banking Commission and the Swiss National Bank. The delegation of the United States included John M. Fedders, Director of the Division of Enforcement of the Securities and Exchange Commission ("SEC"); Edward F. Greene, General Counsel of the SEC; other representatives of the SEC, Roger M. Olsen, Deputy Assistant Attorney General, Criminal Division, Department of Justice; John R. Crook, Assistant Legal Adviser for Economic and Business Affairs, Department of State; and other representatives of the Department of State and the Department of Justice.

2. The consultations included a discussion of concerns in both countries with respect to recent cases involving persons who used Swiss banks as intermediaries to effect securities transactions in the United States, at a time when such persons may have possessed material nonpublic information concerning the securities involved. Trading while in possession of material nonpublic information (insider trading) confers an unfair advantage upon persons who engage in such trading and impairs the integrity of United States capital markets. Such conduct is a violation of the United States securities laws and insofar as it is not yet *per se* punishable under Swiss law is considered dishonorable in Switzerland as well.

3. The parties noted that, when it appears that a securities transaction has been made by persons while in possession of material nonpublic information, the SEC is responsible for conducting an investigation of the

matter. This requires that the SEC be able to learn the identity of the person on whose behalf the transaction was effected and other relevant information. However, Swiss law prohibits banks in principle from disclosing information with respect to a customer utilizing its services.

4. The parties concluded that the conduct of persons who utilize Swiss banks to effect securities transactions in the United States, in order to take advantage of material nonpublic information, is detrimental to the interests of both nations.

5. On the basis of the foregoing consultations, the parties reaffirmed the two countries' interest in mutual assistance in law enforcement matters in accordance with mutually acceptable procedures and in conformity with international and national law, in particular assistance with respect to transactions effected by persons in possession of material nonpublic information.

6. During the consultations the parties engaged in an exchange of opinions pursuant to Article 39, paragraph 1 of the Treaty Between the United States and the Swiss Confederation on Mutual Assistance in Criminal Matters, which became effective on January 23, 1977 (the "1977 Treaty"). Section II of this Memorandum of Understanding memorializes the exchange of opinions and related understandings that the parties have reached.

7. The parties also entered into certain understandings with respect to a private Agreement Among Members of the Swiss Bankers' Association, which is discussed in Section III of this Memorandum of Understanding and is attached hereto.

II. Exchange of Opinions Regarding the Treaty Between the United States and the Swiss Confederation on Mutual Assistance in Criminal Matters

1. The parties note the importance of the 1977 Treaty which provides for cooperation between law enforcement authorities in connection with investigations or court proceedings involving criminal offenses, including fraud. Such cooperation may include assistance in locating witnesses, obtaining statements and testimony of witnesses, production and authentication of judicial or business records and service of judicial or administrative documents.

2. The 1977 Treaty has been used on numerous occasions by the law enforcement authorities of both nations. The parties understand that the 1977 Treaty provides an important means of obtaining information needed to enforce the criminal or penal laws of each nation and should be used to the extent feasible.

3. The parties hereby exchange opinions, pursuant to Article 39, paragraph 1, of the 1977 Treaty concerning the interpretation, application or operation of that Treaty:

a. Article 1, paragraph 1 of the 1977 Treaty provides that the Con-

tracting Parties undertake to afford each, in accordance with provisions of the Treaty, mutual assistance in "investigations or court proceedings in respect of offenses the punishment of which falls or would fall within the jurisdiction of the judicial authorities of the requesting State or a state or canton thereof." This means, for example, that an investigation by the SEC should be considered an investigation for which assistance could be furnished (if the other requirements of the Treaty are met) as long as the investigation relates to conduct which might be dealt with by the criminal courts.

- b. The 1977 Treaty requires that a particular offense be a crime under the laws of each nation in order for compulsory assistance to be required under the Treaty. The parties understand that transactions effected by persons in possession of material non-public information could be an offense under Articles 148 (fraud), 159 (unfaithful management) or 162 (violation of business secrets) of the Swiss Penal Code. As a result, the parties understand that it will often be possible for compulsory measures to be ordered under the Treaty in obtaining information from the banks that executed the securities transactions in the United States that are the subject of the request for assistance.

4. Paragraph 3 of Article 1 of the 1977 Treaty provides that, "The competent authorities of the Contracting Parties may agree that assistance as provided by this Treaty will also be granted in certain ancillary administrative proceedings in respect of measures which may be taken against the perpetrator of an offense falling within the purview of this Treaty." The laws of both parties provide for administrative and judicial proceedings in which sanctions and remedies are available other than prison sentences and fines imposed in criminal prosecutions. The parties have agreed in principle to an exchange of diplomatic notes to facilitate the application of the 1977 Treaty to such ancillary administrative proceedings in cases of offense covered by the Treaty and relating to trading by persons in possession of material nonpublic information. Moreover, the parties undertake to consider whether comparable diplomatic notes should be exchanged with respect to other offenses relating to securities transactions covered by the Treaty.

III. The Private Agreement Among Members of the Swiss Bankers' Association

1. The parties recognize that there may be securities transactions effected in the United States by Swiss banks acting on behalf of persons who possess material nonpublic information, for which compulsory measures would not be available under the 1977 Treaty. Such assistance could not be ordered if available information did not indicate the existence of an offense under the Swiss Penal Code. As the Swiss Federal

Council will submit to the Parliament a bill on the misuse of inside information, this lacuna could be filled. For cases in which the Treaty is not applicable, or in which it is not possible to gather evidence by employing compulsory process, pending the enactment of such legislation, the parties discussed a proposed private Agreement under the aegis of the Swiss Bankers' Association, which would permit participating banks to disclose the identity of a customer and certain other relevant information, under certain specified circumstances, in response to a request made by the Department of Justice on behalf of the SEC and processed through the Federal Office for Police Matters. It would also contain certain safeguards regarding protection of customers and the sovereignty of Switzerland.

2. The said "Agreement with regard to the handling of requests for information from the SEC on the subject of misuse of inside information" which is annexed to the present memorandum will be submitted for signature by the Swiss Bankers' Association to those of the banks located in Switzerland which may trade in the United States securities markets. This agreement will also govern the relationship between the signatory banks and the clients placing orders with the signatory banks for execution in the United States securities markets.

3. As regards specific points of the private Agreement, the parties came to the following understanding:

- The private Agreement establishes certain criteria for volume and price changes in the period preceding an Announcement which, if met, shall satisfy the Commission of Enquiry that the SEC has reasonable grounds to request assistance under the terms of the private Agreement and this Memorandum of Understanding. The parties understand that these thresholds are set at high levels because they are intended to define the circumstances under which the Commission of Enquiry "shall" be satisfied that the SEC has reasonable grounds to make the request. In all other cases in which the criteria are not met, the parties understand that the Commission of Enquiry will be required to review the information submitted by the SEC to decide whether it is reasonably satisfied that the SEC has reasonable grounds to make a request. Accordingly, the the parties understand that a failure by the SEC to meet the threshold criteria specified in the private Agreement shall not result in any presumption of guilt.
- The parties understand that information obtained through the mechanism established by this memorandum and the private Agreement will be used or introduced as evidence only in administrative or judicial proceedings brought by the SEC or Department of Justice relating to trading by persons in possession of material nonpublic information, and may not be used or introduced as evidence in any other proceeding.
- The parties understand that information obtained through the mechanism established by this memorandum and private Agree-

ment shall be kept to the fullest extent compatible with constitutional or legal requirements from disclosure to any other administrative body in the United States or to the public, except to the extent necessary for administrative or judicial purposes of the specific case. Each party understands that the other will use its best efforts to assert legal rights to prevent disclosure of such information other than as authorized by this memorandum or the private Agreement.

- If the Commission of Enquiry arrives at the conclusion that a client is not an insider as defined by the private Agreement, the SEC will judge this opinion as one made in good faith, use moderation and take into account the existence of this memorandum and the private Agreement when considering alternative measures.
- The parties understand that there may be instances in which the Federal Office for Police Matters may determine that a report submitted by a bank pursuant to the terms of the private Agreement may not be transmitted to the SEC without considerable harm either to the essential interests of Switzerland or to third persons who appear to have no relationship to the offense which gave rise to the request for assistance. In such cases, it is understood that the Federal Office for Police Matters will use its best efforts to adapt the report so that useful information may be provided to the SEC without causing such harm to the interests of third persons or to Switzerland. In the same spirit, it is understood that the SEC will judge this opinion as one made in good faith and use moderation when considering alternative measures.

IV. Further Consultations

1. In order to continue and improve international law enforcement cooperation in a manner consistent with the interests of both nations, the parties understand that the SEC and the Federal Office for Police Matters will undertake further contacts or consultations in the future when the need to do so is recognized mutually.
2. There will be contacts or consultations between the parties concerning the following matters:
 - a. The parties understand that the SEC will exercise its best efforts to inform appropriate Swiss authorities when an investigation has been initiated with respect to transactions effected by a Swiss bank. Further communications will occur, as appropriate, as an investigation proceeds in order to assure that the interests of both nations are protected. Such contacts or consultations may be related to requests for assistance on behalf of the SEC under the 1977 Treaty or the private Agreement. The parties understand that the Government of Switzerland will use its

best efforts to assure that the information obtained in such communications will not be disclosed to any person except in connection with a request for assistance by the SEC or an investigation or enforcement action conducted by Swiss authorities, and to handle such information with appropriate care to prevent it from becoming known to the bank customer or customers involved.

- b. At the termination of the private Agreement, the parties will consult regarding experience under the private Agreement and the 1977 Treaty as well as the effect of such termination on this memorandum.
- c. The parties agree that any questions or disputes between them with respect to the interpretation or application of this "Memorandum of Understanding," the exchange of opinions included herein pursuant to Article 39, paragraph 1, of the 1977 Treaty or the operation of the private Agreement shall be settled by means of consultations.

V. Other

1. Notwithstanding any other provision herein, the parties agree that this Memorandum does not modify or supersede any laws or regulations in force in the United States or Switzerland.
2. The parties agree that they do not intend to confer any right on any customer of a bank which is a signatory of the private Agreement to judicial review in the courts of the United States with respect to any decision to disclose information to United States' authorities under the terms of the private Agreement.
3. The parties understand that the Swiss Bankers' Association will use its best efforts promptly to obtain the signatures of the banks concerned and to keep the SEC informed through the Federal Office for Police Matters of the banks which are signatories to the private Agreement.

IN WITNESS WHEREOF, the respective representatives, duly authorized for this purpose, have signed this "Memorandum of Understanding."

Done at Washington, D.C., in duplicate this 31st day of August, 1982.

SIGNATURES

On behalf of the
Government of
the United States of
America

On behalf of the
Government of Switzerland

John S.R. Shad
Chairman
Securities and Exchange
Commission

Jean Zwahlen, Minister
Chief of the Financial
and Economic Section,
Federal Department of
Foreign Affairs

APPENDIX B**AGREEMENT XVI**

of the Swiss Bankers' Association with regard to the handling of requests for information from the Securities and Exchange Commission of the United States on the subject of misuse of inside information.

Preamble

In consideration of the inquiries from the Securities and Exchange Commission (hereafter: SEC) of the United States on the misuse of inside information and so far as the banks cannot be obliged to furnish information to the appropriate Swiss authorities for submission to the SEC in a legal assistance procedure, the member banks of the present Agreement (hereafter: the *banks*) undertake to respect the following stipulations:

Article 1

If within 25 trading days prior to a public announcement ("*Announcement*") of

(A) - a proposed merger, consolidation, sale of substantially all of an issuer's assets or other similar business combination ("*Business Combination*") or

(B) - the proposed acquisition of at least 10% of the securities of an issuer by open market purchase, tender offer or otherwise ("*Acquisition*"), a customer gives to a bank an order to be executed in the U.S. securities markets for the purchase or sale of securities or put or call options for securities of any company that is party to a *Business Combination* or the subject of an *Acquisition* ("*Company*"), the bank, upon an inquiry by the Federal Office for Police Matters ("*Inquiry*"), shall disclose to the appropriate authorities pursuant to this Agreement the information stipulated under Article 4 thereof when:

- a) the U.S. Department of Justice on behalf of the SEC or itself has sent to the Federal Office for Police Matters written application in connection with a formal investigation concerning a possible violation of the U.S. inside trading laws in connection with the *Acquisition* or *Business Combination*; and
- b) the provisions of Articles 3 *et seq.* of this Agreement are met.

Article 2

1. The Board of Directors of the Swiss Bankers' Association shall appoint a Commission of inquiry (the "*Commission*") composed of three members and three deputies. Neither the members of the Commission nor their deputies may exercise an executive function in a company which is subject to the Federal Law on Banks and Savings Banks.

2. As selected representatives of the banks in accordance with Article

47, paragraph 1, of the Federal Law on Banks and Savings Banks, the members of the *Commission*, their deputies and staff are bound by the rule of banking secrecy for all the facts of which they are apprised in the course of the procedure set out by the present Agreement.

3. The *Commission* shall be domiciled at the office of the Swiss Bankers' Association.

4. The *Commission* shall organize its own secretariat.

Article 3

The *Commission* shall handle the *Inquiries* when

1. the *Inquiry* is transmitted to it by the Federal Office for Police Matters and is based upon the written application referred to in Article 1(a) hereof;

2. the *Inquiry* is accompanied by documentation and by a confirmation from the U.S. Department of Justice or the SEC that it will place at the *Commission's* disposal all evidence or appropriate summaries thereof materially relevant to the *Inquiry* in its possession which it is free to reveal;

3. the *Inquiry* is accompanied by specific identification of the transactions of the *Company's* securities or put or call options therefore made within 25 trading days prior to the *Announcement* of the *Acquisition* or *Business Combination*;

4. the SEC has established to the reasonable satisfaction of the *Commission* that (i) material price or volume movements have occurred with respect to trading in the securities which are the subject of the *Acquisition* or *Business Combination* during the 25 day period prior to its *Announcement* or (ii) it has other material indications that the transactions referred to in 3. above were made in violation of U.S insider trading laws. The *Commission* shall be satisfied in all cases in which the daily trading volume of such securities increased 50% or more at any time during the 25 trading days prior to such *Announcement* above the average daily trading volume of such securities during the period from the 90th trading day to the 30th trading day prior to such *Announcement* or the price of such securities varied at least 50% or more during the 25 trading days prior to such *Announcement*. In all other cases, the *Commission* shall review the information submitted by the SEC to decide whether it is reasonably satisfied that the SEC has reasonable grounds to make the *Inquiry*;

5. the *Inquiry* is accompanied by an undertaking by the SEC not to disclose the information to be provided pursuant to Article 4.3 to any person except in connection with an SEC investigation or a law enforcement action initiated by the SEC against alleged purchasers or sellers of the *Company's* securities or put or call options therefore for violations of U.S. insider trading laws in connection with the *Acquisition* or *Business Combination*.

Article 4

1. The *Commission* shall promptly call for an appropriate report from the banks on the transactions concerned.
2. Upon receipt of such call, the bank shall immediately inform the customer and invite him to furnish the bank, within 30 days after dispatch of the bank's communication, all evidence and information which, in the customer's opinion, are apt to demonstrate that the customer's transactions were not made in violation of U.S. insider trading laws in connection with the *Acquisition* or *Business Combination* or that the requirements set forth in this Agreement are not met.
3. The bank shall file its report, together with all useful evidence, with the *Commission* as a rule within 45 days after receipt of the *Inquiry*. The report shall in particular state
 - a) name, address and nationality of the customer, and
 - b) all details of the customer's transactions in the securities or call options for the securities of the *Company* during 40 trading days preceding the *Announcement*.
4. Together with the report, the bank shall file with the *Commission* all materials received from the customer.
5. If the *Commission* needs further information for the sake of the *Inquiry*, it will approach the SEC through the Federal Office for Police Matters.

Article 5

The *Commission* shall furnish to the Federal Office for Police Matters a report containing the evidence requested in the *Inquiry*, to be forwarded to the SEC, unless the bank's report or the customer establishes to reasonable satisfaction of the *Commission* that

1. he is not an entity or individual which placed one of the specific purchases or sales identified by the SEC pursuant to Article 3 hereof;
2. or that he is not an insider under the following definition
 - a) a member of the board, an officer, an auditor or a mandated person of the *Company* or an assistant of any of them; or
 - b) a member of a public authority or a public officer who in the execution of his public duty received information about an *Acquisition* or a *Business Combination*; or
 - c) a person who on the basis of information about an *Acquisition* or a *Business Combination* received from a person described in 2. a) or b) above has been able to act for the latter or to benefit himself from inside information.

Article 6

The customer, within the meaning of Articles 2 to 5 hereof, includes the beneficial owner of the assets identified in accordance with the Articles 3 to 6 of the Agreement of 1st July, 1982 on the observance of care by the banks in accepting funds and on the practice of banking secrecy.

Article 7

If the conditions for the supply of information to the SEC are not fulfilled, the *Commission* shall deliver to the Federal Office for Police Matters a report, to be forwarded to the SEC, explaining the reasons.

Article 8

In the case of any doubt arising as to the material accuracy of the report furnished by the bank, the *Commission* by itself or the SEC, through the appropriate channels, may request the Federal Banking Commission to examine whether the report given conforms to the facts and to the present Agreement. The bank shall provide all information needed for examination. If any material inaccuracy is discovered, an amended report showing the correct information shall be forwarded to the Federal Office for Police Matters, to be forwarded to the SEC. Any other appropriate measures of the Federal Banking Commission in accordance with the provisions of the Law on Banks and Savings Banks are reserved.

Article 9

1. If the criteria of Article 1 (a) and Article 3 are fulfilled, the bank, at the *Commission's* notice shall immediately block the customer's account, to the extent of a sum equivalent to the profit (or the loss avoided). The amounts blocked shall be held by the bank pending disposition of the matter by the SEC or U.S. courts.
2. The bank undertakes to place such amounts to be held in an interest bearing account at the disposal of the *Commission*. The latter will remit such amounts, plus accrued interest, to the SEC on request, if
 - a) the amount demanded is not higher than the unlawful profit, and either
 - b) the proceedings in a U.S. court have terminated in a final judgment, by consent or otherwise, adverse to the customer, or
 - c) the customer consents in writing.
3. Any sums blocked pursuant to Article 9.1 hereof shall be unblocked if
 - a)(i) no request pursuant to Article 8 hereof is received, on the thirteenth day after the Federal Office for Police Matters forwards to the SEC the *Commission's* report pursuant to Article 7, or
 - (ii) request for review pursuant to Article 8 hereof is received, on the sixtieth day after the date of receipt of such inquiry where no amended report pursuant to Article 8 hereof has been issued, or on the tenth day after the date any report

- under Article 7 which has been issued is forwarded to the SEC, whichever is earlier, or
- b) the proceedings in a U.S. court have terminated in a final judgment, by consent or otherwise, not adverse to the customer, or
 - c) the SEC consents in writing.
4. The evidentiary proof concerning the conditions listed under 2 a), b) and c) and 3 a), b) and c) hereof shall be communicated through the Federal Office for Police Matters.

Article 10

In the case of violation of the provisions of this present Agreement, the Board of Directors of the Swiss Bankers' Association

- a) shall issue a warning to the bank responsible; and
- b) in serious cases or where there is repetition of a violation it shall exclude the bank from the Agreement, and shall inform the Federal Banking Commission and the SEC accordingly.

Article 11

The Agreement is in force for a fixed period of three years as from 1st January, 1983. It shall be thereafter renewed on a year to year basis if not terminated by one of its members by giving advance notice of at least six months addressed to the Swiss Bankers' Association. In the case of its being terminated, all parties to the Agreement must be informed thereof without delay; they then have the right, within a month from that date, to become a party to such termination even when there is no longer six months to run up to the expiration of the termination term. The Agreement shall remain in force and effect for those members who have not terminated it.

The Agreement will be abrogated in the case of the Swiss legislature enacting legislation on the misuse of inside information.

In the case of the Agreement being abrogated, proceedings already instituted with the Federal Office for Police Matters will be carried through to settlement.

Article 12

The banks undertake to inform their clients in due form about the contents of the present Agreement.

