

“DIRTY MONEY” AND SWISS BANKING REGULATIONS

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1. Introduction

Traditionally banks have been held to have two main duties:

- first, to properly execute the orders of each client and, more generally, to act in the best interests of each client;
- second, towards all clients, to manage the bank in a way that is not only profitable, but also does not create too great a risk, so that the solvency of the bank is maintained.

There are today some tendencies to impose new duties on banks, in the general interest of the community:

- Should banks promote the general interest of the community in their lending policy, for instance, by providing funds to enterprises in difficulty?
- Should banks agree to take, perhaps provisionally, the control of a domestic company, to avoid control being taken over by undesired foreigners?
- Should banks avoid lending funds or providing services to foreign countries considered to have an unacceptable foreign policy or internal regime?

These “new duties” are not yet embodied in banking regulations, but perhaps already are considered in some banking policy decisions. Yet the duties may be in conflict with the second traditional duty mentioned above, of maintaining the profitability and solvency of the bank. They also raise the question whether banks, although private enterprises, should be treated as public services.

In this article, I describe the evolution of one of these new duties in Swiss banking regulation: the duty of the bank not to accept “dirty money,” or cooperate, even negligently, in criminal, illegal, immoral or “irregular” acts. In Switzerland, this duty may be based upon two different legal sources:

- The Swiss banking law (SBL), adopted in 1934 and last revised in 1971, contains some very general rules. The managers of the bank must have a “good reputation” and must have the qualities allowing the bank to be “properly managed” [1]. Moreover, the Swiss Banking Commission, which is the banking supervisory authority, is empowered to take “all necessary measures” in case a bank has violated the law or has entered into “any irregularity” [2]. These rules have been applied in a broader way in recent years.

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● The Agreement of Care (ACB) is a private contract between all Swiss banks (and the Swiss Bankers Association) on the one side and the Swiss National Bank on the other side. This Agreement regulates the duties of a bank when accepting new clients' funds, to ensure that the bank knows exactly who is its customer. It also contains rules prohibiting the "aiding and abetting of capital flight, tax evasion and similar acts." This Agreement, entered into in 1977, is in force until June 1987; it is not certain whether it will be extended for a further period or replaced by a new agreement to which, probably, the Swiss National Bank would not be a party.

Both the SBL and ACB are sometimes applicable to the same facts. The Agreement of Care is much more precise, but only regulates some specific problems; for instance, it does not regulate at all the duty of banks to examine the "economic background" of clients' operations. The application of the banking law relies on the broad (too broad?) powers of the Banking Commission.

2. The Duty to Know its Customer

The bank must take all reasonable measures to properly identify its clients [3]. This is normally an easy matter, although some difficulties may arise for some kinds of foreign clients.

More important is the duty to identify the beneficial owner of the account [4], if it appears that the client is acting for the account of a third party or if the account is opened by a so-called "domiciliary corporation," that is, by a corporation with no business premises of its own or no staff of its own, other than an administrative staff. In that event, the bank has the duty to identify the persons controlling the domiciliary corporation. If these controlling persons are again domiciliary companies, the bank must do the same until it comes to individuals or operating companies.

This duty to identify may be very difficult to implement. Many clients will not understand readily why these questions are asked of them, especially because they normally would not be asked by banks in countries other than Switzerland. They may feel that such questions imply some mistrust of them, a mistrust which would be regarded as an unsuitable basis of relations between a bank and its clients.

If the beneficial owner does not want to give its identity to the bank, and if this owner is not yet ready to have any personal contact with the bank such that the owner would not be forthcoming about its identity, it would be very difficult for the bank to know that the identification given was not true.

The Agreement of Care provides an exception where the client is represented by an attorney or a certified accountant [5]. In both cases, the professional secrecy of the attorney or accountant is protected, and the name

of the beneficial owner is not to be given to the bank. However, the attorney or accountant must certify that he knows the beneficial owner and that "by observing all the care which can be reasonably expected under the circumstances, no fact is known to him which gives indication of banking secrecy being availed of abusively by the client..." [6].

Unfortunately, it seems that this provision, which was to be an exception, has been used more and more extensively. This means that the duty of the banks to "know their customers" is taken over by attorneys and accountants who are often not in a position to implement the goals of the Agreement.

In its annual report for the year 1985, the Swiss Banking Commission expressed some doubts whether this so-called "attorney privilege" was compatible with the banking law. In a specific case, the Swiss Banking Commission decided that, if a bank lends funds to a "domiciliary corporation," the bank must always know the identity of the "beneficial owner" of the loan and not satisfy itself with an attestation of an attorney or accountant. This problem is presently under review by the Swiss Banking Commission, the banks, and the attorneys' and accountants' associations.

Some commentators argue that the duty of banks to know their customers is even broader than that described above. They assert that the banks should, before accepting a new client, take information as to the client's social and economic background, as if the client were requesting a loan.

In principle, this broadened duty seems excessive. However, if the client is not known at all by the bank, especially if it is a foreign client, some kind of background information would be easy to obtain and the recording requirement would probably be justified, if the bank needed to avoid cooperating with irregular acts.

Furthermore, since the banks are today taking important measures for determining "country lending limits," some commentators argue that the banks could just as well inquire into the countries from which the funds are coming, and put some general limits or conditions on categories of clients. Indeed, banks themselves recognize today that they would normally not accept important private deposits from foreign officials, unless they can ensure that these deposits are really the private property of the client. But, the banks must take into consideration that a contact with a new client can hardly begin with mistrust and that most banks abroad, even the ones that are best-operated, do not make such delicate inquiries.

3. The Duty to Examine the "Economic Background" of Clients' Important Operations

It is clear that a bank is required to know the economic background of any operation for which the bank will bear a financial risk. This principle has been

progressively extended in recent years by the Banking Commission. It now applies to all important, complicated, or unusual clients' operations, even if these operations do not imply a direct financial risk for the bank. Generally, the banks do not appeal the decisions of the Banking Commission; however, with respect to the economic background issue, Commission's decisions have been appealed, although the Swiss Supreme Court in turn has affirmed all decisions of the Banking Commission:

- In one case, a bank had agreed to buy an important quantity of securities from a client, who was himself acting through a corporation based in Liechtenstein. The client had the right to buy back the securities at the same price. In view of the importance and the unusual character of the operation, the Banking Commission decided that the bank was not allowed to enter such a transaction unless it knew precisely its economic background [7].
- In another case, a Panamanian corporation had received an important fee in remuneration for its activity in the conclusion of an international contract. The fee was required to be reimbursed, if the contract was not implemented. The Panamanian corporation put the corresponding amount in escrow in a Swiss bank and asked the bank to guarantee the reimbursement. The Banking Commission decided that the bank could not make such a guarantee without knowing the economic background of the fee and inquiring whether the transaction was illegal or immoral [8].
- In yet another decision, a bank, controlled by a few foreign shareholders, had given loans to a foreign entity, internally guaranteed by the deposits of the shareholders of the bank. The same bank had given its guarantee to a foreign corporation for obtaining a loan abroad, this guarantee being again fully covered by the shareholders of the bank. In both cases, the Banking Commission decided that this was not an ordinary banking operation and that the bank should check its economic background [9].
- In the most recent case, a client feared that its assets, especially a ship, could be seized by a foreign state. The client asked the bank to provide an important loan to be pledged by the ship, so that the possible seizure of the ship by the foreign state would not be effective. But this loan, and especially the pledge, was rather fictitious, as it was internally guaranteed by a deposit of the same amount made by the client. The Banking Commission considered this operation not to be a loan, but only a scheme for deceiving the foreign state. Here, the bank had considered the economic background of the operation. The Banking Commission ordered that, in the event the foreign state seized the ship, the bank should, if asserting its rights in the ship, mention the existence of the deposit guaranteeing fully the reimbursement of the "loan." Of course, because of the Commission's order, the whole scheme became worthless [10].

The Swiss Supreme Court affirmed the decision in a far-reaching manner: "It is true that the principle aim of the banking law is to ensure that the banks remain solvent. However, the supervision of banks is also related to their credibility. The fact that a bank co-operates in an illegal or immoral business may affect not only the credibility of this particular bank, but of the Swiss banking system in general. This is why a bank has the duty to examine the economic background of an operation if there are some indications that it could be illegal or immoral; if so, the bank should refuse to co-operate. In particular, the banking law forbids a bank to co-operate in an operation intended to deceive some Swiss or foreign authorities or private persons, or to let them incur an illegitimate injury...."

A similar duty may be incurred even if the bank is not actively co-operating with the client, but only implementing routine banking orders, if the situation is exceptionally important or unusual. In a recent case involving drug trading, it appeared that some of the drug sellers had utilized Swiss banks to "wash their dirty money." For instance, foreign clients, without the bank's awareness, opened an account in which important amounts were transferred, or brought by cash or check, and afterwards were quickly transferred again to another foreign country. Some banks either refused to open the account or, after a few of these transactions, decided to close the account. Some other banks did not object, and apparently did not worry at all as to the economic background of these important and unusual transfers of money.

It is clear that such cases should definitely be brought to the attention of the general management of the bank and that such accounts should not be carried forward if the bank has no idea of the economic reasons for such unusual transfers.

Sometimes the client asks the bank to constitute and to manage some "domiciliary corporations," incorporated either in Switzerland or abroad, for its account. In such cases, the bank provides some of its staff as directors of the "domiciliary corporation"; consequently, the duties of such directors are considered also to be duties of the bank itself, which should know precisely the "economic background" of all operations.

The situation may not be very different if the bank is providing the client with formally independent professionals to organize and manage the corporations, if the client considers these professionals to be only there "pro forma," and that its only real partner is the bank.

4. The Duty to Freeze "Dirty Money"

If a bank is asked to open an account for a new client or to participate in some irregular operations, the bank should refuse. The situation is much more

difficult if the bank discovers only over the passage of time that it has co-operated in irregular operations, either because it has been deceived by the client or because it had not asked the client the appropriate questions in due time. The traditional solution, which is actually provided in the Agreement of Care [11], is that the bank has the duty to break off the relationship with the customer immediately. However, one may wonder whether such a break off would be sufficient for every act to which the bank could unwillingly co-operate.

In the past, Swiss banks have at times been very helpful with the police upon discovering that funds deposited with them were acquired by criminal acts, like drug or arms trading, or a ransom. Some banks have even spontaneously divulged such information to the police, so that official measures could be taken to seize the money, and arrest the perpetrators of the crime. But this has been the case only for important crimes, which were widely recognized as such.

The problem has been recently raised in a very different situation. At the end of March 1986, the new government of the Philippines alleged that the country's former president, Mr. Ferdinand Marcos, as well as other "related" persons, had deposited important funds in Swiss banks. However, at that time, the Filipino government had not officially requested any international assistance in criminal matters from the Swiss authorities. It appeared very likely that a substantial part of Mr. Marcos' wealth consisted of "fees" paid to him pursuant to contracts executed by the Filipino government. In such a situation, one must ask what was the duty of the Swiss banks if Mr. Marcos, now in exile, requested release or transfer of the funds?

In a public press release of March 21, 1986, the Banking Commission expressed the view that the banks had an "increased duty of care" for accepting new funds from Mr. Marcos, and also in releasing funds to him. The existence of such an "increased duty of care" was affirmed by a circular letter of the Banking Commission, dated March 26, 1986, to all important banks of Switzerland. The banks were requested to give notice if they held accounts belonging to Mr. Marcos or "related" persons, and to divulge whether they agreed not to reimburse any such funds without the prior consent of the Commission [12]. These measures were revoked after one month, because the government of the Philippines had by then requested international assistance and had obtained the issuance of similar provisional measures by the Department of Justice.

The legal validity of the measures of the Banking Commission has been disputed. The problem remains as to the duties of the banks, and the possible measures to be taken by the competent authorities, if it appears that, regardless of the issue of their possible negligence, banks have in fact co-operated in irregular acts or accepted "dirty money." This problem is especially difficult if the acts are not clearly criminal. The perception of irregularity or use of "dirty

money" can vary greatly over time and from country to country. Clearly, the test cannot be based merely on moral precepts or on doubts about illegality in some foreign country.

5. Final Remarks

It is an accepted principle in Switzerland that a bank cannot close its eyes when accepting new clients, or cooperating in important or unusual transactions. But the difficult problem remains: how far should a bank be curious, ask questions, and check answers? Where are the limits of illegality, immorality, or irregularity? And finally, what should a bank do if it appears that it has unwillingly cooperated in illegal or irregular activities?

Furthermore, one must ask whether regulation in this field should concern only the offices of the bank in Switzerland or also its branches, or possibly even subsidiaries abroad. The Agreement of Care is formally not applicable to the foreign branches or subsidiaries. However, the duties imposed by the banking law could well be applicable to foreign offices; in any case, regulation should probably apply if the decisions of these foreign branches or subsidiaries are made either totally or partially by the Swiss management of the bank, or if the operations are regularly reported to the Swiss management.

This subject is in full evolution. It sits at the limit between law and ethics, with very important international implications. This is why I am particularly happy to present this contribution in honor of Professor Noyes Leech: he has always been interested in ethics, financial regulations and international law... and he is a very good friend of Switzerland.

Notes

- [1] Federal Law of Nov. 8, 1934, Relating to Banks and Savings Institutions, *as amended by* Federal Law of Mar. 11, 1971, art. 3 (2)(c).
- [2] *Id.*, at art. 23, ter-1.
- [3] Agreement on Guidelines for the Acceptance of Funds and the Practice of Banking Secrecy, 16 I.L.M. 767 (1977) [hereinafter cited as ACB].
- [4] ACB, *supra* note 3, at arts. 4, 5.
- [5] *Id.*, at art. 6.
- [6] *Id.*
- [7] Bulletin of the Banking Commission Nr. 7, December 1980, at 39, *aff'd by the Swiss Supreme Court*, Judgment of July 11, 1980, 106 ATF I(b) 145.
- [8] Bulletin of the Banking Commission Nr. 7, December 1970, at 35.
- [9] Bulletin of the Banking Commission Nr. 11, December 1982, at 15, *aff'd by the Swiss Supreme Court*, Judgment of June 25, 1982, 108 ATF I(b) 186.

- [10] Bulletin of the Banking Commission, Nr. 15, July 1985, at 5. *aff'd by the Swiss Supreme Court*, Judgment of June 25, 1985, 111 ATF I(b) 125.
- [11] ACB, *supra* note 3, at art. 11.
- [12] At the same time, the Swiss Government made a decision to block the accounts of Mr. Marcos in a few banks. I do not discuss here this exceptional decision.