View metadata, citation and similar papers at core.ac.uk

brought to you by CORE

provided by Archive of European Integration

Institute for European Studies
Vrije Universiteit Brussel

Swiss Banking Secrecy

The Erosion of an Institution

Marie Lamensch

IES WORKING PAPER 2/2008

Swiss Banking Secrecy

The Erosion of an Institution

Marie Lamensch

All rights reserved.
No part of this paper may be published without
the permission of the author.

The **Institute for European Studies** (IES) is a Jean Monnet Centre of Excellence. The IES operates as an autonomous department of the Vrije Universiteit Brussel (VUB). It hosts advanced Master programmes and focuses on interdisciplinary research in European Studies, in particular on the role of the EU in the international setting. Within this scope, the IES also provides academic services to scholars, policy makers and the general public.

The **IES Working Paper Series** is a collection of scientific articles on topical issues that deal with the EU in its international context. The Series aims to provide policy-relevant insights to and raise discussion in an audience of practitioners, decision-makers and academics dealing with European and international affairs. The Series covers multiple disciplines, including law, political sciences, social sciences and economics. Instructions for sending IES Working Paper submissions as well as comments may be found at the Series' homepage (see www.ies.be).

ISSN Number: pending
© Marie Lamensch
Institute for European Studies, VUB
Pleinlaan 2, B-1050 Brussels, Belgium

ABSTRACT

Switzerland has for a long time been an important centre of banking services in Europe and beyond. Consequently, the banking sector has become important to Switzerland's prosperity. This paper focuses on a central reason behind the success of the Swiss banking sector: the institution of banking secrecy, deeply enshrined in the Swiss history and tradition. The rapid development of international markets that eventually gave rise to a "group structuration process" has, however, progressively eroded Swiss banking secrecy. It has had to bend before the duty of transparency within the groups in order not to promote financial criminality through accelerated asset inflows. Switzerland has also had to develop a comprehensive legislative frame to tackle financial criminality, and to enter into international agreements providing for mutual assistance. This process has undoubtedly and irremediably weakened the Swiss banking secrecy. Most importantly, nevertheless, the questionable ethical and socio-economic grounds of this controversial institution could and should also start to erode it from within.

ABOUT THE AUTHOR

Marie Lamensch is member of the Brussel's bar and currently works as a lawyer for Kremer Associés and Clifford Chance (Luxembourg). She previously worked for Simont Braun (Brussels) and as a teaching assistant at the Université Libre de Bruxelles (ULB). She holds a law degree from the ULB and an LL.M degree (Master in International and Comparative Law) from the Vrije Universiteit Brussel's (VUB) PILC Program, organized under the auspieces of the Institute for European Studies (IES). The views expressed in this paper are purely personal and do not reflect the position of any of the institutions mentioned above.

TABLE OF CONTENTS

ABSTRACT 1

ABOUT THE AUTHOR 1

Table of Contents 3

1 INTRODUCTION - THE DEVELOPMENT OF SWISS BANKING SECRECY 5

1.1 The Swiss banking secrecy tradition 5

1.2 Regulating secrecy in Switzerland’s emerging international banking market 6

2 THE PROGRESSIVE FADING OF SWISS BANKING SECRECY 10

2.1 The unclaimed assets crisis 10

2.2 The internationalisation and diversification of the Swiss banking sector 11

3 CAN THE SWISS BANKING SECRECY SURVIVE WITHIN THE GLOBAL COOPERATION TO TACKLE FINANCIAL CRIME? 13

3.1 Tax fraud 14

3.2 Money laundering 15

3.3 Legal provisions 16

3.4 The efficiency and effects of the Swiss regulation on financial criminality......... 19

4 BANKING SECRECY AND THE EU-SWITZERLAND RELATIONS IN TAXATION 21

4.1 In the background - the European Savings Directive.............................. 21

4.2 The Bilateral Agreements II 22

5 ERODING BANKING SECRECY FROM THE OUTSIDE—AND FROM WITHIN 24

BIBLIOGRAPHY 27

PREVIOUS IES WORKING PAPERS.. 32

1 INTRODUCTION - THE DEVELOPMENT OF SWISS BANKING SECRECY[1]

Banking secrecy, broadly speaking, consists of keeping information concerning bank clients out of the reach of third parties, whether they are private or governmental.[2] The institution is based on the assumption that everyone is entitled to the right to secrecy, which implies protection from any external interference, as well as any interference by the holder of any given information.[3]

Switzerland has for a long time been an important centre of banking services in Europe and beyond. Banking secrecy is part of Switzerland's tradition, and is strongly protected by specific legal provisions whose amendment would require the approval of the Swiss Parliament and - as it is one of Switzerland's traditions - most probably of the population, by means of a referendum.[4] However, this institution has considerably faded during the 20th century.

This contribution aims to determine first, why banking secrecy developed so successfully in Switzerland and, second, why it has lately progressively eroded.

1.1 The Swiss banking secrecy tradition

In most European countries, the creation of a modern, investment-based banking system started after the industrial revolution.[5] Since the Swiss industrial sector was less developed and the few Swiss manufacturers that existed self-financed their activities, Switzerland was not party to this initial evolution. The synergies between industries and banks developed much later[6] and the emergence of Switzerland as an international financial market place only occurred in the 20th century. Consequently, Swiss banking activity originally focused on savings, mortgage practice and portfolio management.[7] In these sectors of private banking, confidentiality happened to be essential;[8] herein lies the origin of the Swiss banking secrecy *tradition.*[9]

---

[1] The author would like to thank Servaas van Thiel for having prompted this contribution and shown continuous support to its achievement.

[2] Swiss law does not provide any statutory definition of banking secrecy. Thus, this paper refers to the doctrine that summarises the characteristics of this institution suggested by the different legal materials dealing directly or indirectly with the matter, such as Farhat (1970); Baudart (1977); Campbell (1992, 663); Aubert and others (1996, 995); Briscoe (1999, 302); Lombardini (2002); and Besson (2004, 5).

[3] It should be underlined here that such a concept could only arise in democratic States as democracy is a *sine qua non* condition to any kind of privacy protection. Banking secrecy and democracy are therefore intimately linked. On this topic, see Zondervan (1973).

[4] De Watteville 2002, 2.

[5] Rappo 2002, 17.

[6] Ibid., 18.

[7] Importantly, the French banks Pereire and Rotschild invested in the building of the Swiss railway, not a Swiss group (Erb 2002, 45; Rappo 2002, 19; Besson 2004, 38).

[8] Besson 2004, 21.

[9] Rules of confidentiality actually date back to the civil codes of the Middle Age. Thereafter, during the 16th and 17th centuries, Protestant bankers that had taken shelter in Switzerland fostered the duty of discretion, especially towards their peers who had remained in the catholic France and Italy (Campbell 1992, 663; Besson 2004, 21).

1.2 Regulating secrecy in Switzerland's emerging international banking market

Before the First World War, even though Switzerland only had a subsidiary place in the banking world, it started to attract foreign investors from all over Europe. The Swiss tradition of *discretion* was an important reason for the interest. The investments allowed Switzerland to take advantage of the rising taxes elsewhere across the continent. Banking secrecy was at that moment based on tradition and civil law provisions.[10]

After the First World War, a deep depression shattered Europe's economies. This prompted European governments to regulate their banking sector and to prohibit their citizens from trading in foreign currency. In spite of this, accounts were opened in Switzerland by citizens from all over the world. Indeed, as Switzerland had remained the continent's only free trade zone in gold and currencies, and the only country immune to decrease in currency, wars and revolutions, it eventually came to be considered as the safest place to deposit assets. Consequently, between 1913 and 1939, Swiss banks grew considerably, and rivalled already the biggest French and German banks.[11]

Switzerland had thus acquired an international reputation;[12] in order to maintain it, it was forced to establish indisputable rules that would formalise the strong banking secrecy policy. Nowadays, many authors consider that the increasing French and German tax enquiries on their citizens' Swiss accounts were the main arguments for the Swiss government to adopt criminal rules that sanctioned breaches of banking secrecy.[13] These enquiries indeed have troubled the consciousness of the Swiss public, who consider them a violation of privacy, which Switzerland has always tried to protect. Accordingly, a broad debate ensued in this economically liberal country on how to protect banking secrecy in the most efficient way. Swiss leaders eventually came to the conclusion that in order to defend its liberal economic convictions, Switzerland had to rely on an indisputable and unambiguous criminal act on banking secrecy, not solely on tradition and on civil law.

At the same time, Switzerland was urged to act in the field of banks supervision, as the global monetary crisis of 1929 had just been followed by the bankruptcy of one of the biggest Swiss banks[14] in 1931. As a matter of fact, since Switzerland has a long and strong liberal economic history, economic regulation was, for a long time, at an embryonic state. No surveillance of banks had ever been established when the monetary crisis and the ensuing general withdrawal of assets occurred.[15] A regulation was therefore a necessity. However, despite general support for a better control of the banking field, the whole financial sector and many politicians insisted on the necessity of preserving banking secrecy against all tax authorities.

These two divergent positions were eventually reconciled by the adoption of the Federal Act on Banks and Saving Banks of 8th November 1934 (the "1934 Act"). The 1934 Act encompasses rules concerning the supervision of banks. It also provides that banking secrecy, which already existed as a civil and customary obligation, becomes an obligation sanctioned by criminal law. By introducing banking secrecy infringements in the criminal

---

[10] de Garidel-Thoron 2002, 24; Guex 1999.
[11] Besson 2004, 25
[12] Rappo 2002, 19.
[13] Salminen 1988, 10; Rappo 2002, 22; Eggli 2003. See also Hug (2000, 12) and Besson (2004, 26).
[14] Banque de Genève.
[15] Briscoe 1999, 162.

sphere, the Federal Parliament explicitly reinforced the protection already granted to bank clients.[16] Consequently, Switzerland became the country where banking secrecy was the best protected. This naturally led to a further in the volume of transfers to Swiss Banks.[17]

A politico-historical element is often brought forth to explain the criminalisation of banking secrecy breaches: the Nazi pressure upon the Swiss banking establishment. Indeed, the banking industry often claims that the strong legal provisions on banking secrecy originate from the pre-war period, during which Hitler assigned a death penalty to German citizens who owned assets abroad.[18] Three Germans were executed as a result of Gestapo-led espionage missions into Switzerland.[19] According to some authors, these missions convinced the Swiss government to reinforce its banking secrecy provisions. Violations of banking secrecy were condemned in order to claim neutrality and independence from the Third Reich.[20] This explanation on the hardening banking secrecy regulation is nowadays harshly criticized.[21] Modern doctrine cautiously deconstructs the whole theory on the protection against the Nazis as the origin and justification for the legislation. It is certain that the Act helped some to evade capture by the Nazi authorities. However, there was no evidence that Swiss bankers were ever particularly sensitive to the situation of German savers. The banking secrecy should not, therefore, be seen as a moral caution.

As was mentioned above, an informal institution of discretion grew in the Swiss banking sector in the late 19th century. Civil legislation was referred to as the basis for confidentiality in business relationships. Then, in the early 1930's, a criminal provision was adopted to strengthen the obligation.[22] Under positive Swiss law, banking secrecy is thus simultaneously protected by civil and criminal law.[23]

1.2.1 Civil law

The civil law theory finds its basis in the substantial jurisprudence of the Federal Court and in article 28(1) of the Swiss Civil Code. Article 28(1) does not clearly establish banking secrecy, but provides that *"Whoever suffers from an illegal offence (against his person) is entitled to ask a judge for relief against anyone joining in the offence"*.[24]

Another civil provision to consecrate banking secrecy is article 398 alinea 2 of the Code of Obligation. This Article provides rules relating to the contract of mandate. The rules are

[16] de Garidel-Thoron 2002, 24.
[17] Hug 2000, 12; Eggli 2003; Besson 2004, 26.
[18] de Garidel-Thoron 2002, 24. Hitler's objective was to gather all "German" funds in German banks. This act later became the tool used by the Nazis to ground the Jewish spoliation. Furthermore, in July 1933, an act providing the confiscation of all assets belonging to the enemies of the German State was also adopted (de Garidel-Thoron 2002, 24; Turk 2003, 157).
[19] The method of the Gestapo was the following: agents were sent to Switzerland with the mission to make a deposit on the account of suspected persons in all Swiss Banks. If the cashier would accept to credit the account, it was the proof that the suspect owned an account abroad. After that, the German government obtained mandates from those persons to repatriate money in favour of the German State, of course by pressuring them (Rappo 2002, 19).
[20] As the Nazis kept on tracking German assets on the Swiss territory, Swiss government adopted an Act on spying, eventually integrated in the penal code in 1937.
[21] Hug 2000. See also Guex (2000, 237; 2002, 25), Montebourg (2000, 27), Eggli (2002) and Besson (2004, 25).
[22] Schwok 2002, 25.
[23] Economic or tax espionage by a foreign country's authority also became an offence.
[24] Author's translation. This provision refers to all aspects of the personal sphere, including the right to privacy. La place financière Suisse 2003, 10.

considered applicable by analogy in most banking relations.[25] When this is not the case, however, the Federal Supreme Court has stated that a bank's obligation to observe secrecy becomes a part of the contractual relationship through the principle of good faith, inherent in customary law.[26] From the point of view of civil law, the duty of secrecy is therefore, regardless of the exact relationship between a bank and a client, an obligation that applies in all contractual and extra-contractual relations linked to banking activities.

1.2.2 Criminal law

The Swiss Penal Code sanctions infringements of banking secrecy in two provisions, namely Articles 162 and 320, which deal with trade secrets, confidential business information and secrets obtained in the practice of employment.[27]

The most important legal basis for the protection of banking secrecy lies, however, in the 1934 Act,[28] which was adopted in the particular context discussed above. With this Act, Switzerland has simultaneously created a bank surveillance system and strengthened banking secrecy by extending it to the sphere of criminal law.

Article 47 of the 1934 Act is dedicated to banking secrecy. It specifically provides that:

> "1. Whosoever discloses a secret that has been entrusted to him or of which he has received knowledge in his capacity as an officer, employee, agent, liquidator or commissioner of a bank, as a representative of the Federal Banking commission or as an officer or employee of a recognised auditing firm, or whosoever attempts to induce somebody else to commit such a violation of professional secrecy, shall be punished with imprisonment up to six months or with a fine amounting to 50.000 [Swiss] franks. 2. If the act has been committed by negligence, the penalty shall consist of a fine of up to 30.000 [Swiss] francs. 3. The violation of professional secrecy remains punishable beyond the termination of the official or professional relationship, or the exercise of the profession.*(…)*.

It is worth repeating that the 1934 Act was adopted after the stock market crisis of 1929 had triggered global economic malaise and had prompted most European countries to strictly regulate their banking sectors. At that time, Switzerland thus clearly distinguished itself from other European countries by providing a very liberal body of economic

[25] Le Centre d'Economie Bancaire 1971, 179.

[26] This affirmation was further developed by the court in 1932: "Bank secrecy is nothing than the right of each bank client to demand the strictest confidence from the bank in the business affairs with which it is entrusted; it is equally, and conversely, the bank's duty to keep completely quiet about these affairs. For the banker in particular, this duty is independent of the legal relationship between the banker and his or her client. Whether there is a written contract or not, violation of bank secrecy constitutes a wrongful act according to articles 41 et seq. of the labour code." (Campbell 1996, 666).

[27] The first provides that "[a]ny person who has disclosed a trade secret, confidential business information that was meant to be kept secret by virtue of a legal or a contractual obligation, any person who has used this information to his or her benefit or to that of a third party, will be, on prosecution, punished by imprisonment or by fine". The second provides that "1. Any person who has disclosed a secret entrusted to him or her as a representative of authority or a civil servant, or who has acquired knowledge by means of his or her practice or employment, will be punished by imprisonment or by fine. The disclosure remains punishable even when the practice or employment has terminated. 2. The disclosure will not be punishable if it was made with the written consent of a superior authority". (Author's translation).

[28] See supra.

legislation. Furthermore, the Swiss government has maintained the 1934 Act in force over the years in spite of general international opposition.[29]

The Swiss population seems to support this radically liberal policy: in 1984, in the framework of a public referendum, 74% of the population voted in favour of the retention of banking secrecy.[30] On 2 July 2003, the National Council even called for the inclusion of banking secrecy into the Swiss Constitution.[31] This latter initiative is, however, mainly symbolic: banking secrecy is already guaranteed in law, and, as such, a constitutional provision would not offer a higher level of protection.[32]

[29] Farhat 1970, 46.
[30] Besson 2004, 111; Swiss Bankers Association in 2004, pt 4.6.
[31] Article 13 of the Constitution now provides that "Banking secrecy is guaranteed". Between autumn 2002 and January 2004, six cantons proposed cantonal initiatives that pursued the same objective.
[32] Swiss Bankers Association 2004, 4.6; Besson 2004, 111.

2 THE PROGRESSIVE FADING OF SWISS BANKING SECRECY

When Switzerland adopted the 1934 Act, it made quite clear its intention to make banking secrecy a firmly established principle and anticipated service.[33] However, during the second half of the Twentieth Century, the institution has progressively faded. An examination of the reasons for and the circumstances surrounding the *erosion* of the Swiss banking secrecy are somewhat surprising, however: the ethical and philosophical principles behind the inception of banking secrecy are in no way linked to its decline. As a matter of fact, history shows that in the last decades, banking secrecy has only been considered (and often tackled) from the viewpoint of its effects and consequences on *criminality*. It has not been perceived as a concept which in itself calls for a review.

2.1 The unclaimed assets crisis[34]

During the Second World War, Jews from across Europe had deposited their assets in Swiss banks in order to avoid Hitler seizing them. Indeed, banking secrecy, combined with Swiss neutrality, offered high protection.

By the end of the war, many of the account holders had died and their money remained unclaimed.[35] The Allied immediately encouraged Switzerland to look for assets that had been deposited by the victims of the Nazi genocide.[36] In the name of banking secrecy, Swiss banks however disregarded this request and refused for decades to disclose the names of their clients,[37] arguing that the problem of unclaimed assets would easily be solved when their owners would eventually come to claim them. For most of them, of course, that never happened.[38] Ironically, the very protection originally afforded to Jewish savers was – and still is – put forward as an example by Swiss banking representatives to justify the institution of banking secrecy.

In the 1990s, a public campaign took place that shed light on the friendly relations that Switzerland had had with the Third Reich.[39] This forced Switzerland to take action. In May 1996, the "Independent Committee of Eminent Persons" (ICEP) was given the mandate to investigate the specific issue of dormant accounts. Alongside the ICEP, a Commission, generally known as the Bergier Commission,[40] was established in December 1996. The Commission was given an extremely broad mandate to investigate, from a historical and

[33] Perrenoud 2003, 113; de Garidel-Thoron 2002, 24.
[34] This issue must be distinguished from the argument which the Allied and Switzerland had on Nazi leaders' acécounts and gold stolen from foreign National Banks.
[35] Bower 1997; Perrenoud and others 2002.
[36] In 1962, a Federal Decree was adopted to encourage banks in the same way, but there has been no follow-up to this initiative.
[37] Lebor 1997, 209.
[38] Levin and Dornberg, 1999; Turk 2003, 163. See also U.S. Department of State (1997); Chargéraud (2001); Besson (2004, 34.)
[39] The setting up of the Committee followed a Memorandum of Understanding, concluded on the 2nd of May 1996 between the World Jewish Restitution Organization, the World Jewish Congress and the Swiss Bankers Association. (Junz 2003)
[40] The chairman of the Commission was Professor Jean-François Bergier from the Institute for History at ETH Zürich.

legal point of view, the volume and fate of assets moved to Switzerland before, during and immediately after the Second World War.[41]

Both the ICEP and the Bergier Commission came to the same conclusion: *"the recurrent theme that runs like a red thread through thousands of pages of analysis is the "business logic first attitude" of Swiss Banks.*[42]

In reaction, Swiss Banks eventually agreed to publish a list of accounts that had remained unclaimed since the beginning of the Second World War. The names of 1872 Jews that had opened accounts before 1945, but had not had contact with the bank for at least 10 years, went public, which allowed the account holders' heirs to claim the assets. Banks also promised to disclose the names of persons who were thought to have died during the Holocaust; they eventually identified 64 000 dormant accounts that might have contained assets of Jewish for which Swiss citizens were account trustees.

In the course of this process, Switzerland has thus accepted foreign examination of some of the accounts held in its banks. This has been the most significant waiving of the Swiss banking secrecy hitherto. Moreover, this event has, on the one hand, demonstrated that banking secrecy is not to be considered as totally unconditional[43] and, on the other hand, showed that the moral ground on which the Swiss government allegedly based its policy on banking secrecy, was pure fiction. It unfairly took many years for the families of account holders to recover funds their relatives had tried to hide from the Nazis' confiscation.[44]

Although these historical events have shown the limits of banking secrecy, they nevertheless remain an exception. Therefore, they are unlikely to cause a full dismantling of the secrecy provisions.

2.2 The internationalisation and diversification of the Swiss banking sector

Until the beginning of the 1970s, Switzerland's economic development permitted Swiss banks to concentrate their activities on Swiss soil.[45]

In the 1970s, the rapid growth of international financial markets proved an incentive for banks to establish themselves where their operations were taking place. In addition, the political and economic stabilisation of foreign markets persuaded banks to provide their services and reinforce their position abroad.[46] This gave rise, in the mid 1970s, to a new economic phenomenon in the banking sector: multinationalisation or "group structuration".[47] Banks formed alliances to cope with the pressures of international competition.[48]

---

[41] 24 other governments have set up national commissions to document and assess how this issue has been dealt with in their respective countries. Chargéraud 2001; Junz 2003; Besson 2004, 34.
[42] Junz 2003.
[43] Even though, on this occasion, very specific conditions governed its withdrawal.
[44] Guex 1999.
[45] Rappo 2002, 25; Besson 2004, 30.
[46] OCDE 1983.
[47] Haegler and Jeger 1993, 60; Frick and Honegger 1996, 50.
[48] Since 1987, the number of groups of banks has dramatically increased all over the world, but also in Switzerland (Rappo 2002, 26). According to the Swiss National Bank, 143 foreign banks were active in Switzerland in 2002. They managed more or less 20% of the total assets deposited in the country and,

Initially, these alliances only occurred through mergers. After a while, other sorts of groups formed: holding companies (that did not exercise any banking activities) started integrating banks into their groups. The strategy allowed them to make management savings, ameliorate global risk control and thereby support their international development.[49] The groups were able to finance themselves through banks of their own, which has, in turn, contributed to their growth.[50]

Although this evolution in financial structures has led to an economic blossoming, it appears to have been one of the reasons why banking secrecy has recently faded. Indeed, the international expansion of banks constitutes an inherent threat to the institution. Firstly, there is a conflict between the clients' rights to secrecy and the obligation of parent companies to strictly control their subsidiaries or branches.[51] Secondly, banking secrecy cannot be enforced over an international banking area. States control banks in terms of risk, yet not all states acknowledge similar levels of banking secrecy. Accordingly, "transparency" may to a certain extent have blurred banking secrecy for international groups of banks.[52]

The most critical issue has nonetheless been the development of group structures. A tightening of financial networks has indeed led to acceleration in the flows of assets, which in turn promotes financial criminality.[53] And, in order to tackle financial criminality, the Swiss banking secrecy regulation was dramatically narrowed in scope during the 1990's.[54] This is currently the main threat to Swiss banking secrecy.

---

already at the end of the 1990's, two thirds of the banks established in Geneva belonged to foreign groups (Helbing 1993, 92; Briscoe 1999, 162; Besson 2004, 43).

[49] Rappo 2002, 27.

[50] This mechanism also allows groups to remain discrete on the operations that they run abroad, because the transfer networks are located inside them. Some other groups have integrated banks in their structures, not only for this reason, but as a service they can offer to their clients. (Ibid.*)*

[51] Frick and Honegger 1996, 50.

[52] OCDE 1983; Frick and Honegger 1996, 55; Rappo 2002.

[53] Helbing 1993, 92.

[54] De Watteville 2002, 3; Besson 2004, 31.

3 CAN THE SWISS BANKING SECRECY SURVIVE WITHIN THE GLOBAL COOPERATION TO TACKLE FINANCIAL CRIME?

Most Swiss financial institutions have lifted banking secrecy to the level of an absolute and unconditional principle without exceptions. Bankers' associations invariably convey this strict position in their opinions on legislative proposals or in commentaries on case law.

Nevertheless, with the globalisation of the world's financial markets and the liberalisation of capital movements, Switzerland, when applying a strict banking secrecy policy, has become more than ever exposed to the risk of its financial institutions being misused by criminals.[55] In this context, a strict banking secrecy policy can only be maintained if it is accompanied by measures designed to prevent such abuse.

Switzerland fully recognises that such measures are a necessity. Yet the Swiss are also plainly conscious that their banking activity and code of secrecy remains one of the factors that determines their competitive position in the international markets. Indeed, in terms of employment, tax revenues and added values, the financial sector is a key element of Swiss economy.[56] The Swiss banking has centrally contributed to the success.[57]

But no financial market can be attractive if it does not offer full guarantees that its activities do not promote financial criminality.[58] Switzerland has therefore committed itself to constructing a system where a reconciliation between tackling financial criminality and preserving its reputation as an international banking centre is possible.[59]

---

[55] Pieth and Aiolfi 2003.

[56] Contributing – directly or indirectly – up to 12% of Swiss GDP, employing 6% of the active population and generating over 20% of collective tax revenues. In 2002, the Swiss Stock Exchange had the eighth largest market in terms of market capitalisation. Switzerland also has the world's fifth largest bond market and accounts (UBS 2001; Eggli 2002; Guex 2002, 27; Erb 2004, 116). See also Rappo (2002, 25). Switzerland actually has the lead in portfolio management business, as private banking represents more or less 80% of the banking activity. Half of the 80 % is dedicated to foreign assets management. Accordingly, 59% of tax income provided by the banking sector comes from portfolio management (Swiss Bankers Association 1996, 39).

[57] However, it is worth mentioning that the success of Switzerland is also based on other factors such as the political stability and neutrality, the geographical location at the centre of Europe, and the availability of numerous specialised services with a high level of expertise (Helbing 1993, 174; De Watteville 2002, 12).

[58] Besson 2004, 31.

[59] As we have seen, Switzerland's market is open for banks and financial institutions from all over the world and it provides a system in which banks act both in commercial banking and investment banking businesses. Consequently, more than one third of banks that are located in Switzerland are foreign ones. However, all banking operations in Switzerland are subject to the Swiss Federal Act on Banks and Savings institutions of 8 November 1934. This act has a very large scope as it applies to all business associations engaged in the banking business. In 1997, a Federal Ordinance with respect to foreign banks came into effect. The Ordinance clearly stated that any foreign bank that is effectively managed in or from Switzerland is considered to be a domestic bank, and is therefore subject to all relevant Swiss banking provisions (Briscoe 1999, 161-2).

3.1 Tax fraud

International transfers of capital and capital market globalisation in general have dramatically expanded in the 1990's.[60] Along with this exponential development have come new challenges and risks, such as tax evasion. Swiss banking secrecy has regularly been criticised as a means to promote this type of criminality.[61] The confidentiality of undeclared funds is indeed one of the key advantages of the Swiss banking area.[62] Moreover, Switzerland has always applied a rather restrictive definition of tax fraud: under Swiss law, the simple "dissimulation of taxable assets" does not fit under the definition, only collateral frauds (like the falsification of documents).[63] Given these two elements of confidentiality and restrictive tax laws, Switzerland is a key target for tax related criminality, especially in the portfolio management sector.[64] Switzerland's participation in international prevention mechanisms is therefore a necessity.

In order to avoid encouraging financial criminality, Switzerland has progressively adopted specific legislation or entered into international agreements providing for mutual cooperation. At the domestic level, the Swiss Federal Act on International Mutual Cooperation in Criminal Matters of 20 May 1981[65] entered into force in 1983. It intends to regulate all the procedures that relate to international cooperation in criminal matters. It however also provides that there it shall not allow information requests when they relate to acts that seem to diminish tax revenues or infringe monetary, economic or commercial policy measures (article 3 alinea 3).[66] Tax evasion is therefore explicitly not addressed by it.[67]

---

[60] Helbing 1993, 152; Helleiner 1994; Germain 1997; Cerny 1998.

[61] Buzelay 2001, 667; Le Centre d'Économie Bancaire 1973, 12. It should be recalled here that in the introduction it was mentioned that the pressure of the Third Reich is traditionally presented as the historical background for the development of banking secrecy. Its original meaning, however, was tax evasion.

[62] There have also been other reasons for making Switzerland an attractive place for foreign assets since the end of the 19th century. In particular, most European states chose to impose a high tax burden from early on—also in the field of succession—while Switzerland offered, and still does offer, a very attractive tax regime.

[63] Lefèbvre 1997; Guex 2002, 25. Some cantons may even compete with some tropical tax havens thanks to the so-called "fixed-price practice". Under this system, individuals who wish to get established in Switzerland are allowed to negotiate the amount of tax they will pay, via the intervention of a lawyer or a banker. Some other cantons offer advantages to companies with a very low tax rate. For instance, the canton of Zug offers a tax rate of 17 %, while Belgium's rate is 33 % and Germany's 39 %.

[64] Between 25 % and 35 % of the worldwide offshore private wealth (the one that is not managed in the country of origin of their owner) is managed in Switzerland; this gives Switzerland the top ranking in the sector.

[65] This law allows Switzerland to grant judicial assistance to states with which Switzerland has not concluded a bilateral agreement and which are not parties to the European Convention.

[66] Aubert and others 1995, 449; Aubert 1996, 111.

[67] This Federal Act, however, provides exceptions to the general refusal to cooperation. Examples include situations where the proceeding intends to discharge a person (article 63, al 5); or certain tax fraud matters that involve a crime (article 3 al. 3 in fine). In practice, it seems that these exceptions, nevertheless, have quite a restrictive scope. For the judicial cooperation be granted, the constitutive elements of fraud in tax matters must be obvious from the facts. On that point, the Federal Tribunal has adopted a rather strict definition so that the requesting state must actually disclose serious evidence of tax fraud and, to this effect, deliver a copy of any falsified documents, which are much closer to evidence than a mere suspicion. It may be added that amendments to the Act on International Mutual Assistance in Criminal Matters, which took effect on 1 February 1997, have eased

At the international level, the Swiss-American Treaty on Judicial cooperation in criminal matters provides that a judge will be entitled to discharge a witness from his or her duty of confidentiality if a request in that sense has been lodged within the framework of the prosecution of a common crime.[68] However, since legal assistance will be refused if the proceedings are related to political, fiscal or military matters, the Treaty's efficiency is strongly limited.[69] Furthermore, the Treaty also provides that all testimonies, declarations, or other evidence obtained by the requesting state on the basis of the Treaty cannot be used in a procedure, other than the one for which judicial cooperation was established. Accordingly, a person cannot be pursued for tax fraud on the basis of information collected in the course of another proceeding via the Treaty.

Nevertheless, article 7 of the same Treaty provides that for proceedings in the field taxation of natural persons, judicial cooperation will be granted if the enquiring state considers it necessary in order to assure the prosecution of people affiliated to a criminal organisation or if, in the absence of cooperation, obtaining such information would constitute an excessive charge for the enquiring state. With these provisions, the inviolability of Swiss banking secrecy may thus be compromised in extremely rare situations.[70]

At the present, the Swiss regulation aiming at tackling tax fraud is thus not likely to cause a dismantling of Swiss banking secrecy. This might, however, be subject to change in the near future (see Chapter 5).

3.2 Money laundering

Money laundering may be defined as "any act or attempted act to conceal or disguise the identity of illegally obtained proceeds so that they appear to have originated from legitimate sources".[71] Such activities not only hinder global security, but also compromise

---

the process of assistance noticeably. In particular, they have clearly shortened the procedures involved by limiting the possibilities of appeal and by reducing the number of persons permitted to resort to these means to those personally and directly affected by the mutual assistance measure. The revised Act also permits, under certain conditions, the Swiss criminal prosecution authorities to transfer information and evidence to a foreign penal authority on their own initiative. Moreover, it has enlarged the powers of the Swiss federal authorities to act directly when provisional measures must be taken, as well as in complex cases or in cases of special importance.

[68] Aubert 1996, 117-20.

[69] Article 2 of the European Convention on Judicial Cooperation in Criminal Matters (Campbell 1996, 691; Schwok 2002, 25).

[70] Rappo 2002, 34. It may be noted that the Swiss Federal Law on Mutual Legal Assistance in Criminal Matters came into force on the 1st of January 1983 and was adopted subsequent to the Federal Law of 3 October 1975 regarding the Treaty between Switzerland and the USA on Mutual Legal Assistance in Criminal Matters. Both acts follow the principles of the existing European Conventions on Extradition and Mutual Legal Assistance. This federal Law was revised and its current version has been in force since 1 February 1997. Although cooperative procedures exist for the prosecution of alleged tax evaders, Switzerland has been criticised for sheltering people charged with tax crimes elsewhere.

Switzerland has participated in the setting up of international standards, including the International Monetary Fund's and the World Bank's assessment programs on the financial sector in 2001 and 2002. These standards apply to tax fraud prevention, as well as to the suppression of other kinds of financial criminality such as money laundering and corruption (see the following section). Lastly, to date Switzerland has concluded 66 double taxation agreements. This cooperation in preventing tax fraud has convinced the Tax Affairs Committee of the OECD to withdraw Switzerland from its "black list" (Swiss Bankers Association 2004, 4.3; International Monetary Fund & World Bank.

[71] Working definition adopted by the Interpol General Assembly in 1995. See also Swiss Bankers Association Report (2001, 3), in which the banking association defines money laundering as the act of

the transparency and efficiency of financial systems, thereby undermining global economic stability.[72] For obvious reasons, banking secrecy may be an obstacle to the prevention of money laundering. It is moreover presented as being a driving force for this kind of criminality.[73]

Although Switzerland tries to preserve its banking secrecy, it has, in the last decades, taken important initiatives to curb money laundering through a cooperative approach. Among all the regulations that have been adopted in the financial sector at the end of the 20th century, those concerning money laundering have in fact affected Swiss banking secrecy the most directly.[74]

3.3 Legal provisions

In 1977, banks in Switzerland were the first to conclude a "Code of conduct with regard to the exercise of Due Diligence".[75] Customer Due Diligence rules have their origins in prudential law and international risk management within financial institutions.[76] They are founded on the premise that understanding the customer's business and conducting a diligence check is the most effective way to minimise the risk of financial criminality. In the development of such rules, the Swiss experience was crucial.

Under the Convention, bankers are obliged to identify the holders of all the accounts. As a consequence, even when accounts are listed by number, the identity of the holder may be retrieved.[77] This provision has strongly influenced subsequent international texts, such as the Forty recommendations of the FATF (see infra).[78]

However, banks were, initially, not under the obligation to ask for the name of the account holder when he/she was represented by an intermediate, so that circumvention remained possible. But in 1991, the Federal Bank Commission decided to oblige all financial agents, lawyers, notaries, and fiduciary or portfolio managers to indicate the name of their clients to banks.[79]

Switzerland outlawed money laundering back in 1990.[80] Under articles 305bis and 305ter of the Swiss Penal Code, active money laundering as well as lack of due diligence in handling money are curbed. However, all money coming from activities that are not qualified as

"concealing the origins of money and releasing it unnoticed into legitimate business activities" (Pieth and Aiolfi 2003; Besson 2004, 69).

[72] World Bank.

[73] Briscoe 1999, 302.

[74] Pieth and Aiolfi 2003; Besson 2004, 69.

[75] The first version of the Convention dates back to 1977. It has been revised since then every 5 years. The sixth version of this Convention entered into force on 1 July 2003 and provides quite severe obligations on the identification of bank's customers. See Swiss Bankers Association Press Release (2003).

[76] Pieth and Aiolfi 2003.

[77] Campbell 1996, 695; Eggli 2002; Erb 2002, 46.

[78] Pieth and Aiolfi 2003.

[79] Montebourg 2000, 52. This was an answer to the FATF requirements, expressed in July 1989. The Swiss Federal Banking Commission has enacted directives that are consolidated in an Ordinance of 1 July 2003, that establishes strict requirements of diligence. See Switzerland's Federal banking Commission (1998).

[80] Articles 305bis and 305ter of the Swiss Penal code, according to which the supervisory authorities are required to inform the penal authorities if they are aware of violations of the penal provisions that are contained in the specific surveillance legislation or in the Penal Code.

crimes under Swiss law (like simple tax fraud) falls outside of its scope.[81] In this respect, the law's efficiency is limited.

The Money Laundering Act of 10 October 1997 came into effect on 1 April 1998. It intends to prevent money laundering within the meaning of articles 305bis and 305ter of the Swiss Penal Code. The Money Laundering Act is based on the abovementioned agreement on the Swiss Banks' Code of Conduct with regard to the Exercise of Due Diligence and the Swiss Federal Banking Commission guidelines on money laundering. It has provided major changes to the tracking of this kind of criminality.

Firstly, the Swiss anti-money laundering policy nowadays covers not only all financial intermediaries, but also all payment services which are executed without the involvement of a bank (this latter part addressing financial intermediaries from the non-banking sector). It contains a broad definition of financial activities considered to be particularly vulnerable to money laundering and it specifies the exact duties of the banking sector as well as of financial intermediaries. Secondly, the surveillance of the regulation has been entrusted to a specific control authority: the Money Laundering Reporting Office, to which all suspicious transactions must be reported without delay. All assets in relation to suspicious transactions will be frozen.[82] In order to ensure the full implementation of the Act, bankers or financial agents who act with the required care and in good faith will not, in any case, be pursued for violation of professional secrecy or for contract infringement when giving such reports.

The Swiss Federal Banking Commission monitors the compliance of all intermediaries under its supervision under the Money Laundering Act. The same applies to the Federal Office of Private Insurance with respect to insurance companies. Furthermore, the Money Laundering Act requires that all financial intermediaries be authorised. This enables authorised self-regulatory organisations to implement measures to combat money laundering in their sector of activity. Such organisations must themselves be authorised and are supervised by the Money Laundering Control Authority, which is integrated in the Federal Finance Administration. In addition, the Banking Commission is responsible for directly monitoring compliance with the obligations laid down in chapter 2 of the Money Laundering Act for legal and natural persons who are not subject to any other federal supervision.[83]

Taking into account that the Money Laundering Act is one of the most comprehensive pieces of regulation in this matter,[84] it is noteworthy that the Swiss Money Laundering reporting office has received a particularly small number of declarations since its creation in 1998. There is even a downward trend in the number of communications made. In 2004, there were 821, down from 863 in 2003.[85] Swiss authorities explain the results by the fact

---

[81] In most countries, money that is obtained through tax evasion and injected into the market is usually considered as laundered money (Montebourg 2000, 50; Besson 2004, 33).
[82] Article 10 alinea 3 of the MLA.
[83] In 2000, a commission of experts launched the idea to create an integrated surveillance authority, different from the one already existing within the Federal Finance Administration. It was aimed at exercising the tasks of the Federal Banking Commission and of the Federal Office of Private Insurance by gathering all surveillance activities within a single authority. After consulting the concerned partners, a second expert commission was designated to transpose this recommendation into Swiss legislation. As with all new legislation, it is no easy task when negotiations are ongoing (Schaerer 2005, 11).
[84] Eggli 2002.
[85] MROS 2004, 7. It may be noted that the figures for 2003 were already themselves surprisingly low as regards the number of banks located in Switzerland.

that only serious hints lead to communications.[86] Since only 544 condemnations for money laundering for 562 discharges were sentenced upon declaration between 1 April 1998 and 31 December 2004,[87] this statement is quite doubtful.

Some months after the Money Laundering Act was adopted, the FATF stated that

> "Switzerland's central geographical location, its relative political, social and monetary stability, the current context of liberalisation and the professional secrecy that characterises the country's financial system are attractive to all investors, whether the origins of their funds is legal or illegal. In addition, advances in technology and a great diversity of institutions in the financial centre, exposes Switzerland to being used in international money laundering schemes. In this context, Switzerland is used primarily, but not exclusively, at the "layering stage of the money laundering process".[88]

Consequently, the Swiss government conferred to the Finance Federal Department the task of creating a working group and adapting the abovementioned Money Laundering Act accordingly.[89] The project to amend this text has been submitted to the consultation of most "cantons", judicial institutions, academic institutions and associations which all responded favourably. The project has thus been amended on the basis of these recommendations. The government has decided to postpone the follow-up report, because a third evaluation of Switzerland is being carried out by the FATF.

Finally, many other international initiatives, in which Switzerland took part, have been launched in order to tackle money laundering since the 1980's. Examples include the Council of Europe's recommendation on measures against the transfer and the safekeeping of funds of criminal origin[90] (1980); the UN Convention Against Illicit Trafficking of Narcotic Drugs and Psychotropic Substances (The Vienna Convention) (1988); and, the OECD Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, (1990).[91] All of these provide rules and guidelines that are summarised in the 40 recommendations of the FATF.[92]

[86] Montebourg 2000, 63.
[87] MROS 2004, 57. In September 2003, the Attorney-General of Geneva Daniel Zappelli recalled that in twelve years, only 30 out of 896 proceedings brought in Geneva for money laundering had lead to condemnation, mostly under the form of penalties. Of the 45 enquiries opened in Zurich between 1998 and 2001, none were followed up (Besson 2004, 72).
[88] FATF 1999, 43.
[89] 2003.
[90] Recommendation No. R (80) 10 of Council of Europe.
[91] This list is not exhaustive.
[92] One can also mention 1) the Basle Committee on Banking control that was founded in 1974 by the central governors of the G10. In 2001, it has adopted a set of minimum standards for the identification of clients. Those are the latest standards in the field in question; 2) the International Monetary Fund which in 2001 extended its mandate by launching an action plan for the fight against money laundering and terrorism financing (see infra); 3) the Wolfsberg Group, created in 2002 and encompassing some of the biggest banking institutions whose task is to establish, at the global level, directives on the fight against money laundering in the private banking sector; 4) the United Nations conventions and the Security council resolution that form the basis of the public international battle against terrorism financing (Convention for the suppression of the financing of terrorism – 1999 and the Convention against transnational organised crime - 2000); and 5) the Council of Europe, founded in 1949 that has devoted several conventions to the fight against money laundering and criminality as well as to international cooperation.

3.4 The efficiency and effects of the Swiss regulation on financial criminality

Switzerland's strong will to maintain banking secrecy may be questionable. However, as far as prevention of criminality is concerned, one must note that it was a pioneer and remains one of the most regulated states, mainly in the field of money laundering.[93] International organisations evaluating the quality of countries' banking surveillance and the level of cooperation with international organisations such as the FATF even acknowledge that Switzerland has undertaken some of the most stringent measures in that field.[94]

Indeed, Switzerland was the first, in 1977, to introduce rules on the identification of clients in the framework of the Diligence Convention, which eventually inspired the FATF to issue its 40 recommendations.[95] From the viewpoint of the revolutionary Swiss duty to "know your customer", despite banking secrecy, nothing is secret anymore between Swiss banks and their client.[96]

Another example is that the Money Laundering Act of 1998 has extended the application of anti-money laundering rules to all financial intermediaries, including lawyers, which is not the case in most other European countries or in the United States. Indeed, the United States and the United Kingdom have only imposed a duty of verification of client's identity after the 9/11 attacks, and this obligation is still less extensive than it is in Switzerland, as it does not concern American nationals.[97] However, both the United States and the United Kingdom differ from Switzerland by the massive volume of transactions that banks declare to the competent authorities:[98] more than 30 000 declarations were made in the United Kingdom, and more than 200 000 in the United States, which is far greater than in Switzerland.[99]

The multiplication of normative instruments aimed at tackling money laundering is now to be considered as the main cause of the erosion of the Swiss banking secrecy, which has also weakened the attractiveness of Swiss banking. According to professionals, the number of clients that have fled to the Caribbean or the Anglo-Norman islands[100] as a consequence of the measures to prevent this kind of criminality has dramatically increased over the last decades.[101] Consequently, the Swiss banking practice seems to have evolved[102] and the relations that Swiss banks now have with their foreign clients have changed. Traditionally, the clients would bring their assets into Switzerland, most of the time undeclared, and give bankers the liberty to manage and invest them. Nowadays, Swiss banks tend to establish themselves where their clients live.[103] Pressures on the Swiss banking system with respect to the fight against money laundering indeed seem to have been so great that portfolio management and other private banking practices could have become easier outside

---

[93] Pieth and Aiolfi 1999, 302; Eggli 2002.
[94] Eggli 2002, 36.
[95] See supra.
[96] Pieth and Aiolfi 2003.
[97] Ibid.; Besson 2004, 81.
[98] Besson 2004, 81.
[99] Ibid.; Comptroller of the Currency Administrator of National Banks (OCC) 2000.
[100] Ibid., 78.
[101] This allegation remains difficult to assess. Overall, anti-money laundering measures are quite expensive for the banking sector. Indeed, their implementation implies that an internal "police" be set up, that workers be educated, and that computer surveillance systems be created – all at the expense of banks (Pieth and Aiolfi 2003).
[102] Besson 2004, 78.
[103] Ibid., 107.

Switzerland than inside it. In the short term, this tendency will, of course, not lead to an emptying of the Swiss financial market as Switzerland still represents an attractive place, thanks to its traditional advantages of discretion and guaranteed know-how.

As far as tax evasion and tax fraud are concerned, things are different. Measures to tackle harmful tax competition and tax evasion could be a sensitive issue regarding banking secrecy. But, since the matter is particularly difficult to deal with, banking secrecy remains, so far, out of reach. The first obstacle to international cooperation in this field is the lack of mutual interest in global cooperation,[104] the second that any cooperation in the field of taxation is highly sensitive to the non-participation of third countries as all efforts can be useless if assets are transferred out of the cooperative area.[105]

Strong pressure from the international community persists anyway. As soon as demand to cooperate in the field of tax fraud had become unbearable, Switzerland had to harshly negotiate in order to counterbalance the negative effects of cooperation on its banking secrecy. Switzerland has, for instance, negotiated in the framework of a bilateral Tax Agreement with the European Union (EU) to exchange banking information, but rather to apply a withholding tax. This is a major arrangement for the future of the Swiss banking secrecy and it will be addressed in the following chapter.[106]

[104] Eggli 2002, 36.
[105] Ibid.
[106] The US is also an important actor in terms of tax cooperation pressure. However, its role will not be elaborated here. The focus is rather on the relations that Switzerland has with the EU.

4 BANKING SECRECY AND THE EU-SWITZERLAND RELATIONS IN TAXATION

Switzerland is not a member of the EU, nor is it part of the European Economic Area (EEA). It is nevertheless geographically, culturally and economically very close to it, so that numerous bilateral agreements have been and are being negotiated between the EU and Switzerland in areas of common interests.[107] The so-called Bilateral Agreements II, for example, were concluded in 2004 and deal *inter alia* with the fight against tax fraud. As far as banking secrecy is concerned, they are of particular concern.

4.1 In the background - the European Savings Directive[108]

The EU Directive on taxation of savings income in the form of interest payments (the “Savings Directive”) was adopted on 3 June 2003. With this directive, the EU intends to fully harmonise tax competition throughout the EU Member States and ensure a minimum taxation on the interests payments made to individuals resident within the EU. The directive requires either an exchange of information or the application of a withholding tax,[109] where in the state, the savings income is uncontrolled. This is part of the internal evolution of the EU – namely the achievement of the common market and its corollary, the Monetary Union.

The Savings Directive, which was initiated at the European Summit of Feira in 2000, covers savings income in the form of an interest payment from a *paying agent* established in a Member State to a *beneficial owner,* i.e. a natural person resident in another Member State.[110] Therefore, it only affects individuals who are residents of one of the Member States and earn bank interest or other savings income on deposits or investments under a proper name in another Member State.[111]

Initially, the idea was to impose an exchange of information between all Member States. But in Feira, three European countries that have a banking secrecy regulation – namely, Austria, Belgium and Luxembourg –insisted that such a measure should not be adopted if equivalent rules were not applied by several financial centres located outside the Union.[112] Those states feared that there would otherwise be loopholes that would jeopardise the whole system and favour the banking sectors of third countries.[113]

---

[107] Switzerland applied for EU membership in 1992. This application was directly linked with the negotiations for the conclusion of the Agreement on the European Economic Area (EEA Agreement), which aimed at getting the EFTA nations closer to the EC. With the Swiss’ rejection of the EEA Agreement in a public referendum in 1992, the issue of EU membership was put on ice. A further referendum was held in March 2001, calling for an immediate start to negotiations on EU membership, but it lead to a resounding negative answer (77%). Nevertheless, in 2004 the Swiss Parliament decided to maintain the application for membership.

[108] Directive 2003/48/EC on taxation of savings income.

[109] Schwok and Levrat 2001, 335; de Limbourg and Borgeons 2003; KPMG 2003.

[110] Erb 2002, 47; Margelisch 2002, 22. These terms are defined in the Savings Directive.

[111] Docclo 2005.

[112] Namely with 5 “European Non Members”: Andorra, Liechtenstein, Monaco, San Marino and Switzerland, as well as with 10 associated and dependent territories (Anguilla, Aruba, British Virgin Islands, Cayman Islands, Guernsey, Isle of Man, Jersey, Montserrat, Netherlands Antilles, Turks and Caicos Islands). Bilateral Agreements have been concluded accordingly.

[113] Buzelay 2001, 665; Margelisch 2002, 23.

In 2003, the refusal of Switzerland to automatically exchange information on tax-related matters compelled the Union to find a compromise: Austria, Belgium and Luxembourg were authorised to preserve their banking secrecy as long as Switzerland[114] would not accept information exchange standards as defined by the OECD. As a counteroffer, these three Member States were required to introduce a withholding tax of 15% in the first three years (from 1 July 2005 to 30 June 2008), 20% in the next three years (from 1 July 2008 to 30 June 2011), and 35% after 1 July 2011. With regard to the distribution of their withholding tax, the Savings Directive provides that these States will retain 25% of all receipts at their end and will transfer the remaining 75% to the Member State where the beneficiary owner is resident. Of course, the beneficiary's home state will not receive any personal details of individual customers.[115]

4.2 The Bilateral Agreements II

The scope of the Savings Directive naturally only covers EU Member States. However, due to the proximity of Switzerland, discussions were rapidly started to apply the same or equivalent measures under a bilateral agreement. In the framework of these discussions, the Swiss banking secrecy was rapidly put to the forefront.

An agreement that would have provided an automatic exchange of information within the framework of fully open cooperation between Switzerland and the EU would certainly have deprived Swiss banking secrecy of its meaning.[116] Switzerland could not, however, simply refuse to cooperate with the Union. Switzerland was thus confronted with a dilemma. On the one hand, it would indubitably suffer grave economic consequences if the level of banking secrecy were to be diminished. On the other hand, should Switzerland not execute EU's requests, it would have to endure unprecedented pressure from the Union.

Switzerland could not cope for long with the pressure imposed by the EU. Consequently, a set of specific agreements called Bilateral Agreements II was negotiated and eventually adopted on 19 May 2004. In these agreements, Switzerland aligned itself more or less with the Community regime, but managed nonetheless to preserve its banking secrecy.[117]

The Bilateral Agreements II indeed provide measures equivalent to those applicable to Austria, Belgium and Luxembourg under the Savings Directive. Switzerland has thus become a collecting agent for the EU by withholding a minimum tax on all interest payments made by Swiss paying agents to individuals resident in a Member State.[118] This is certainly a major step ahead. The withholding tax system is still an alternative that is albeit not as profitable as domestic traditional taxation.

Switzerland has also agreed to exchange information, upon request, within the framework of an investigation on administrative, civil or criminal law grounds on tax fraud, or the like, under the laws of the requested state. The fraud must concern incomes specifically

[114] And other third states mentioned under footnote 112.
[115] Guide to the European Savings Tax directive, see www.irishpermanentintl.com/docs/EUSD%20Guide.pdf.
[116] de Garidel-Thoron 2002, 24.
[117] Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments (European Commission).
[118] As a counterpart, Switzerland has obtained measures equivalent to those laid down in the Parent-Subsidiary Directive 90/435/EEC and the EU Interest and Royalty Directive 2003/49/EC.

covered by the Bilateral Agreements II.[119] Any information so exchanged should be dealt with in accordance with double taxation agreements that are to be concluded between Switzerland and the relevant Member States.[120] In this respect, Switzerland has agreed in a memorandum of understanding to enter into bilateral negotiations with each of the Member States. The agreements would provide for administrative assistance in the form of exchange of information in the cases mentioned above.[121] There lies the weakness of the arrangement. As a matter of fact, since the term “tax fraud and the like” is to be interpreted under the laws of the requested state (i.e. the state where the funds reside), requests by a Member State will be denied by Switzerland whenever they relate to cases of tax evasion without collateral fraud. Indeed, as mentioned, simple tax evasion is under Swiss law merely an administrative offence; it will not give rise to cooperation under the Treaty dealing with offences.

Another weakness is that only natural persons are covered by the arrangement:[122] screen and off shore companies, or trustees from outside of Switzerland, may therefore be used to circumvent the rules.

Regardless of its weaknesses, the adoption of the Bilateral Agreements II raises the question on Switzerland’s future room for manoeuvre in the field of combat against tax fraud. The Swiss certainly tried to avoid such an agreement.[123] And we can expect the Union to apply pressure again, if other European regulations demand it. Such further regulation even seems inevitable, because the current deal with Switzerland does not efficiently prevent tax fraud.[124]

The EU's regulatory process may thus, in many ways, exceed the boundaries of the European Union. Issues and problems that arise within the territory of the Union often become concerns for third countries, as the EU tries to avoid the negative consequences of its own regulative efforts. For that reason, Switzerland is in a particularly weak position: It is geographically located at the centre of the EU, but not member to it.

---

[119] Article 10 of the Agreement.
[120] Blum Attorneys at Law.
[121] Currently, Switzerland only grants administrative assistance to the extent that it is necessary for the application of a tax Treaty. It does not grant it solely for the application of the domestic law in another contracting state.
[122] In addition, it may be noted that an individual is not deemed to be a beneficial owner when he or she acts as a paying agent within the meaning of the EU-Swiss agreement, acts on behalf of a legal person, an investment fund or a comparable or equivalent body for investments in securities, or acts on behalf of another individual who is the beneficial owner and discloses to the paying agent his identity and state of residence.
[123] Schwok and Levrat 2001, 335; Margelisch 2002, 23.
[124] In this respect, “European pressure” may already have played a role in the past: the Money Laundering Act can be perceived as a mere reaction to the EU Directive on money laundering rather than a voluntary, spontaneous action. The EU text, then again, was directly inspired by the FATF recommendations.

5 ERODING BANKING SECRECY FROM THE OUTSIDE—AND FROM WITHIN

The financial sector (and banking more specifically) was crucial to Switzerland's emergence as an international market place. A central reason behind Switzerland's achievement is the high level of banking secrecy in the country. Indeed, the successes in the financial markets fed back into to further enhancements in the Swiss banking secrecy .

Banking secrecy is commonly connected to financial criminality. Therefore, the financial sector became in the 1990's, after its complete liberalization, one of the most regulated services sectors. The rapid internationalisation of the sector and the formation of group structures together with the creation of new financial instruments and institutions have put banking secrecy into the centre of the discussions. Combating financial criminality is not feasible without an international cooperative approach, and transparency is required within the financial groups. Because Switzerland is an important actor in the sector, foreign states or institutions have put pressure on the Swiss to fully participate in the international cooperation mechanisms. The conclusion of the Bilateral Agreements II between the EU and Switzerland is a good example: the Agreements are a necessary complement to EU's Savings Directive, and the Swiss had no other choice but to cooperate.

Financial regulations and international agreements such as the Bilateral Agreements II, which provide for mutual assistance, have been central to the risk of erosion of the Swiss banking secrecy. Although the Swiss have so far managed to preserve their banking secrecy by not agreeing to automatically exchange banking information, international actors such as the EU have the means to force Switzerland to fully cooperate. They will certainly not hesitate to enforce compliance, either. Switzerland is therefore confronted with the difficult balancing act of preserving a tight banking secrecy regulation while not promoting international financial criminality. This process may be identified as the main threat to the survival of banking secrecy in Switzerland in the coming years.

There is more to the issue, however. Indeed, while recent attacks on banking secrecy focus on the risks in terms of criminality, modern authors and politicians never seem to consider and assess the institution of banking secrecy as such. By focusing invariably on how the disguising of profits favours criminality one never arrives at discussing whether strict banking secrecy is defensible in a fair and democratic society to begin with.

The reasons for the emergence of the banking secrecy tradition (and eventually legislation) in Switzerland, were initially ethical and philosophical, and based on historical grounds. Indeed, as was explained above, banking secrecy developed as a part of the long Swiss tradition of neutrality and individualism. It eventually became enforceable before criminal courts in the early 1930's, and was presented as a central element in the fight of the individual against the tendencies of states to hinder essential civil liberties. However, such justifications cannot be maintained anymore. Nowadays, governments that would prohibit their citizens from holding assets abroad could be opposed by simply refusing to cooperate with their countries in financial and other policies. The refusal could be justified merely on the grounds of human rights and privacy, without having to rely on banking secrecy more specifically. Therefore, arguments based on human rights considerations should no longer be accepted in assessing the institution of banking secrecy.

A closer look at the grounds of banking secrecy rather than its consequences reveals that keeping money safe from State control and interference is what this institution is about. Yet, surprisingly, no detailed assessment of what banking secrecy really is about - i.e. its intrinsic meaning and philosophical implications—has been made in the last decades. This means that while fortunate people enjoy the fundamental liberty of becoming and remaining rich, their ability to hide finances actually dismantles the very functioning of the state: they can avoid participating in the general financing mechanisms of the society. However, no society, not even the most liberal ones, can function without the basic fairness, equity and social solidarity that lie behind an effective and neutral taxation system. Therefore, besides the fact that a strict banking secrecy contributes to financial criminality, there are fundamental reasons to question the existence of the institution.

So far, the main risk for Swiss banking secrecy has been external and indirect—the fight against international financial criminality. The erosion of the institution could—and should—however also have an internal and direct reasoning: the secrecy's inherent socio-economic unfairness.

BIBLIOGRAPHY

Aubert, Maurice and Paolo Bernasconi. 1996. Relations bancaires et entraide internationale en matière pénale. In *Les nouveaux défis au secret bancaire suisse*, edited by Paolo Bernasconi. Lugano-Vezia, Suisse: Centre d'études bancaires, Association bancaire tessinoise.

Aubert, Maurice, Jean-Philippe Kernen and Herbert Schönie. 1995. *Le Secret bancaire suisse: droit privé, pénal, administratif, fiscal, procédure, entraide et conventions internationales*. Bern: Stämpfli.

Baudart, H. 1977. Le secret bancaire face au pouvoir du fisc et du pouvoir judiciaire en droit comparé, Thesis, ULB.

Besson, Sylvain. 2004. *Le secret bancaire. La place financière suisse sous pression*. Lausanne: Presses polytechniques et universitaires romandes.

Blum Attorneys at Law. Memorandum. http://www.blumlegal.ch/ (Accessed May 2007)

Bower, Tom. 1997. *L'or nazi, les Banques suisses et les Juifs*. Paris: Plon.

Briscoe, Andrew. 1999. *Banks and the control of Money Laundering*. London: Carlton Laws.

Briscoe, Andrew. 1999. *The Regulation of Banking in Europe*. London: Carlton Laws.

Buzelay, Alain. 2001. Secret bancaire, évasion fiscale et blanchiment de l'argent en Europe. *Revue du Marché commun et de l'Union Européenne* (453):665-668.

Campbell, Dennis. 1992. *International Banking Secrecy*. London: Sweet & Maxwell.

Centre d'Economie Bancaire and the Centre Universitaire d'Etudes des Communautés Européennes of the Paris I University. 1971. *Report of the colloquium on Le secret bancaire dans la CEE et en Suisse*. Paris: Université Panthéon-Sorbonne (Paris I).

Cerny, Philip C. 1993. The Deregulation and the Re-regulation of Financial Markets in a more Open World. In *Finance and Worlds Politics: Markets, Regimes and States in the Post-hegemonic Era*, edited by Philip C. Cerny. Aldershot: Edward Elgar.

Chargéraud, Marc-André. 2001. *La Suisse présumée coupable*. Lausanne: L'Age d'Homme.

CNN. Europe. www.cnn.com/2000/WORLD/europe (Accessed May 2007).

Comptroller of the Currency Administrator of National Banks (OCC). 2000. Bank Secrecy Act/Anti Money Laundering. Comptroller's handbook. Consumer Compliance Examination. Basel: Web Publication, 2000. Available from <www.occ.treas.gov/handbook/bsa.pdf>.

Confoederatio Helvetica. 1974. Initiative populaire fédérale "contre l'abus du secret bancaire et de la puissance des banques" of the 8 octobre 1974. http://www.admin.ch/ch/f/pore/vi/vi133t.html (Accessed 23.5.2007)

Coudret, Paul. 2003. Développements du Monde Onshore-Offshore, un faux débat? *Denaris*(3).

De Garidel-Thoron, Alexandra. 2002. Le secret bancaire suisse: de la protection des minorités à la protection des états. *Banque stratégie* (196): 24-28.

De Limbourg, N. Fiscalité de l'épargne des non-résidents dans l'UE : Conséquences fiscales de l'entrée en vigueur de la directive. Seminar Van Ham et Van Ham, Brussels, June 9 2005.

De Limbourg, N. and P. Borgeons. 2003. Fiscalité de l'épargne européenne. Seminar Van Ham et Van Ham, Brussels, 13 March 2003.

De Watteville, Jacques. 2002. The Swiss Banking Secrecy and the Fight against Financial Crime. Working Paper presented at the International Wealth Management executive MBA, Schloss-Hünigen, Switzerland 18 April 2002.

Docclo, Caroline. 2005. Secret bancaire ou échange d'information, ce qui va changer après l'entrée en vigueur de la directive épargne, Seminar Van Ham et Van Ham, Brussels, June 9 2005.

Eggli, Caroline. 2002. Le secret bancaire suisse face aux pressions internationales. In *Place financière suisse, évasion fiscale et intégration européenne*, edited by René Schwok, 31-42. Genève: Europya, Université de Genève.

Erb, Michael. 2002. Le secret bancaire a-t-il un avenir? *Revue économique et sociale*, 60 (1): 5-8.

European Commission. DG External Relations. The EU's Relations with Switzerland. www.europa.eu.int/comm/external_relations/switzerland/ (Accessed April 2007).

Farhat, Raymond. 1970. *Le secret bancaire – Etude de droit comparé (France-Suisse-Liban)*. Paris: Librairie générale de droit et de jurisprudence.

Financial Action Task Force. www.fatf-gafi.org (Accessed April 2007)

Financial Action Task Force. 1999. Financial Action Task Force on Money Laundering (FATF) *Annual report 1998-1999*. Paris: OECD.

Financial Market Surveillance Expert Group. 2000. Final report on La réglementation et la surveillance des marchés financiers en Suisse (banques, assurances, allfinances et conglomérats financiers, autres services financiers). Novembre 2000. www.oecd.org/dataoecd/62/3/2067265.pdf.

Frick, Thomas and Peter Honegger. 1996. Les groupes de sociétés face au secret bancaire. In *Les nouveaux défis du secret bancaire suisse*, edited by Paolo Bernasconi, 47-58. Lugano-Vezia, Suisse: Centre d'études bancaires, Association bancaire tessinoise.

Garret, Geoffrey. 1995. Capital Mobility, Trade and the Domestic Politics of Economic Policy. *International Organization*, 49 (4): 657-87.

Germain, Randall D. 1997. *The International Organisation of Credit. States and Global Finance in the World-Economy*. Cambridge: Cambridge University Press.

Guex, Sébastien. 2002. Intégration européenne et banques Suisses: Quelques réflexions historiques. In *Place financière suisse, évasion fiscale et intégration européenne*, edited by René Schwok, 21-29. Genève: Europya, Université de Genève.

Guex, Sébastien. 1999. Les origines du secret bancaire Suisse et son rôle dans la politique de la confédération au sortir de la seconde guerre mondiale. *Genèse* (34):4-27.

Guex, Sébastien. 2000. The origins of the Swiss Banking Secrecy Law and its Repercussion for Swiss Federal Policy. *Harvard Business History Review*, 74 (2):237-266.

Guide to the European Savings Tax directive. Isle of Man Government. www.irishpermanentintl.com/docs/EUSD%20Guide.pdf

Haegler, U. and M. Jeger. 1993. *Explaining the Performance of Swiss Banks from 1987 to 1990 in Banking in Switzerland*. Studies in Contemporary Economics, 1993.

Helbing, T. 1993 Explaining the Presence of Foreign Financial Intermediairies in Switzerland. In *Banking in Switzerland*, edited by Niklaus Blattner, Hans Genberg and Alexander Swoboda. Heidelberg: Physica-Verlag.

Helleiner, Eric. 1994. *States and the re-emergence of Global Finance. From Bretton Woods to the 1990's*. Ithaca: Cornell University Press.

Hug, P. 2000. Les vraies origines du secret bancaire, démontage d'un mythe, *Le temps* (Switzerland) April 27:12.

Hölz, M. 2005. A Genève, l'histoire bancaire bégaie. *Le courier* (Switzerland) July 21.

International Monetary Fund & World Bank. Financial Sector Assessment Program – Final Report. www.edf.admin.ch. (Accessed April 2007)

Junz, H. J. 2003. *Confronting Holocaust History. The Bergier Commission's Research on Switzerland's Past*. Jerusalem: Jerusalem Centre for Public Affairs.

KPMG. 2003. Communication of the Financial services Tax Group on The EU Savings directive in the EU and in Switzerland.

Kurzer, Paulette. 1993. *Business and Banking: Political Change and Economic integration in Western Europe*. Ithaca: Cornell University Press.

LeBor, Adam. 1997. *Hitler's Secret Bankers. The Myth of Swiss Neutrality During the Holocaust*. New York: Birch Lane Press Book.

Lefèbvre, Francis. 1997. *Suisse – juridique, fiscal, social, comptable*. Levallois: Dossiers internationaux - Editions Francis Lefèbvre.

Levin, Itamar and Natasha Dornberg. 1999. *The Last Deposit: Swiss Banks and Holocaust Victims' Accounts*. Westport, CT: Greenwood.

Levrat, Nicolas and René Schwok. 2001. Switzerland's relations with the European Union after the adoption of the Seven Bilateral Agreements. *European Foreign Affairs Review* 6 (3): 335-54.

Lombardini, Carlo. 2002. *Droit bancaire suisse*. Zurich: Schultess.

Margelisch, Claude-Alain. 2002. Quelques réflexions à propos du devoir de discrétion du banquier suisse. *Banque stratégie* (196).

Martin, E. 2004. True meaning of the "Swiss banking secrecy": What it is? What it is not? Tokyo: Japan Centre for International Finance.

Mihail, Philippe. 2003. *International Tax and Estate Planning*. Paris: Maxima.

Money Laundering Reporting Office Switzerland (MROS) 2004. *7th Annual Report*. Bern: Federal Department of Justice and Police, Federal Office of Police (FedPol).

Montebourg, Arnaud. 2000. Rapport d'Information sur obstacles au contrôle et à la répression de la délinquance financière et du blanchiment des capitaux en Europe at the French Assemblée Nationale, 30 March 2000. Paris: Assemblée Nationale.

OCDE. 1983. *Report on Les pouvoirs publics face à l'internationalisation des activités bancaires*. Paris: OCDE.

OECD. 1998. *Harmful Tax competition. An Emerging Global Issue*. Paris: OECD.

OECD. 2003. *Improving Access to Bank Information for Tax Purposes. The 2003 Progress Report*. Paris: OECD.

Perrenoud, Marc. 2003. Secret bancaire et politique étrangère de la Suisse (1932-1962), *Relations Internationales* (113):27-40.

Perrenoud, Marc, Rodrigo López, Florian Adank, Jan Baumann, Alain Cortat and Suzanne Peters. 2002. Final Report of the Bergier Commission on la place financière et les banques suisses à l'époque du national-socialisme. Les relations des grandes banques avec l'Allemagne (1931 – 1946), Vol. 13. Commission Independande D'Experts de Suisse—Second Guerre Mondiale.

Pieth, Mark and Gemma Aiolfi. 2003. *Anti-money-laundering: levelling the playing field*. Basle: Basel Institute of Governance.

Poyetton, Virginie. 2003. Le secret bancaire menace l'emploi, *Le courrier* (Switzerland) Septembre 22.

Rappo, Aurélia Joyce. 2002. *Le secret bancaire : sa portée dans le temps, dans l'espace et dans les groupes de sociétés*. Bern: Stämpfli Editions.

Saint-Alary, Bertrand. 2002. Le partage du secret: tolérances et limites. *Banque stratégie* (196).

Salminen, T. 1988. Banking secrecy legislation in Western Europe. *Issues in The World of Banking* 7 (9/10):10.

Samin, Thieffry. 1997. *Le secret bancaire*. Paris: ABF.

Schaerer, Barbara. 2005. Les prochaines étapes de la nouvelle surveillance des marchés financiers. *La vie économique* (3):10-14.

Schwok, René, ed. 2002. *Place financière suisse, évasion fiscale et intégration européenne*. Genève: Europya, Université de Genève.

Strange, Susan. 1987. The Persistent Myth of Loss Hegemony. *International Organization* 41 (4):551-79.

Swiss Bankers Association. Home page. www.swissbanking.org (Accessed March 2007)

Swiss Bankers Association Press Release of 17 July 2003.

Swiss Bankers Association. 1996. Report on Le secteur bancaire Suisse: Evolution, structure et position internationale. Basel: SBA.

Swiss Bankers Association. 2001. Switzerland and the fight against Money Laundering. Basel: SBA.

Swiss Bankers Association. 2004. Activity report 2003/2004. Basel: SBA.

Swiss Business Federation. 2004. Bilatérales II: Dossier de la fiscalité de l'épargne. Dossier Politique n° 36/1 of 27 Septembre 2004. Genève: Swiss Business Federation. www.economiesuisse.ch/web/fr/PDF%20Download%20Files/DP_Europe_20040927.pdf.

Swiss Federal Banking Commission. 1998. Circular 98/1 on Money laundering.

Swiss Federal Departement of Finance. 2003. Report on La place financière Suisse – Aperçu des principaux thèmes et évolutions dans le domaine financier. June 2003. Bern: FDF.

Turk, Eleanor L. 2003. *Issues in Germany, Austria and Switzerland*. Westport, CT: Greenwood Press.

U.S. Department of State. 1997. Report on U.S and Allied Efforts to Recover and Restore Gold and other Assets Stolen or Hidden by Germany during World War II ("the Eizenstat report"). May 1997. www.ess.uwe.ac.uk/documents/asetindx.htm

Weber, R. and R. Getsch. 2005. L'importance des standards internationaux pour la surveillance des marches financiers. *La vie économique* (3):16.

World Bank. www.1.worldbank.org/finance/html/amlcft/index.htm. (Accessed March 2007).

Zondervan, Richard. 1973. *Le secret bancaire Suisse et sa légende – une appréciation critique*. Brussels: Centre d'Etudes Bancaires et Financières.

Legal documents

Decision 2004/911/EC of the Council of 2 June 2004 on the signing and conclusion of the Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments and the accompanying Memorandum of Understanding [2004] OJ L 385/28

Directive 90/435/EEC of the Council on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [1990] OJ L225/6

Directive 91/308/EEC of the Council of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering [1991] OJ L166/73

Directive 2003/48/EC of the Council on taxation of savings income in the form of interests payments [2003] OJ L157/38

Directive 2003/49/EC of the Council on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L157/49.

Federal Act of 10 October 1997 on Combating Money Laundering in the Financial Sector (Anti-Money Laundering Act, AMLA). SR 955.0

Recommendation No. R (80) 10 of the Council of Europe, Council of MInisters on measures against the transfer and the safekeeping of funds of criminal origin. 27 June 1980.

Treaty on mutual assistance in criminal matters with related notes. Signed at Berne May 25, 1973; (entered into force January 23, 1977). SR 0.351.933.6

THE IES WORKING PAPER SERIES

1/2008	Lewis, Richard. New Europeans, New Identities. Reflections on Europe's Dilemma.
2/2007	Devuyst, Youri. American attitudes on European political integration – The Nixon-Kissinger Legacy
1/2007	Schnyder, Melissa. Getting by with a little help from their (EU) Friends: NGO cooperation and involvement across multi-level policy processes