SWISS BANKING SECRECY

The individual right to privacy is a basic concept that democratic countries recognize and reinforce with constitutional guarantees. Since this democratic principle is the cornerstone of all personal liberties, the erosion of privacy through government surveillance of citizens activities and attitudes and, more recently, through the penetration of electronic data processing in various segments of private life raises disturbing questions in any free society.

Ever since the Swiss Confederation came into existence seven centuries ago, Switzerland has resisted invasions of privacy that have threatened to compromise its traditions and principles. In addition to defending its independence an(l neutrality, Switzerland is particularly concerned with the asylum from l)ersecution it has granted to foreign political refugees. The cantons (which are the equivalent of States in the USA) at the foot of the Alps have been a safe shelter for all comers for hundreds of years.

Under the Swiss Constitution, individual liberty and private ~)roperty are consi(lere(l indivisible human rights and therefore are given e(lual protection of the law extended to both Swiss and foreign citizens.

Because of the high value place(l on individual liberty and privacy, the Swiss banking system has gaine(l a favorable reputation as a life preserver" for countless thousands of political refugees and their money – seeking to escape severe persecution and penalties. Ironically, this humanitarian, l)rotective l)ra(~tice has given rise to widespread misunderstanding and myths about Swiss banking practices.

The purpose of this booklet is to explore those myths and give the reader a clearer I)icture of the Swiss banking system with respect to individual privacy and international law. To this end, we shall examine the following, often misunderstood facts:

– Secrecy or discretion, in banking matters is not unique to Switzerland alone. In fact, it is practice(l in various degrees

in most (ountries. Lu Switzerland, however, it is protected by criminal penalties.

- Anonymous niinilwrecl accounts do not exist in Swiss banks; ntIInl)ers an(1 passwords may be used to identify certain counts. In this *case* the identity of the customer is known only to a few senior bank officials.
- Bank secrecy is not absolute. Under specific legal circumstances (prosecution of criminals for example), Swiss authorities may grant *access* to private banking records.

Banking Secrecy is not exclusively a Swiss concept

Banking secrecy or more precisely, banking discretion, which can 1w defined as a hankers' professional obligation to keep in strictest confidence the (letails of a client's financial and personal affairs – **is** not peculiar to Swiss law. It is observed hx institutions throughout the world in varying (legrees.

The principle of financial confidentiality was incorporated in ancient law an(1 was eonhirme(1 in medievel times by the civil codes of German 1)rin(iPalities anti of the cities in northern ItaI~. As tra(le expande(l and feudal privileges crumbled under the increasing struggle for individual rights, confidence in the discretion of 1)aflkefs became indispensible for the I)rotection of prix *ate* property and the correct conduct of commerce. By the middle of the 19th century, virtually all the government of western Europe had vali(Iated 1)anking secrecy, and comparable legislation has since been enacted in every country concerfle(1 with an orderly I)anking system.

Where Swiss law (liffers from almost every other is in its protection of I)anking secrecy by criminal law.

Banking Secrecy – Life preserver for political refugees

The Swiss Banking Law, enacted in 1934 **to** I)olster the security of the banking system after the Great Depression and during the Nazi period and to ensure the Rafety of clients' deposits. represents a Ian(lrnark in bank regulation. Its section dealing

with banking secrecy puts this concept, for the first time in history, under official protection of penal law.

The provisions of the Banking Law and of the Criminal Code were "life preservers" for those who escaped Nazi terror and for countless thousands of political refugees from states in Eastern Europe after World War II. Espionage agents trie(I to crack the secrecy of accounts by offering bribes to Swiss banking employees. Once a depositor ~as known, the agents demanded all of his or her assets under the threat of reprisals against relatives still living in that enuntry.

Although some Swiss citizens were sentenced for accepting hril)es, in the overwhelming majority of cases the offers were reported to the authorities anti the agents were ordered out of Switzerland.

Characteristics of banking secrecy under Swiss law

A special feature of banking secrecy in Switzerland is, as mentioned above, that a violation of trust is subject to criminal prosecution. As with violations of official secrecy, a breach of banking secrecy **is** prosecuted cx officio by law, whereas violations of professional secrecy (medical doctors, attorneys etc.) are prosecuted oniy **U~Ofl** express request of the injured party.

rfhe J)rotection of banking secrecy under penal law is far-reaching. Whoever willfully divulges a secret CfltrUSte(1 to him in his capacity as a rel)resentatixe, officer, employee, authorized agent, liquidator or commissioner of a 1)ank, as a representative of the Banking Commission (the official Swiss supervisory I)o(Iy), officer or employee of a recognized auditing coml)any, or anyone who has become aware of such a secret in this capacity, and whoever tries to induce others to violate banking secrecy, shall be 1)unished by a prison term of ~p to six months arid a fine of up to 50,000 Swiss francs.

Not only is the deliberate and intentional violation of confidence punishable, hut also violation by negligence, which is punishable by **a fine of** up to 30,000 Swiss francs. A person who

was subject to the banking secrecy law at any time must keep any such secrets for the rest of his life. While these laws may seem stringent, they are necessary to ensure the trust inherent in the Swiss banking system.

Swiss electorate overwhelmingly in favor of bank secrecy laws

On May 20, 1984 Swiss voters rejected by a three to one margin a Socialist liroposal that would have substantially weakened banking secrecy laws. It is obviously the prevailing opinion of a large majority of the electorate that the present legal status of banking secrecy, as an important element in the protection of the bank customer's privacy, remains justified. After the rejection of the Socialist proposal, any possible doubt has been dispelled and the stringency of the bank secrecy regulations will be upheld in the future. The Federal Council has expressly declared that banking secrecy will not be affected by the forthcoming partial revision of the Banking Law.

Switzerland, as an international financial center, will continue to provide effective safeguards for the foreign client and the infringenient of bank secrecy will continue to be a matter for prosecution.

The myth of numbered accounts

All bank accounts in Switzerland enjoy the same protection of secrecy. As we have seen, the banker is required by law to maintain silence about his client's affairs under penalty of fines and even iml)risonlnent.

The Banking Law has no stipulation concerning accounts designated by numbers or by passwords, since they do not extend the 5N)l)C of banking secrecy or reinforce its protection.

The numbering of an account is an internal technical measure ensuring that only a limited circle of bank executives know the actual identity of the depositor. Generally speaking, the name that goes with the nuniber will be known to a very small

number of key staff personnel. Thus, the bank reduces the chances that any of its personnel will be induced through indiscretion, bribery or blackmail to divulge information about the customer. At the same time, it protects rank-and-file employees from becoming the targets of foreign intelligence activities.

Anonymous numbered accounts do not exist

Contrary to popular belief, anonymous numbered accounts – a term used and frequently misused particularly by certain authors or "novelists" – simply do not exist. The name of anyone holding an account designated by a number or password in a Swiss bank is known to the bank.

Numbered accounts are opened only when the (lepositor is already a customer of the bank or, in case of a new customer, when the bank has established through interviews and references that he or she has legitimate reasons for wishing this protection.

Observance of care in accepting funds

In 1977, the Swiss banks and their professional organization, the Swiss Bankers' Association, established binding rules of good conduct in bank management with the signing of the ~Agreement on the Observance of Care by the Banks in Accept-in'~ Funds and on the Practice of Banking Secrecy". The Agreement, reached with the Swiss National Bank (Swiss central bank), requires the banks to ascertain the identity of their customers on a systematic basis. Furthermore, the banks agreed not to actively assist in the transfer of capital from countries whose legislation restricts the investment of funds abroad.

The Agreement was extended in October 1982 for an additional five years, with considerably stiffer provisions. The revised Agreement also prohibits the banks from maintaining accounts for persons and companies known by the bank to use their accounts professionally for the purpose of assisting capital flight or tax evasion (articles 8/9 of the Agreement of July 1,

1982). It also extends to the renting of safe-deposit boxes, requiring the banks rent such facilities only to persons whose trustworthiness gives no cause for doubt.

The new rules, with a maximum fine of 10 million Swiss francs for non-compliance, are considerably tougher than comparable provisions abroad. In fact, the Council of Europe has recommended the Swiss "Observance of Care" Agreement as a mo(lel to be emulated by the other member states.

Limitations of banking secrecy under Swiss law

Where stipulated in the law, banks are required to furnish to public authorities l)ertinent information on clients' accounts. Such disclosures are mandatory in actions involving inheritence, bankruptcy and debt collection as well as in all criminal cases, but not in ordinary tax matters and when violating foreign exchange regulations.

Switzerland is party to many bilateral und multilateral conventions for legal assistance with other countries. Where such treaties exist, Swiss authorities assist foreign countries in crimma1 cases under conditions provided by these treaties. To be prosecuted as a crime, however, the alleged offense must always be considered a crime under Swiss law, too. Violations of foreign political or monetary laws and infractions of tax or exchange rules are not considered crimes under the terms of Swiss legislation.

Civic responsibility is the cornerstone of Swiss legislation

Deviations from the principles governing the Swiss juridical system for the sake of international cooperation remain exceptions. The cornerstone of Swiss legislation and, for that matter, of the Swiss tax system is the civic responsibility of the individual, who is trusted to comply with regulations. In the event that his return is questioned, the authorities can ask a taxpayer to furnish documented evidence of his financial matters (all income and assets).

But the law forbids Swiss authorities to demand clarification or affidavits from banks for the purpose of uncovering undeclared assets. Tax authorities are no exception and the law prohibits banks from giving them access to such information. Banking secrecy applies equally to foreigners with respect to their deposits in Swiss banks.

The Swiss government believes it is the responsibility of every country to devise procedures and create a climate for getting its citizens to meet their obligations to the state. It is unrealistic to expect Switzerland as a sovereign nation to change its fundamental laws to aecomodate the wishes and needs of a foreign country, however much it may sympathize an(l agree with that country's objectives.

Domestic tax evasion for example - defined as the simple failure to declare or pay taxes – is not a criminal offense but misdemeanor in Switzerland, whereas it is a crime in the United States and many other countries. As a result, in cases where foreign government authorities have asked for information on Swiss bank accounts belonging to suspected tax evaders, the competent Swiss authorities have been obliged to refuse on the ground that no crime had been commited under Swiss law.

Bridging the gap between different legal systems

Following lengthy negotiations, the "Swiss-American Treaty on Legal Assistance in Criminal Matters" was signed in 1973 and went into effect January 1977. This treaty contains special provisions allowing more extensive legal assistance, on a ease-by-case basis, in the prosecution of members of organized crime. While recognizing the threat organized crime represents to every constitutional state, Swiss authorities have taken all precautions to restrict legal assistance to only those criminal matters punishable under Swiss law.

It must be noted, however, that information provided by Swiss banks may be used only for the exact purpose and only in the proceeding for which it was obtained. Thus, a well-

balanced solution was found, which permits an effective fight against crime while protecting individual citizens from unreasonable interference with their right to privacy.

On January 1, 1983 a new Swiss Federal Act on International Mutual Assistance in Criminal Matters (AMAC") was put into force, largely based on the Swiss-American Treaty. It govems all forms of legal assistance between states and ends the dependence of such measures on state treaties or cantonal arrangements (Cantons are equivalent to the States in the U.S.). The new legislation represents a further cooperation since it states that legal assistance can be granted in cases of tax fraud. broadly defined to include other state levies besides taxes. such as customs duties) where willful deception through the use of false docunients can lie proved.

The Socialist 1)roposal mentioned above attempted to extend the AMAC" to eases of infractions of exchange rules and simple tax evasion. After its rejection on May 20, 1984, the current legislation will be maintained, and legal assistance will be liniit—ed to cases of tax fraud.

Law enforcement cooperation in the field of insider trading

So-called Insider trading" involves financial transactions where l)~~5Ohi5 ~)ossessing non—1)ublic information use their privileged knowledge to reap gains or avoid losses at the expense of other securities investors. The U.S. Securities and Exchange Commission (SEC) has long sought the names of Swiss banking clients j)resLinled to possess such information and on whose behalf securities were being traded in the United States. The Swiss banks, on the other hand, were prohibited until recently from giving information since the misuse of inside information is not indictable in Switzerland as a criminal offense.

As an interim arrangement, an Agreement of the Swiss Bankers Association and a Memorandum of Understanding between the Swiss Confederation and the United States were

reached. They permit the banks, based on a special client authorization, to participate in a procedure, in which a possible "insider" is checked by a Commission of Swiss Lawyers. If this person is found to be an "insider" according to the definition of the Agreement and if certain specified circumstances are present, the Commission will disclose the identity of the customer and certain other relevant information in response to a request made by the U.S. Department of Justice on behalf of the SEC and transmitted by the Swiss Justice Department. This provisional solution is due to be superseded by legislation being prepare(l that would outlaw insider trading in Switzerland itself.

Established procedures for intergovernmental assistance must be respected

Switzerland recognizes the interest of foreign authorities in investigating suspected violations of their own penal regulations and agreed upon well-defined procedures for providing assistance to legitimate enforcement in criminal matters. This cooperation must be consistent with Swiss and international law and can only be secured through the established channels. Even if there is no disagreement as to the ultimate objective, i.e. obtaining documents or evidence, the procedural requirements being of equally great importance must he respected. Consequently, any attempt to obtain information bypassing the established procedures of intergovernmental cooperation is considered contrary to international law and therefore illegal.

Switzerland – A traditional center of international finance

Secrecy is by no means the only, or the most important, reason for Switzerland's success as a center of international finance. Of far greater significance are the country's tradition of neutrality, its political, social and economic, particularly its monetary stability and the quality of the services Swiss banks are able to offer.

It would be naive to deny that unscrupulous individuals may have passed the scrutiny Swiss banks give to applications for accounts before approving them. The overwhelming appeal an(l iml)act of the Swiss banks, however, rest upon the soundness of the system as a whole and upon the strength and resilience of the in(livi(lual institutions.

Bankers are not always happy with the regulatory framework within which they have to operate. But they abide, nevertheless, by the tra(lition of self-restraint and the spirit of cooperation with the authorities. The endeavor to live up to the responsibility towards clients and to safeguard their assets contimes to generate the same confidence so many generations have placed in Swiss banks.

International but Swiss-based

The main source of Swiss banks' capital are the (leposits of the country's (~itizens arid (~oml)anies.

Firmly relying on their (lolnestic base, Swiss banks have built one of the world's most important institutions for capital flow. Characteristically, since the mid-1960s, Swiss bank assets abroad have shown a growing surplus over their liabilities. In other words, Swiss banks place more funds on international markets than they owe to foreign creditors.

The role of the Swiss institutions in worldwide transactions cannot l)e realistically assessed in terms of balance sheet totals alone, sin(e an iml)ortant l)art of their activity is not reflected in these figures. As managers of the funds entrusted to them by their clientele, the three largest Swiss banks, Credit Suisse, Swiss Bank Corporation and Union Hank of Switzerland, rank among the most prominent investors in international finance.

Distortion is no reason to sacrifice a worthy principle

To sum up, Swiss banking regulations reflect the character of the people whose sj)ecific attitudes can be tracked back to

history and geography. From its precarious perch in the heart of Europe, Switzerland has been able to retain its independence by conforming meticulously to its policy of neutrality that is internationally recognized since 1815.

Because of its strength and appeal, the Swiss banking system has attracted clients from all over the world. But clients want to be safe from indiscretion, let alone from wanton or malicious prying. Banking secrecy, as it has been practiced in Switzerland, keeping up with the times to meet the requirements of the electronic era, is the best insurance against violations of privacy.

Still, as this booklet has (lemonstrated, the concept of Swiss banking secrecy has its limitations, and Swiss authorities do effectively cooperate with other governments in the interest of l)ul)lie law and safety.

If banking secrecy has been used in some isolated cases for illegitimate purposes, contrary to the public interest of a foreign nation or of Switzerland itself, this distortion of a worthy 1)rineiple cannot possibly eonstitute a reason to sacrifice the principle itself. For, as we have seen, it has served the world well as a bulwark in (lefen(ling the individual's right to liberty, to privacy - and even to life itself.

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