

# The Future of Bank Secrecy

By Jaime Carvallo & Steven M. Levitt

November 13, 2009



## Executive Summary

Switzerland has long been an offshore venue for investors seeking bank secrecy. More recently, as Switzerland has been accused of harboring investors seeking to commit tax evasion, the country has defended its practice as a venerable one of simply offering privacy for investors around the world looking for a stable economy, protection and longevity of their assets. This paper explores the attack on bank secrecy impacting Switzerland and other offshore banking jurisdictions.

In addition, transparency, which has been the recent focus of attention of the press, has significantly evolved over the past few months through the release of tightly-guarded financial information jealously safeguarded by Swiss banks. The jury is still out as to whether or not bank secrecy has been eliminated in its entirety.

## Introduction

Many declared that banking secrecy ended on February 18, 2009, when UBS agreed to release the names of 250 account holders suspected of tax fraud by the U.S. Never before had a Swiss bank released such information, compromising one of their most celebrated financial safe harbor practices. In the background, a larger push from the G20 is forcing Switzerland and other jurisdictions to fall in line with greater transparency. The current spotlight on bank secrecy has caused Swiss banks to be more cautious, refusing to open or maintain American accounts. It appears that the days of using offshore accounts for tax evasion may be numbered and the entire basis for the existence of tax haven economies may collapse. A closer analysis, however, suggests that the importance of banking secrecy, as well as the current assault on it, may be exaggerated.

## The Origins of Bank Secrecy

Bank secrecy was cemented in the Swiss Banking Law of 1934, which criminalized the release of depositor information. Since then, Swiss bankers have used this law as a shield to protect clients' identities despite protests from governments worldwide. Information is only released when banks believe sufficient evidence exists of a serious crime. Notably, the Swiss government does not consider tax evasion to be a crime, and less so a situation requiring the disclosure of client information.

Other jurisdictions have adopted similar policies to position themselves as offshore destinations. The most frustrating factor for nations requesting information is that the offshore location has discretion on what to release. With little leverage, the requestor nation is often left empty-handed. Despite the notoriety of certain investigations, such as the \$52 million verdict against Igor Olenicoff for fraud, most Americans are able to maintain offshore accounts with minimal interference from the IRS.

## Attacks on Secrecy

With \$7 trillion in assets held in offshore accounts, developed nations lose an estimated \$180 billion a year in evaded taxes.<sup>1</sup> Faced with reduced tax collections, governments are no longer finding this figure acceptable. An April 2009, G20 meeting threatened sanctions on non-compliant nations, based on an OECD list that categorized nations into a whitelist, graylist, or blacklist depending on levels of compliance. In addition to the blacklist, which is composed of “jurisdictions that have not committed to the internationally agreed tax standard,” the G20 is targeting the graylist, “jurisdictions that have committed to the internationally agreed tax standard, but have not yet substantially implemented [them]”,<sup>2</sup> which includes the usual suspects of Luxembourg, Singapore and Switzerland.<sup>3</sup>

Nations are taking the threat of sanctions seriously, as the four blacklisted nations, Costa Rica, Malaysia, the Philippines, and Uruguay, have since committed to the internationally agreed tax standards and have been reclassified to the graylist.<sup>4</sup> Switzerland has agreed to Article 26 of the OECD’s tax convention, which would enhance its disclosure with other compliant nations. More recently, Liechtenstein has also bowed to pressures, signing a disclosure agreement with both the U.S. and Germany, with more agreements planned. A limiting feature of these agreements is that they only allow for the release of information upon specific request.

This all comes while the U.S. is in a heated legal dispute with UBS -- which was recently settled. The U.S. Justice Department had been in the process of suing the bank, the largest in Switzerland, for defrauding the Internal Revenue Service. In 2004, the bank issued a memo stating that the “Swiss solution” can help affluent Americans avoid taxes by hiding money in offshore havens, such as the Bahamas.<sup>5</sup> UBS had already paid \$780 million and unprecedentedly revealed 250 client names in February in hopes of avoiding further prosecution. However, in a parallel case, the U.S. continued its demands for the release of the names of 52,000 additional U.S. account holders. The Swiss government denounced the case and stated its intent to prevent UBS from releasing any information, citing that doing so would break Swiss law.

The ferocity with which UBS and the Swiss government fought against the release of information may seem incongruous given all the proclamations that bank secrecy is dead. The reason for this, despite the apparent progress made by the G20, is that very little has changed. Governments still require a “smoking gun” in order to satisfy the Swiss that sufficient evidence exists. In this Catch-22 scenario, there must be enough substantial evidence to prove the criminal activity to warrant the release of information that would be evidence of criminal activity. Other jurisdictions’ disclosure agreements, such as

---

<sup>1</sup> Aldrick, Philip. “G20 summit: Blacklisted tax havens face sanctions.” Telegraph 3 Apr 2009.

<sup>2</sup> “A Progress Report on the Jurisdictions Surveyed by the OECD Global Forum in Implementing the Internationally Agreed Tax Standard.” OECD 2 Apr 2009.

<sup>3</sup> “OECD country lists on tax openness.” The Associated Press 7 Apr 2009.

<sup>4</sup> “OECD removes all countries from tax havens blacklist” MercoPress 7 Apr 2009.

<sup>5</sup> Browning, Lynnley. “UBS Pressed for 52,000 Names in 2nd Inquiry” The New York Times 2 February 2009.

Liechtenstein's, also carry this stipulation. This eliminates any possible fishing expeditions, which is what the Swiss are accusing the U.S. of doing in the UBS case.

## The Fallout

There is much attention focused on how the attack on bank secrecy will affect countries that depend on it as a competitive advantage. However, areas long associated with secrecy often have an even more important feature: stability. As confidence has recently been destroyed in many markets, investors are more reliant than ever on the stability of offshore locations. In fact, Switzerland has had an inflow of assets over the past two years, suggesting that some of the assets leaving UBS shifted to smaller niche Swiss players, such as Pictet.<sup>6</sup> Other sources of cash are the Middle East, Russia, and Asia, all of which have low personal tax rates, diminishing Switzerland's benefit as a tax haven. The benefit to these clients is Switzerland's political and economic stability.

It is also unclear if any location can fully protect secrecy. Singapore has positioned itself as "Asia's Switzerland" by developing tough secrecy laws to attract assets. It too, however, will comply with international standards and negotiate with countries individually over the release of information.<sup>7</sup> The clear trend is a glacial move towards more transparency, and no bank can now completely guarantee total secrecy. Bank secrecy alone is not enough to create a competitive advantage for a jurisdiction.

The tangible effects of the G20 Agreement will be limited. With the current scrutiny over Switzerland, Swiss banks have encouraged Americans to register their accounts in the U.S. and have shown more discretion in opening new accounts. The UBS case serves as a warning to other banks of the dangers in helping Americans evade taxes, which will curb the supply of offshore accounts. International tax fraud investigations will benefit from greater access to account information. However, this will not end the use of offshore accounts for tax evasion. Recent agreements do not enforce a free flow or automatic exchange of information, leaving the offshore jurisdiction with discretion. Investigations without indisputable smoking gun evidence or from nations lacking influence may be challenged.

## Recent Developments

Since February, there has been controversy over resolving the legal dispute between the U.S. and Swiss governments regarding whether UBS should be mandated to turn over the names of 52,000 clients with accounts in Switzerland. (UBS has already provided the names of 250 to 300 U.S. customers to U.S. authorities.) The dispute turned on whether UBS should hand over the additional names of clients with approximately \$14.8 billion in offshore bank accounts that were not part of the original agreement where the Swiss bank paid a \$780

---

<sup>6</sup> Nixon, Simon. "The Secret of Swiss Banks' Success" [The Wall Street Journal](#) 30 Jun 2009.

<sup>7</sup> Paris, Costas. "Singapore Stands Set to Defend Bank Secrecy, to a Point" [The Wall Street Journal](#) 8 May 2009.

million fine as part of a deferred prosecution arrangement.<sup>8</sup> However, it appears that court pressure to reach a resolution by August 3rd was successful.

Initial settlements were made in mid August,<sup>9</sup> and a few days later, Switzerland had agreed to reveal the names of approximately 4,450 wealthy American clients of UBS AG to U.S. authorities as part of the tax settlement that had previously been indeterminate. The settlement agreement was motivated by the promise to end years of unsettling discovery investigations over the Swiss bank and its clients.<sup>10</sup>

The details of the settlement are paradoxical, involving the collaboration of both the Swiss and U.S. tax authorities with no precedent to guide them. The agreement terms were to have the information released in batches over a period of several months, and they would proceed first through a Swiss Review System. The process includes turning these names over to a Swiss tax administration in Bern, which will review them before they are transmitted to U.S. authorities. Then the cases will be submitted to the IRS working in conjunction with the Justice Department before determining cases appropriate for criminal prosecution.<sup>11</sup>

In late September, reports came of the detrimental after-effects of the settlement for UBS. As this bank felt the restrictions of the regulations, it voiced its fear and anxiety over the new obligations of the settlement, and witnessed hundreds of millions in clients' assets go out the door. Oswald Gruebel, Chief Executive of UBS, addressed how bank secrecy was behind Switzerland's rise to become the world's biggest offshore center, and his view that relaxing that asset would propel Switzerland to switch its concentration to another significant focal point – namely, the effective management of clients' assets. Additionally, he indicated that Swiss banks would seek to expand further in Asia, where the tax dispute with the U.S. (and Swiss branding for that matter) was not tarnished. It is clear that the Swiss bank focus on offshore banking business would most likely shift to Emerging Markets, as Europe and the U.S. are now focused on clamping down on tax dodgers. As the bank has been already struggling to deal with the credit crisis and problems in its own balance sheet, the relaxation of bank secrecy has only exacerbated the bank's problems.<sup>12</sup>

In late October, reports of the very first UBS client sentencing for tax fraud started surfacing as the bank began to conduct tax probes based on the UBS investigations and recent settlement.<sup>13</sup> Interestingly, it appeared that the U.S. Justice Department was exercising leniency in the sentencing based upon the Defendants' cooperation by converting their

---

<sup>8</sup> Brannigan, Martha. "No Deal Yet Between U.S., Swiss Governments Bank Secrecy Case" [The Miami Herald and news.mcclatchy](#). 29 July 2009.

<sup>9</sup> Brannigan, Martha, "Governments reach settlement in UBS bank secrecy case." [The Miami Herald](#) August 12, 2009.

<sup>10</sup> Rhodes, Jason and Dixon, Kim. "Swiss to reveal UBS accounts to settle U.S. tax battle." [Reuters Market News](#) . 19 August 2009.

<sup>11</sup> Mollenkamp, Carrick, Saunders, Laura, and Perez, Evan. "UBS to give 4,450 Names to U.S." [The Wall Street Journal](#). 20 August, 2009.

<sup>12</sup> Thomasson, Emma. "Banks see damage from tighter Swiss regulation." [Reuters Market News](#). 25 September 2009.

<sup>13</sup> Brown, Tom. "Ex-client of UBS gets house arrest for tax fraud." by Tom Brown, 28 October 2009 [Reuters Market News](#). 28 October 2009.

potential prison terms to house arrests, fines, and significantly reducing their tax penalties.<sup>14</sup>

## Conclusion

The investigations by the U.S. Department of Labor resulted in a settlement agreement that clearly pushes for enhanced transparency in the private banking system. This has set a benchmark that nations will no longer allow offshore jurisdictions to brazenly deny information under a blanket policy.

However, the pulse of secrecy continues to endure regardless, as indicated by Swiss politicians and local bankers. The recent agreement does not suggest that U.S. authorities will be given information on all of the offshore accounts held by Americans in Switzerland. Tax authorities from other countries will need to supply probable evidence of tax fraud by an offshore account holder to gain Swiss support. Additionally, Swiss banking supporters claim that while some Swiss banks may have been adversely impacted by the regulations that emerged from the bank secrecy settlement, there is still a surge of money into Switzerland from major European economies.<sup>15</sup>

However, are we to believe the supporters of Swiss banking that tax-compliant banking secrecy continues to be a useful attribute of offshore centers such as Switzerland?<sup>16</sup> Some argue that this is not the reality, and that even while Switzerland's banks would like the rest of the world to believe that it can cope with the fallout, the feasibility of this is dubious in light of the loss of offshore money.<sup>17</sup> Frankly, it is only natural that Switzerland would like to be viewed in a favorable financial light, and perhaps it is too early to ascertain whether its slant of the situation is realistic or simply self-serving.

For the time being, perhaps we can afford Switzerland the benefit of the doubt until the terms and effects of the settlement play out. European investors see that Switzerland has proven to be a resilient Western economy despite a global real estate crash. Switzerland has attracted immigration for reasons including stable politics and economics, as well as a favorable tax system, as reflected by the fact that 55% of the billionaires living in Switzerland are German, Swedish, or British according to Forbes.<sup>18</sup> This lends support to the argument of Swiss banking supporters that Switzerland can rebound from what many think in the financial industry is the most significant transformation since its codification in the 1934 Swiss Banking Act.<sup>19</sup>

---

<sup>14</sup> "Another UBS informant gets leniency for tax fraud.." [Reuters](#). October 2009.

<sup>15</sup> "Banking Secrecy Is Alive and Well, Claim Supporters." [The Wall Street Journal](#). 9 November 2009.

<sup>16</sup> *Ibid.*

<sup>17</sup> Bain, David. Editor's Letter. [The Wall Street Journal](#). 9 November 2009.

<sup>18</sup> Bain, David. "Cutting Edge." [Wall Street Journal](#). 9 November 2009.

<sup>19</sup> *Supra*. "Banking Secrecy is Alive and Well Claim Supporters." 9 November, 2009.

Park Sutton Advisors is a leading authority on the financial services industry, and specializes in providing high-touch, confidential advisory services on small- and middle-market transactions. These include mergers and acquisitions, valuations, divestitures, strategic alliances, joint ventures, fairness opinions, and planning for equity transitions and successions.

For Latin American families, Park Sutton Advisors offers exceptional wealth management services. Operating under the key principles of objectivity and transparency, Park Sutton Advisors is instrumental in helping families achieve harmony and success in asset growth and transfer across multiple generations.

## About the Authors



### **Jaime Carvallo**

*Co-Founder, [Jaime.Carvallo@ParkSuttonAdvisors.com](mailto:Jaime.Carvallo@ParkSuttonAdvisors.com)*

Jaime co-founded Park Sutton Advisors. Prior to Park Sutton, Jaime spent 8 years advising Latin American high-net-worth individuals representing over \$500 million in assets. Most recently, he was a Private Banker with Deutsche Bank, actively involved in developing the Andean Region client base for the bank's New York office.

Prior to Deutsche, Jaime spent over three years with HSBC Private Bank, also focused on developing the Andean Region market and advising clients on their wealth management needs. At HSBC, with the bank's CEO for Latin America, Jaime co-managed the largest offshore relationship managed from New York. He was also awarded membership into the high-profile Group Private Bank's High Potential Development Programme ("HPDP"), a 3-year program accepting only 50 new members globally each year. Prior to HSBC, Jaime spent over four years with The Citigroup Private Bank also actively advising wealthy Latin American clients. From 1995 through 1999, Jaime was a corporate banker with Banco de Credito del Peru, the country's largest commercial bank, managing a significant portfolio of loans and performing credit analyses for some of Peru's largest private corporations.

Jaime is a dual Peruvian – Italian citizen and holds a BA in Business Administration from the University of Lima, Peru. He also holds an MBA in Finance, Marketing, and Strategic Management from The Wharton School of the University of Pennsylvania. He is Series 7, 24, 63, and 66 certified. Jaime is passionate about 20<sup>th</sup> Century French decorative arts.



### **Steven M. Levitt**

*Managing Director & Co-Founder, [Steven.Levitt@ParkSuttonAdvisors.com](mailto:Steven.Levitt@ParkSuttonAdvisors.com)*

Steven leads and co-founded Park Sutton Advisors. He has focused on middle-market M&A and strategic advisory work in the financial services sector for the past 13 years working with asset and wealth managers, broker-dealers, and fund administrators globally.

Prior to co-founding Park Sutton, Steven worked with three investment banking boutiques where he focused on strategic and transactional work in the securities and investment advisory industry. He was a partner with Cambridge International Partners, which he joined from MilleniumAssociates where he led that firm's North American practice. Earlier, Steven worked at Putnam Lovell.

Steven holds a BA degree in Economics from Stanford University and an MBA in Finance from The Wharton School of the University of Pennsylvania. He is an alumnus of Stuyvesant High School. He is also a General Securities Principal.

Steven is a frequent speaker at industry conferences and seminars, and has been particularly active in the Speaker Retainer Program of the CFA Institute speaking on the topic of valuation of asset and wealth managers. He has served as an investment banking course instructor for Baruch College of the City University of New York. He is fluent in Spanish and prior to Wharton spent several years living in Mexico City.