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## UBS plunged itself and Switzerland into crisis

In a treaty with the USA, Switzerland retroactively annulled banking confidentiality for 4,500 American clients of UBS. This step enabled the bank to move out of the firing line of the US judicial authorities. Domestically, the affair sparked fierce confrontation between the Swiss parties. The Federal Council, in particular, came in for severe criticism. By René Lenzin

Switzerland has saved its largest bank, UBS, from the threat of collapse twice within two years. Using emergency legislation, federal government came to the bank's rescue with six billion Swiss francs in October 2008 after it had become embroiled in the US mortgage crisis. At the same time, the Swiss National Bank relieved UBS of 40 billion dollars of toxic US securities. National government argued that these measures were unavoidable as the bankruptcy of UBS would have brought the entire economy to its knees. UBS was deemed system-relevant and "too big to fail". This effectively meant that both major banks, UBS and Credit Suisse, were granted state guarantees.

On the same premise, federal government also intervened when UBS got itself into hot water with the US judicial authorities. Some of the bank's client advisors were accused of helping American citizens to avoid taxation, leading the tax authorities to launch investigations into tax fraud. The USA threatened UBS with prosecution at the end of 2008 and demanded the disclosure of 52,000 client names. In August 2009, Switzerland and the USA reached agreement on a compromise settlement. The USA refrained from filing



Left-wing politicians demonstrating with vuvuzelas in front of the Federal Palace against Parliament's approval of administrative assistance in the USA-UBS case.

civil charges and withdrew its demand for the disclosure of the 52,000 client names. At the same time, it submitted a new request for administrative assistance to Switzerland concerning 4,450 UBS clients. Switzerland undertook to filter out cases of tax fraud and serious tax evasion within a year and to pass the details to the US authorities. The Federal Council claimed this agreement was necessary to save UBS, which was still struggling with the impact of the economic crisis, from a trial in the USA that it would find almost impossible to sustain.

### Court stops the Federal Council

For the clients concerned, the agreement means that Switzerland would retroactively annul banking confidentiality in their cases.

However, the Federal Council failed to take account of the Federal Administrative Court, which declared the disclosure of the account details to the US authorities illegal and stopped the transfer. The court said that Parliament would firstly have to establish a legal basis for administrative assistance on tax evasion. Under international pressure, Switzerland had in fact resolved to provide foreign authorities with administrative assistance in cases where reasonable grounds for suspicion of tax evasion existed (see "Swiss Review" 2/2010). However, the corresponding agreements have yet to enter into force.

In light of this, the Federal Council resolved to present the UBS settlement with the USA to Parliament for approval as a treaty. The National Council and Council of States passed this treaty in emergency proceedings in the summer session. This should ensure the timely processing of administrative assistance, which should prevent UBS from facing further legal action in the USA, at least for the time being. However, the approval of the treaty triggered complex wrangling between the political parties in Switzerland.

Initially, three camps emerged: the Free

## FEDERAL COUNCIL SUBJECTED TO HARSH CRITICISM

Owing to its business practices in the USA, UBS was left teetering on the brink and caused Switzerland major political problems. However, the Federal Council's management of this crisis was far from exemplary. This is the conclusion reached by the control committees of the National Council and the Council of States. In a 370-page report, the committees stated that the bank itself was the

cause of the problem, but that matters were subsequently handled poorly by the authorities.

The control committees were shocked "that the Federal Council was clearly unable to work in an atmosphere of trust and confidentiality". In September 2008, for instance, former Swiss President, Pascal Couchepin, ordered no minutes should be taken for the Federal Council's discussions

on the UBS case over fears of revelations. This mutual mistrust in national government was still evident at the beginning of 2009 when it had to deal with the UBS tax affair in the USA.

Individual members of the Federal Council had failed as well as the body as a whole. Finance Minister Hans-Rudolf Merz was the biggest culprit. He had been well informed about the problems fac-

ing UBS by the regulatory authorities and his own department, but had not adequately passed this information on to the rest of the Federal Council, for fear of disclosures in particular, according to the report. Foreign Minister Micheline Calmy-Rey and Justice Minister Eveline Widmer-Schlumpf were also guilty of providing insufficient information, said the control committees. The



Democrat-Liberals (FDP) and the Christian Democrats (CVP) saw the agreement as undesirable but necessary to prevent UBS and the Swiss economy from facing difficulties. The Swiss People's Party (SVP) rejected the agreement because it did not want to relinquish banking confidentiality. The Social Democrats (SP) and the Greens made their approval dependant on special taxes on bonuses and stricter regulation of the banks. As the FDP and CVP do not have a parliamentary majority by themselves, approval only seemed possible with concessions to the left. But at the last minute, the SVP changed its mind and gave its backing to the proposal. It claimed its decision was based on preventing a tax on bonuses, but critics argued it had bowed to industry pressure.

#### Parliament turned upside down

A paradoxical situation emerged: the SVP, a vehement defender of banking confidentiality, helped to soften Switzerland's stance on this, and the SP, which has criticised it for years, was the only party defending it. This highlights just how much the debate was shaped by party political considerations. The parties supporting unconditional approval of the treaty were ultimately triumphant. However, the issues of high bonuses and tighter banking regulation remain on the table. The parties all agree in principle that the "too big to fail" issue must be resolved. The government should never again have to come to the rescue of a major bank. This is most likely to be achieved through higher equity ratios for banks. However, agreement has yet to be reached on the specific form such measures will take.

## Unemployment insurance – balancing the books

The economic downturn has caused the unemployment insurance deficit to widen further. The Federal Council and Parliament want to bring it under control through additional receipts and benefit cuts. The unions and the left-wing parties have called for a referendum. By René Lenzin

The financing of Swiss unemployment insurance (ALV) is currently based on an average jobless total of 100,000. However, the figure now stands at over 150,000 and did not even fall below the target average during the economic boom. The unemployment insurance debts have therefore mounted to 9 billion Swiss francs. This is not only the result of the current economic crisis, but also due to a structural deficit or, in other words, a permanent imbalance between income and expenditure. These debts are to be reduced through a mixture of higher premiums and benefit adjustments in an effort to restore the insurance scheme's finances to good health. The following measures are anticipated:

**More income** (CHF 646 million per year): The deductions from insured income (up to CHF 126,000) will be increased from 2 to 2.2%. One percent will now be levied on the salary component from CHF 126,000 to CHF 315,000.

**Savings** (CHF 622 million per year): Unemployed persons without children will in future also be obliged to accept jobs that are not in line with their qualifications. Under-25s without maintenance obligations will only be entitled to 200 as opposed to 400 days of unemployment benefit. Unemployed

persons who have made contributions for a maximum of 12 months will receive only 260 as opposed to 400 days of unemployment benefit. School-leavers and graduates must wait 120 days before they can claim unemployment benefits. Government job creation programmes will no longer count as contribution time.

The National Council approved the proposal by 91 votes to 64, and the Council of States by 32 votes to 12. The Federal Council and the conservative parties see the revision as a well-balanced compromise. The Swiss People's Party (SVP) and the Free Democrats wanted even more drastic benefit cuts, but approved the revision in the end in light of a possible referendum. The issue is likely to be decided at the ballot box as the unions, the Social Democrats and the Greens have called for a referendum. They believe the welfare cuts will punish those who are already the most badly hit by the economic downturn.

If the revision is rejected by the Swiss people, the Federal Council will have to increase contributions at the start of 2011, as unemployment insurance has exceeded the deficit level permitted by law. However, without saving measures this increase in premiums will be even higher than provided for under the revision.

committees reported that, in addition to the atmosphere of mistrust, the Federal Council also failed to see the bigger picture.

The report contained both praise and criticism for the financial market supervisory authority (Finma). It had prepared and implemented the billion-franc UBS rescue package well in October 2008 in cooperation with the Swiss National Bank. Finma had

also recognised the significance of the US tax issue at an early stage. However, its investigations had been largely based on a report commissioned by UBS itself, which compromised its independence.

#### UBS needs to review its practices

The committees' report ended with 19 recommendations, 5 proposals and 2 postulates. These

focused on the Federal Council's leadership shortcomings. The control committees want to see national government obliged to keep minutes, even for confidential business.

It should also set up a system for strategic political management as well as a monitoring and early warning system to improve performance in crisis situations. Although the parliamentary super-

visory committees do not have the authority to investigate the conduct of UBS, they also issued recommendations to the bank. They called on UBS to review its own practices during the crisis.

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