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## Clean money – an opportunity for the Swiss financial centre

With the crash of UBS, the softening of the stance on banking confidentiality and the betrayal of clients, the Swiss financial centre has been through its most tumultuous period in many years. What state is it currently in now that UBS has been saved with taxpayers' money and the nation has been forced to relinquish its traditional banking confidentiality? A successful future depends on Swiss asset managers uncompromisingly meeting the challenge of the competition.  
By Lukas Hässig

When the plummeting UBS was courting new negative publicity on a daily basis, the management team even contemplated a change of the bank's traditional name, as the brand with the red lettering and three black keys in its logo seemed too damaged. Who would still associate it with trust, security and discretion? However, in-house personnel were constantly preoccupied with new crises and surveys showed that it was mainly the Swiss public who were critical in their reaction whereas people abroad were far more concerned with the collapse of their own banks.

Figures finally moved back into the black and the dispute with the US judicial authorities that threatened the company's survival was resolved. UBS then broke cover. Since the end of August, it has presented itself as a reformed financial multinational, stating: "You can rely on one thing, we will not rest until you are convinced that you are with the right bank." With both humility and self-confidence, it is implying awareness of its own mistakes and a departure for new horizons.

Walter Bosch, a former advertiser of the year and currently a member of various

boards of directors, endorses the approach. "Advertising may for once have an impact", believes Bosch. However, it is not just the one-time flagship of Swiss banking that urgently needs to take action. The financial centre, which contributes around 11% to the nation's total economic output, is also entering a new phase. Healthy profits that are easily turned thanks to untaxed capital are a thing of the past.

### Was that it?

The crisis, which recently shook the financial markets and triggered fears of an uncontrollable crash, has largely subsided, even though the weakness of the euro, national debt and the risk of recession regularly cause aftershocks. "Was that it?" some people ask, turning to other issues.

Two questions are of particular importance from a Swiss perspective. What prevented tiny Switzerland from suffering even greater damage in this extreme crisis? Secondly, is the Swiss financial industry's current mood of increasing optimism justified and, if so, under what conditions?

The fact that Switzerland and its financial centre emerged relatively unscathed is explained by an odd phenomenon. The alpine republic has a tendency to ride out crises until the bitter end, ultimately leaving leadership to a small elite team. "As mountain dwellers, we know that the weather can sometimes get quite stormy", says Alfred Mettler, a Swiss professor of finance at Georgia State University in Atlanta. "You have to sit tight and keep your composure. We adopted the same approach on this occasion and decided to simply wait until the storm passed over."

However, this approach was not enough to resolve the issue this time around. When the first storm, the financial crisis, threatened the stability of the entire nation, Switzerland put its fate in the hands of a small team of experts. By taking over billions of il-

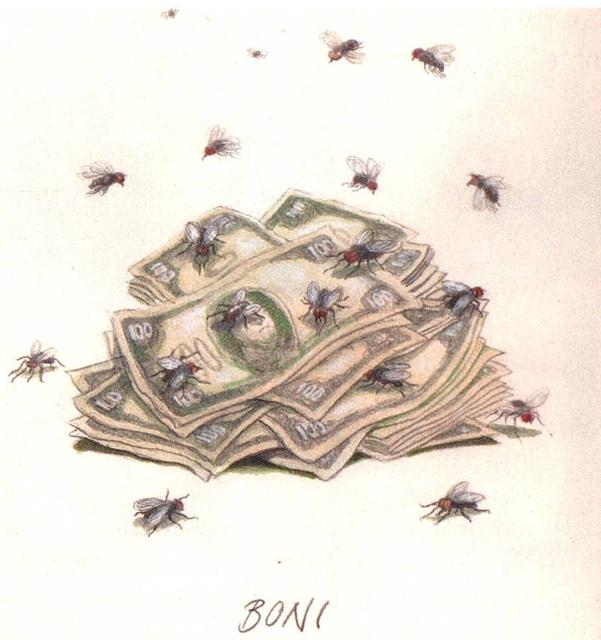


liquid securities, the Swiss National Bank prevented UBS from collapse in autumn 2008 (Credit Suisse also required support and attracted new capital from the Middle East from investors close to the government). This intervention was necessary since UBS had squandered its credit and there were no private investors willing to lend it the capital it urgently required. With insolvency came the threat of an uncontrollable collapse. The significance of that eventuality was highlighted by the example of Lehman Brothers, the US investment bank which had recently crashed, sending shockwaves through the global financial system. Its total assets were three times less than those of UBS.

The Swiss National Bank acted practically without consulting Parliament, relieved UBS of its burden based on a secret plan and orchestrated an equity capital injection with taxpayers' money. The deal had already been wrapped up by the time government bodies approved it several weeks later. The intervention paid off as the Swiss-style rescue plan succeeded. The model based on an elite team being able to act quickly and quietly and to seize the reins in crisis situations paid dividends for Switzerland. Memories were rekindled of the 1990s and the crisis over unclaimed assets from the Second World War when senior Swiss bankers got rid of the problem through a huge one-off payment after much procrastination.

### Turn a blind eye and get on with it

In the US tax case too, those responsible initially adopted a behind-the-scenes approach. However, here the crisis management strategy failed. Why? In contrast to the subprime crash, it was not just UBS in the firing line for assisting tax evasion, but the entire financial centre. The fact that it was Switzerland's leading bank that had taken a particularly aggressive and high-risk approach to offshore business with wealthy foreign clients did nothing to change the blanket threat. Many foreign governments believed all Swiss banks were living off untaxed assets. The USA, which had already launched a major offensive against tax havens, did indeed make a specific accusation



BONUSES

against UBS, but it was nevertheless targeting the offshore haven that was Switzerland. The threat to UBS also applied to the small, wealthy nation and was intended to be a showcase for the Americans in their campaign against tax evasion. The fact that the USA overlooked its own offshore havens, such as the state of Delaware, was of little benefit to Switzerland.

The Federal Council and the heads of the financial centre could have been prepared for this. Back in 2004, one of Switzerland's most well known and highly regarded bankers had specifically referred to the financial centre as a profitable dirty money market. Hans J. Bär, who for many years shaped the private bank of the same name, wrote in his autobiography, "It's Not All About Money", that banking confidentiality for the protection of tax evaders would make us "fat, but impotent". In an interview with "Weltwoche", Bär recalled a time when no-one involved in the Swiss financial centre dared to criticise banking confidentiality with its hair-splitting differentiation between tax fraud and tax evasion. "That is a very questionable issue", said Bär six years ago with refreshing honesty. "It's unethical. I'm probably too stupid to understand the difference. If I provide false information on the tax form, that is not fraud but evasion. Why is that? Because the form is not valid as a document. No Anglo-Saxon can understand that: either you pay tax or you don't, there's no in-between." Bär's wake-up call went unheard as business with large amounts of foreign capital was too

rewarding. Turn a blind eye and get on with it – the supposedly cautious Swiss financial sector made approaches everywhere.

The widespread ignorance of banks, politicians and the public resulted in a collective failure and made the usual behind-the-scenes crisis management more difficult, in contrast to the problem with UBS' subprime securities where intervention was extremely successful. The heads of the financial centre were anxious, as was the Swiss Federal Banking Commission (now the Swiss Financial Market Supervisory Authority – Finma) as the most senior regulator. This body was well aware of the offshore practices of the Swiss as-

set managers, but had failed to stop the pursuit of increasing amounts of capital from foreign private clients in time. How could this authority, on which former (leading) bankers held key positions, take a rigorous line on tackling the crisis when they had previously pursued a laissez-faire policy?

The nation left finding a solution to the increasingly threatening tax dispute with the US to the management of the accused bank, while the administration and politicians provided support. This approach was clearly problematic. Those managers who had tolerated the widespread aiding and abetting of tax evasion on US soil and had even encouraged it in some cases were still in office when the bank was negotiating its survival with the uncompromising US judicial authorities. Despite denials from UBS officials, there was growing evidence that concerned the former bank managers more so than Switzerland and the foreign clients. At any rate, comprehensive investigations by the Parliamentary Control Committee produced doubts about the official line and indicated that the "too-big-to-fail" bank faced prosecution and was once again threatened with collapse. In view of the raging financial crisis, the Americans may only have accused the former heads of the financial multinational of criminal offences to increase their pressure.

A game of brinksmanship was possible in the tax case, but Berne was worried. "Ultimately the stakes were too high and we accepted the Americans' conditions", explains Urs Zulauf, a lawyer at the Financial Market

Supervisory Authority who worked on the case. The rest is history. With the disclosure of the banking information of 250 American UBS clients, to whom Switzerland denied the right of appeal, the nation relinquished the core element of its 75-year-old banking confidentiality in February 2009. Under growing pressure from the international community, shortly afterwards the Federal Council accepted the international standard on disclosure in the event of tax evasion and later introduced a special law which retroactively made it possible to charge a further 4,500 American UBS clients with tax evasion. "We do not want to gain a reputation for sacrificing others to save our own skin", stressed the President of the Swiss private bank Konrad Hummler in the "Sonntag" newspaper. However, even this eloquent and spirited banker was unable to prevent the debacle.

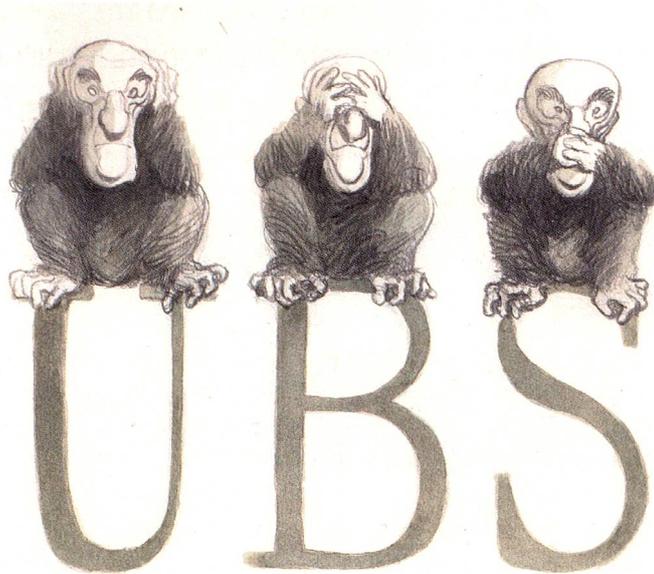
#### Mood of optimism despite poor start

Switzerland had managed to overcome the financial crisis, but not the tax crisis. The US judicial authorities were pursuing further banks, such as the UK-Asian HSBC whose private banking business unit responsible for the asset management of the well-to-do is based in Switzerland. Within Europe, it is the German authorities in particular that are seeking to put an end to the Swiss offshore strategy on untaxed capital. All Credit Suisse branches in Germany were recently searched after the authorities had instigated

#### THE SWISS FINANCIAL CENTRE

Switzerland – historically a special case, now a political oddity? This is the question posed by Peter Hablützel, former head of the Federal Department of Finance, in his book "Die Schweiz und ihre Banken" (Switzerland and its Banks). In it he examines the Swiss financial centre from an historical and political perspective and takes a look at the direction that needs to be taken in future.

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hundreds of cases against the bank's offshore clients. The investigators had previously obtained a stolen CD-ROM containing the names of German tax evaders.

Despite the unresolved future of untaxed assets worth billions from abroad, there is some good news on the dirty money front. This is partly explained by external factors. National debt and the collapse of the currency are forcing the euro countries, especially the major ones like Germany, France and Italy, to change their priorities and some EU countries, such as Luxembourg and Austria, are, like Switzerland, opposed to the automatic exchange of information.

Berne senses a change in the tide. Top crisis-hardened diplomat Michael Ambühl, whom the Federal Department of Foreign Affairs has made available to the Federal Department of Finance to run the new State Secretariat for International Financial Matters, sees withholding tax as the ideal solution. Ambühl told the NZZ in August that it was still too early for detailed information but commented: "I can confirm, however, that there is interest in our proposals which reconcile state requirements regarding tax revenues and those of bank clients in terms of protection of privacy." Ambühl believes that agreement on this issue is vital to prevent Switzerland from running the risk of being blacklisted every other week.

In addition to the comeback kid, UBS, many smaller and medium-sized banks are also currently showing optimism. Traditional banks like Zurich's Julius Bär and Vontobel bank have reported an inflow of assets

worth billions of francs this year. Even government institutions, such as the Zürcher Kantonalbank (ZKB), which are attempting to attract more foreign capital, are also painting a rosier picture of the future. They all affirm that they will only accept "clean", i.e. taxed, new capital from abroad. They are leaving the decision as to what should be done with historical "dirty" untaxed capital to federal government.

Nevertheless, banks are appealing to the conscience of their clients. ZKB, for example, says that it does not require a taxation certificate, but during client meetings attempts to establish whether the client has reported his money to the tax authorities in his homeland. The bank promises that even existing client relationships will be scrutinised. It says: "ZKB advises existing clients with untaxed assets to ensure their tax situation is transparent, but does not provide recommendations on how they can achieve this objective." One thing is clear, millionaires who were once courted are now being dropped like hot potatoes.

#### Genuine clean-money strategy will take time

Is the new optimism on the Swiss financial market justified in light of the unresolved dirty capital issue? A contradictory picture emerges. On the one hand, Swiss asset managers are benefitting from global uncertainty. The strong Swiss franc, the separate political approach outside the EU, fiscal discipline and a high degree of legal certainty still despite the special UBS law are attracting foreign private assets. On the other hand, the international community is showing no sign of relaxing its efforts in the fight against tax evasion. "The UBS case is probably only the beginning. Every Swiss bank, indeed every financial organisation, needs to develop a strategy on how to manage its past and shape the future", says Alan Granwell of renowned law firm DLA Piper in Washington.

To play for time would be reckless, but rigorous measures are also problematic. If

banks were to brand clients who have been with them for many years criminals overnight, they would jeopardise their reputation as reliable partners and indeed their own future. What approach should be adopted? A genuine clean-money strategy, which goes beyond lip service, cannot be achieved without a fundamental change of direction according to Teodoro Cocca, a Swiss banking professor at Johannes Kepler University in Linz. He says that as far as current assets are concerned the financial organisations should call upon clients to make self-declarations, “ideally in combination with a standardised declaration procedure drawn up by the bank”. If this proves unsuccessful “as a last resort, the client relationship must be called into question”. A “declaration guarantee” should be requested from clients for new capital alongside constant “monitoring of the client relationship”. Cocca’s vision for Swiss asset management is a “no tax evasion inside” seal of approval. The banking professor believes that “hardly any private banks” have implemented such a far-reaching clean-money policy, at least “not yet”.

Perhaps this will happen sooner rather than later. The latest developments certainly seem to indicate that Switzerland and its banks are adopting a new approach to tax and are moving in the right direction towards a declared assets policy. That at least is the view of Jeffrey Owens, Director of the Centre for Tax Policy and Administration at the OECD (the organisation responsible for the developed world) and one of the harshest critics of the old Swiss dirty money regime. “Switzerland has made great progress in combating tax evasion”, said Owens this spring when asked. He is also pleased by the clear position adopted by the Federal Council. He believes it is now up to the banks to produce a “new business model for the Swiss financial sector”, one which no longer takes advantage of global tax evasion, but instead excels through professional consulting.

Is all well that ends well? It is still too early to give the all-clear. On the one hand, no other major financial market faces a greater challenge than Switzerland with its two major banks in terms of the “too-big-to-fail” issue. Their combined total assets still amount to four times Swiss annual economic output, whereas in the USA the largest bank represents a sixth of GDP. And with regard to the issue of dirty capital, all of Switzerland’s own efforts will be in vain unless the inter-

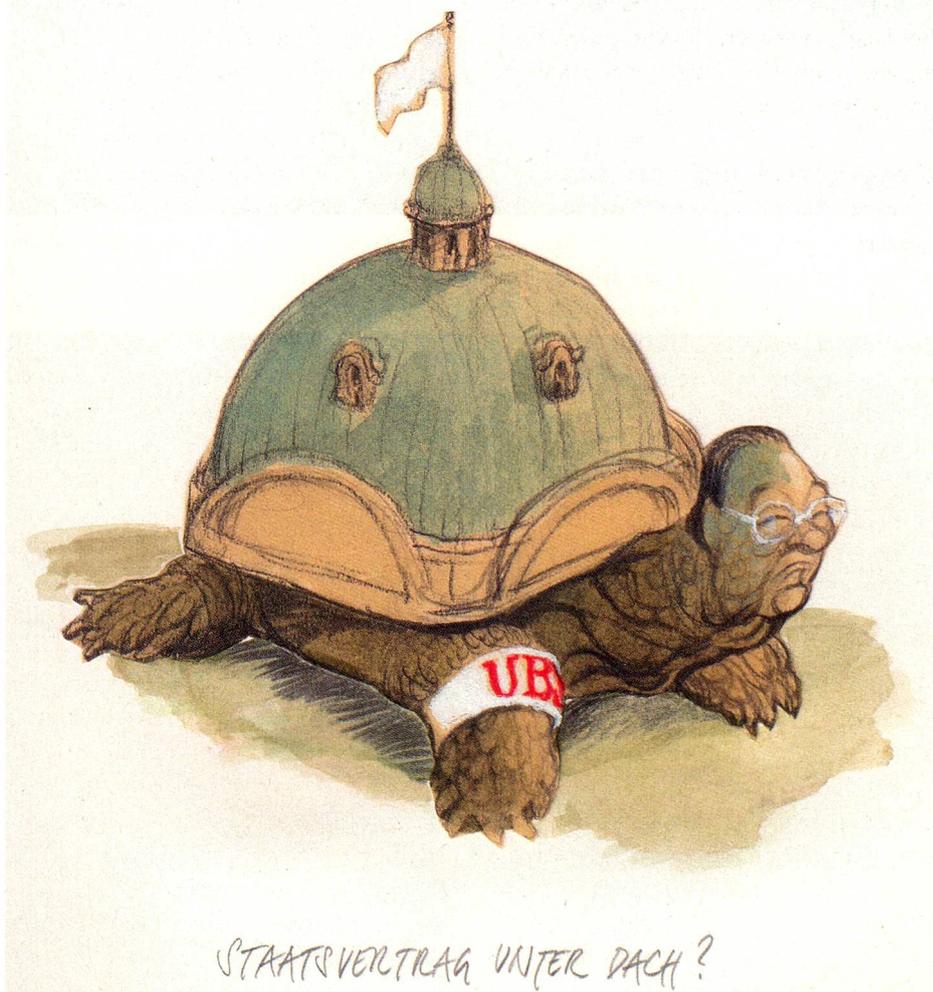
national community is willing to draw a line under historical banking confidentiality, perhaps in return for a one-off payment by the financial centre, as private banker Hummler and other experts have suggested.

Fundamental issues remain – will asset managers change their approach to tax evasion? Will they accept instructions from the Berne-based Financial Market Supervisory Authority, which emerged in a “Tages-Anzeiger” interview and which state that bankers will be acting with “gross negligence” if they continue to accept dirty money? Are Swiss banks and their client advisors really prepared to leave behind the profitable era of turning a blind eye? In short, is the Swiss financial centre ready for a complete overhaul and happy only to accept and man-

age taxed assets? It is a new approach to this contentious issue that will make the difference in the form of a new code that will be able to secure a successful future for Swiss banking. Change has been introduced on paper, but this must now be followed up by action. This is the only way of ensuring confidence in the financial centre.

LUKAS HÄSSIG is a freelance business journalist and the author of the book “Paradies perdu – Vom Ende des Schweizer Bankgeheimnisses” (Paradise Lost – The End of Secret Swiss Banking), published by Hoffmann und Campe.

PETER GUT, born in 1959, is one of Switzerland’s most well known caricaturists and regularly works for the “Neue Zürcher Zeitung” and other publications. We have illustrated the article on the Swiss financial centre with his artistic commentaries on the UBS case and the financial crisis.



INTERNATIONAL TREATY DONE AND DUSTED