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## Foreign Bank Operations in Switzerland: New Regulations and Practical Considerations

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# Foreign Bank Operations in Switzerland: New Regulations and Practical Considerations

## I. Introduction

Switzerland is traditionally renowned for its economic and political stability as well as for its liberal cultural environment. These features, combined with a long-standing understanding of the needs of bank customers and a particular expertise in banking, make Switzerland one of the most important financial centers for the world's economy. Consequently, a number of foreign banks based throughout the world have become interested in establishing their presence in Switzerland. The foreign banks have established their presence under different forms, such as foreign controlled banks, foreign controlled quasi-bank finance companies, branch offices and representative offices. Actually they represent a major part of the international banking network.<sup>1</sup>

The foreign controlled banks and the foreign controlled quasi-bank finance companies are Swiss registered banks in which the majority of shares or voting rights are held by foreigners. They are subject to Swiss banking laws. The foreign controlled banks, and the foreign controlled quasi-bank finance companies which take deposits from the public are allowed to operate in Switzerland on the basis of reciprocity, i.e., the Swiss banks are

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1. 1983/1984 REPORT OF THE ASSOCIATION OF FOREIGN BANKS IN SWITZERLAND 6 [hereinafter cited as 83/84 Report] mentions for the period under review the existence of 175 institutions representing foreign banks.

permitted in return to operate in the foreign shareholder's home country.<sup>2</sup> The foreign controlled quasi-bank finance companies which do not take deposits from the public are not subject to the reciprocity principle.<sup>3</sup> Actually, all foreign controlled quasi-bank finance companies operating in Switzerland do not take deposits from the public.<sup>4</sup> The branches and representative offices of foreign banks in Switzerland also are subject to Swiss banking law. In particular, their operations were regulated by an Ordinance of 1973.<sup>5</sup> This was replaced with a new Ordinance in 1984.<sup>6</sup> Another important legal development impacting foreign banks' operations in Switzerland is the enactment in 1983 (effective January 1, 1985) of a new statute regulating the acquisitions of real estate by foreign residents living abroad.<sup>7</sup> Of particular interest to foreign bankers are the banking secrecy issues arising from the relationship between parent foreign banks and their establishments in Switzerland.

## II. The New Legal Framework

### A. BACKGROUND FOR IMPLEMENTATION

Beginning in the 1960s the major industrial countries entered a new era of international expansion. This process was directly conditioned by an internationalization of the world's economy. In particular, trade and industrial cooperation accelerated this trend and banks generally followed their home country customers abroad to better service their needs and to avoid the loss of potentially profitable relationships. There seems to be a consensus, for example, that the existence of a market in a foreign country consisting of United States nationals (persons and businesses) constituted a key factor in decisions to establish a United States bank presence abroad.<sup>8</sup> Other factors

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2. Federal Banking Law of 1934, as amended in 1971, arts. 1 (2)(a), 3 bis (1)(a), *Recueil des Lois Fédérales* [RO] 808, 809 (1971); Hindle, *Switzerland in BANKING SYSTEMS ABROAD* 207 (Inter-Bank Research Organization, London 1978 ed.).

3. Federal Banking Law of 1934 as amended in 1971, art. 1(2)(a) provides that these finance companies are subject only to arts. 7, 8 dealing with reporting requirements and relations with the Swiss National Bank.

4. 83/84 Report mentions for the period under review the existence of 69 foreign controlled quasi-bank finance companies.

5. Ordinance Concerning the Establishments of Foreign Banks in Switzerland, RO 1574 (1973) [hereinafter cited as the Ordinance of 1973].

6. Ordinance Concerning the Foreign Banks in Switzerland, RO 604 (1984) [hereinafter cited as the Ordinance of 1984].

7. Federal Law on the Acquisitions of Real Estate by Foreign Residents Living Abroad, RO 1148 (1984) [hereinafter cited as the Federal Law of 1983] replaces the Federal Decision (Arrêté Fédéral) Concerning the Authorization of Acquisition of Real Estate by Foreign Residents Living Abroad, RO 209 (1961).

8. See Fieleke, *The Growth of U.S. Banking Abroad: Analytical Survey* 28, paper prepared for the conference on Key Issues in International Banking, Oct. 5-7, 1977, Melvin Village, N.H.; S. KHOURY, *DYNAMICS OF INTERNATIONAL BANKING* 1523 (1980).

that conditioned the multinationalization of banks were the liberalization of financial and monetary transactions at the international level with the accompanying opportunities of profit maximization, the attenuation of protectionist policies, the creation of the European Economic Community, and the restrictive home countries regulations.<sup>9</sup> Traditionally, internationalization was also considered a way of helping a bank to reduce its portfolio risk by increasing the stability of its earnings, although lately this has become a controversial factor because of the impact of the international debt crisis. Furthermore, in the United States there is growth of International Banking Facilities (IBFs) which derive some of their assets from balances booked abroad or that *would have been booked* abroad. Exchange rate charges have also played a role in slowing the increases of the assets of the United States banks' establishments abroad.<sup>10</sup>

In an increasingly competitive international banking environment, Switzerland occupies a particularly advantageous position. The following attractive features of Switzerland's capital market are cited: savings capacity; stability, soundness, and free convertibility of the Swiss franc currency; the political, social and economic stability of the country; political neutrality; efficient, well-organized financial institutions with high equity coverage; simple straightforward laws and international legal service; freedom of capital transfers; highly developed international traffic, telecommunications and tourism, together with knowledge of major international languages.<sup>11</sup>

But, at the same time factors with a negative impact on the activities of foreign banks are also cited: the restrictive bank regulatory structure; the lack of familiarity by foreign bankers, especially those of the United States, with the profitable activities of Swiss banks (e.g., discretionary management of privately owned investment funds, extensive activities in domestic and international markets, and heavy involvement in securities and precious metals trading) due mainly to the different regulations in home countries of foreign banks; and high operating costs of the foreign banks' establishments in Switzerland.<sup>12</sup> Other analysts, including Swiss authorities, mention as a

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9. See S. KHOURY, *supra* note 8, at 68, 135; P.B. Ruffini, *LES BANQUES MULTINATIONALES* 78 (Presses Universitaires de France 1983).

10. Interview with James V. Hout of the Division of Banking Supervision and Regulation of the Federal Reserve Board on February 7, 1985; a Federal Reserve Press Release (Aug. 22, 1983) disclosing assets of foreign branches of member banks showed an abrupt change in the earlier pattern of growth in the assets of foreign branches of the member banks. Thus, after previous increases at an annual rate exceeding twenty percent during the 1970s and about ten percent annually in 1980 and 1981, the combined assets of the overseas branches of member banks decreased during 1982 by 2.5 billion—or 0.6 percent—to a total of 388.5 billion; combined assets, excluding claims on other foreign branches of the same bank also dropped by 0.6 percent from the comparable prior year-end level to 341.3 billion at December 31, 1982.

11. H. MEYER, *SWISS CAPITAL MARKETS* 2 (1983).

12. See *Selective Strategies* 131 *THE BANKER* 59 (1981).

negative factor the restrictive labor policy which does not allow foreign banks to inject much of their home-bred management talent into their Swiss operations.<sup>13</sup> Swiss bankers have shown a certain lack of creativity compared with the ingenious and aggressive approaches of New York, London, and Tokyo bankers. In addition, in many instances other financial markets offered more competitive rates. This combination of factors may explain why Swiss bankers have not been very successful in attracting pension funds, a new breed of international investor.<sup>14</sup> The taxes imposed on the underwriting of new bond issues, on individual gold purchases, and on securities transactions have driven many international investors to other financial markets with less burdensome fiscal policies.<sup>15</sup>

There is a continuous strong interest in maintaining a presence in the Swiss "safe haven," however. By the end of 1983, foreign banks operated several types of banking establishments in Switzerland: ninety-six foreign controlled banks (stock corporations under Swiss law), 17 branch offices; and sixty-two representative offices.<sup>16</sup> At the end of 1983, the aggregate balance sheet total of the Swiss banking system amounted to 657 billion Sfr. the share of foreign institutions (including the sixty-nine foreign controlled quasi-bank finance companies) being 14.4 percent. The latter figure represents an increase of 0.4 percent as compared with 1982.<sup>17</sup>

## B. THE IMPACT OF THE NEW REGULATIONS

The Ordinance of 1984 covers the activities of branches and representative offices of foreign banks in Switzerland, including the acceptance of deposits. It provides that the pertinent sections of the Federal Banking Law of 1934 and of the Ordinance of 1972 Concerning the Application of the Federal Banking Law continue to apply in this area. However, it expressly exempts branches of foreign banks from the application of capital requirements and risk prevention provisions of the Federal Banking Law of 1934.<sup>18</sup>

The Ordinance sets forth the procedure for establishing a branch in Switzerland.<sup>19</sup> The parent foreign bank (hereinafter cited PFB) must apply

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13. See Hindle, *supra* note 2, at 208; H. BAR, *THE BANKING SYSTEM OF SWITZERLAND* 29 (1975) blamed the failure of an American bank in Switzerland partly on the impossibility of providing the necessary managerial supervision from its home office because of the restrictive Swiss labor policies.

14. Anders and Studer, *Switzerland's Banking Gnomes Aren't the Magnet They Once Were for International Cash Hoards*, Wall St. J. Jan. 31, 1985, at 32, cols. 1, 3.

15. *Id.*, cols. 2, 3 showing, for example, that whereas fifteen years ago Switzerland dominated the international bond market, last year it underwrote only 12 percent of the new international bond issues, compared to London's 80 percent.

16. 83/84 Report, *supra* note 1, at 6.

17. *Id.*

18. Ordinance of 1984, art. 2.

19. *Id.*, art. 3.

to the Federal Banking Commission for an authorization. The branch cannot be registered in the Commerce Register before the issuance of this authorization.<sup>20</sup> Several requirements must be met with in order to obtain authorization from the Federal Banking Commission. Thus, the PFB must have an adequate organizational structure, financial resources, and qualified personnel in order to operate a branch in Switzerland. The importance of this requirement is obvious, considering the high costs of operating a branch in Switzerland.<sup>21</sup>

### 1. APPROPRIATE SUPERVISION

Also, the PFB must be subject to "appropriate supervision" in its home country.<sup>22</sup> The meaning of "appropriate supervision" is not established by sole reference to the Swiss standard procedures for banks' supervision. The particular aspects of the policies concerning the banks' supervision in different countries are to be taken in consideration.<sup>23</sup> A special provision of the Ordinance of 1984 also implements an established practice of Swiss banking authorities that the PFB must secure a statement from its home country's supervisory agency that it has no objection to the establishment of a branch in Switzerland and will immediately inform the Swiss Federal Banking Commission upon any subsequent events affecting the interests of the foreign bank's creditors.<sup>24</sup>

The Basle Committee of Bank Supervisors ("Cooke Committee") recommended that banks' international business should be monitored on a consolidated basis<sup>25</sup> and the Swiss authorities followed suit,<sup>26</sup> realizing that imposing upon the foreign banks' branches the same capital requirements as those applicable to Swiss banks does not particularly improve the protection of branches' creditors. The solvency of a branch must be considered along with that of its PFB, which is fully responsible for the branch's obligations. Even though the Cooke Committee did not definitely resolve the issue of the

20. Code des Obligations, art. 935 requires the registration of branches of foreign business enterprises.

21. Ordinance of 1984, art. 3 (2)(a); see *Selective Strategies*, *supra* note 12, at 59.

22. Ordinance of 1984, art. 3 (2)(b).

23. See Commission Fédérale des Banques, *Commentaire de la nouvelle ordonnance concernant les banques étrangères du 22 Mars 1984*, 13 Bulletin de la Commission Fédérale des Banques 26, 27 (1984) [hereinafter cited as *Commentaire*].

24. Ordinance of 1984, art. 3 (2)(c).

25. Cooke, *Developments in Co-Operation among Banking Supervisory Authorities*, 3 J. COMP. L. AND SEC. L. 253, 157.

26. B. Müller *Les autorités de surveillance face à l'évolution bancaire internationale* 6, Speech at the Winter Meeting of the Association of Foreign Banks in Switzerland on January 20, 1984 (reprinted by the Federal Banking Commission) acknowledges that the adoption of the Cooke Committee's recommendations was one of the goals of the Ordinance of 1984. (At the time he made this remark, Dr. Bernhard Müller was Director of the Secretariat of the Federal Banking Commission.)

lender of last resort for foreign branches, in practice most parties would probably expect the central bank in the PFB's home country to provide the PFB with needed liquidity and the PFB, in turn, would provide funds to its foreign branches.<sup>27</sup> Thus, appropriately the Swiss authorities consider that the ultimate responsibility for supervision of these matters rests with the supervisory agency in the PFB's home country.<sup>28</sup>

Two separate cases show how the Federal Banking Commission construes the "appropriate supervision" requirement. The first concerned the application for authorization to operate a banking establishment in Switzerland submitted by a company controlled by a French bank and a Swiss holding company.<sup>29</sup> In turn, the Swiss holding company was controlled by the French bank and two other individuals. Following appropriate inquiries, it was found that the French Commission of Banking Supervision did not supervise the French bank on a consolidated basis. At that time, in France, the guidelines for supervision of banks on a consolidated basis were still at the preparatory stage and not yet in force. The Federal Banking Commission reasoned that the lack of appropriate supervision of the French bank on a consolidated basis would impair the supervision of the Swiss establishment, inasmuch as the extent of control by the French bank and of the nature of the relationship between it and the Swiss establishment could not be precisely determined.

The remedy in this case was to require the interested parties to submit a written statement that the future Swiss establishment would make available the information that the Federal Banking Commission might consider it necessary to exercise its supervisory attributions. Under the pertinent provision of the Federal Banking Law, the Federal Banking Commission may ask for any information it considers significant, documents on which audits were based, auditors' reports, i.e., a total disclosure. The Commission may order an extraordinary audit if the circumstances warrant.<sup>30</sup>

The second case in which the Federal Banking Commission applied the same remedy, asking for a similar written statement, concerned the applications of the Lebanese banks to operate Swiss establishments. Here, despite the fact that the Lebanese Commission of Banking Supervision supervised Lebanese banks on a consolidated basis, the Federal Banking Commission was mainly concerned that the precarious political situation in Lebanon might impair the ability of the Lebanese supervisory authority to effectively perform its supervision duties.<sup>31</sup>

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27. Interview with James V. Houpt of the Division of Banking Supervision and Regulation of the Federal Reserve Board on February 7, 1985.

28. *Commentaire, supra* note 23, at 27.

29. Federal Banking Commission Report for 1984, at 36.

30. Federal Banking Law of 1934 as amended in 1971, art. 23 bis (2).

31. Federal Banking Commission Report for 1984, at 37.

## 2. OWN RESOURCES

The Ordinance of 1984 expressly mentions that other requirements for the issuance of the authorization provided for the Federal Banking Law continue to apply.<sup>32</sup> These include, *inter alia*, the interdiction for the branch to pose as a Swiss entity, the obligation to define in the charter the branch's scope of activity, the establishment of management and internal control structures, the necessity to employ people of an unblemished reputation, and the condition that the majority of the members of the managing body (board of directors, etc.) be domiciled in Switzerland.<sup>33</sup> Under the previous legislation the branches of foreign banks had to comply with certain provisions of the Federal Banking law of 1934, which required banks to maintain their *own resources* (fonds propres)<sup>34</sup> at a safe level and to observe legally prescribed risk protection policies.<sup>35</sup> These provisions are no longer applicable to foreign banks' branches.<sup>36</sup>

The elimination of the provision that required foreign banks' branches to maintain their *own resources* (fonds propres) at a certain safe level entailed three consequences. First, under the previous legislation, the foreign banks' branches had to invest in Switzerland an amount equivalent to the value of their *own resources* (fonds propres) that they were legally required to maintain.<sup>37</sup> Now that the foreign banks' branches are no longer required to maintain their *own resources* at a mandatory level, the new regulation provides that they must permanently maintain ten percent of the value of their liquid assets in Switzerland.<sup>38</sup> Second, the foreign banks' branches are no longer required to maintain reserve funds.<sup>39</sup> Third, the foreign banks' branches are no longer required to disclose their positions in foreign currencies, as it was previously required by the Circular of Federal Banking Commission of December 19, 1974.<sup>40</sup>

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32. Ordinance of 1984, art. 3 (2)(d)(e).

33. Federal Banking Law of 1934, as amended in 1971, arts. 3 (2)(c)(d), 3 bis (1).

34. Ordinance of 1973, art. 13 required a foreign bank's establishment to maintain its *own resources* (fonds propres) computed according to art. 11 of the Ordinance of 1972 concerning the Application of the Federal Banking Law; these *resources* included the *registered capital*, which for a foreign bank's establishment started from minimum 2 million Sfr. (Ordinance of 1973, art. 12), and the *reserves*.

35. Federal Banking Law of 1934, as amended in 1971, art. 4 bis, required banks to maintain certain proportions between their *resources* (fonds propres) and their loans, advances and participations, for risk prevention purposes.

36. Ordinance of 1984, art. 2.

37. Ordinance of 1973, art. 12(5).

38. Ordinance of 1984, art. 5.

39. Commentaire, *supra* note 23, at 28.

40. *Id.*



### 3. GUARANTEES

The structure of guarantees required from branches of foreign banks was also modified. The previous regulation listed in a non-exhaustive manner four situations that could cause a request for guarantees by the Federal Banking Commission. Two of these situations concerned (1) the insufficiency of foreign bank's capital, and (2) the lack of appropriate supervision of the PFB in its home country.<sup>41</sup> Under the new regulation the Swiss authorities will handle these two situations differently, i.e., they will not ask for guarantees, but simply will deny or revoke the authorization to operate a branch.<sup>42</sup>

The other two situations are handled as they were under the previous regulation, i.e., the Federal Banking Commission may ask for guarantees (3) when a foreign bank's branch intends to take savings deposits, or (4) it has suspicions about the financial situation of the PFB.<sup>43</sup> Again the formulation of this provision is non-exhaustive, which means that the Federal Banking Commission may ask for guarantees whenever, in its judgment, it considers it necessary. As previously required, the branch's annual report must include pertinent information regarding its claims and liabilities against its PFB, other branches of its PFB, and any other entities involved in financial or banking activities which are controlled by its PFB.<sup>44</sup>

### 4. ANNUAL REPORT

In another application of the consolidation principle, the new regulation imposes a new requirement concerning the issuance of the branch's annual report, i.e., it has to be issued together with the PFB's report.<sup>45</sup> This will permit a better appraisal of the branch's position within the PFB's organization.<sup>46</sup> There is also an express provision that the PFB's annual report has to be compiled in accordance with the rules in force in its home country and has to be presented in an official Swiss language.<sup>47</sup>

The branch must submit its annual report to an audit by an independent accounting firm.<sup>48</sup> It is desirable to have the annual report audited by the same accounting firm that audited the PFB's annual report.<sup>49</sup> In any event,

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41. Ordinance of 1973, art. 8 (a)(b).

42. Commentaire, *supra* note 23, at 29.

43. Ordinance of 1984, art. 6.

44. *Id.*, art. 7.

45. *Id.*, art. 8 (1).

46. Commentaire, *supra* note 23, at 29.

47. Ordinance of 1984, art. 8 (2).

48. Federal Banking Law of 1934, [1848-1947] 10 Recueil Systématique des Lois et Ordonnances [RS] 325, 332, art. 18 (1).

49. Usually these reports are prepared by the big international accounting firms.

the accounting firm's credentials must be recognized by the Federal Banking Commission.<sup>50</sup>

## 5. *IN TOTO* COMPLIANCE

Finally, insofar as branches are concerned, two well-established practices are given a legal blessing. First, if a PFB operates several branches, an *in toto* compliance, i.e., on a consolidated basis, with the requirements imposed by the Swiss banking authorities is required, and not as to each particular branch.<sup>51</sup> Second, prior to dissolution of a branch, the PFB must obtain an authorization from the Federal Banking Commission.<sup>52</sup> The Commission will grant this authorization when either the creditors are satisfied in full or are given adequate guarantees.<sup>53</sup>

## 6. BRANCH OFFICES

The new regulation contains special provision regarding multiple branch offices (agence). These are offices located separately from the main branch office, where the branch conducts permanent banking activities. Authorization to operate a branch office separate from the main branch office is given on a reciprocity basis, i.e., only if the PFB's home country grants the same permission to a Swiss bank.<sup>54</sup> In this context, the Federal Banking Commission will look particularly at whether or not the PFB's home country limits the number of branch offices.<sup>55</sup>

However, activities that do not involve the public and concern the internal operation of a branch, such as those conducted in the accounting, administrative, planning, and statistics departments are not considered *permanent banking activities*.<sup>56</sup> Thus, for these types of activities, a branch does not need to obtain a special authorization in order to maintain offices located separately from its headquarters. The branch must also prove that it has the organizational capability (staff, financial resources, etc.) to operate several branch offices.<sup>57</sup>

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50. Commentaire, *supra* note 23, at 30.

51. Ordinance of 1984, art. 10.

52. *Id.*, art. 11.

53. Commentaire, *supra* note 23, at 31.

54. Ordinance for the Application of the Federal Banking Law of 1972, [RO] 832, 833 (1972), art. 5 (2).

55. Commentaire, *supra* note 23, at 31.

56. *Id.*

57. *Id.*

## 7. REPRESENTATIVE OFFICES

Another form of representation of foreign banks in Switzerland regulated by the new statute, is the representative office. As its name indicates this office has basically a representative function and does not handle operational banking activities or undertake obligations on its own account. To open a representative office, a foreign bank must apply to the Federal Banking Commission for an authorization. Again, the Commission will consider whether the PFB's home country grants a similar authorization to the Swiss banks, whether the PFB is subject to appropriate supervision in its home country, and whether the representative office's personnel has adequate credentials.<sup>58</sup> It must be mentioned that in all instances where a foreign bank which already operates a branch or a representative office in Switzerland intends to start new branches or representative offices, it has to reapply for authorization in each case to the Federal Banking Commission.<sup>59</sup>

As under the previous regulation, a foreign bank that intends to receive deposits from the public in Switzerland must obtain an authorization from the Federal Banking Commission. Besides requiring appropriate supervision in its home country, the present regulation also requires the foreign bank to adequately inform its client-depositors that it is not subject to supervision by Swiss banking authorities.<sup>60</sup> In certain situations, the Federal Banking Commission may decide to restrict the scope of an authorization for a foreign bank operating in Switzerland to the taking of deposits *only* from nationals of its home country residing in Switzerland.<sup>61</sup>

On December 31, 1983, there were nine branches of American banks that were members of the Federal Reserve System operating in Switzerland. Their total assets were 2.4 million.<sup>62</sup> Recently, it was reported that there is a growing trend among the branches of foreign banks to convert into stock companies under Swiss law.<sup>63</sup> The stock company format is considered as best suited to meet the requirements of foreign businesses.<sup>64</sup>

## 8. REAL ESTATE TRANSACTIONS

In the field of real estate transactions, another recent legal development will also affect the foreign banks' operations in Switzerland. Under the

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58. Ordinance of 1984, art. 15 (2).

59. *Id.*, arts. 3 (3), 15 (3).

60. *Id.*, art. 17 (3)(a)(b).

61. *Id.*, art. 17 (4).

62. Interview with James V. Houpt of the Division of Banking Supervision and Regulation of the Federal Reserve Board, on February 7, 1985.

63. 83/84 Report, *supra* note 1, at 7.

64. R. ROETHMUND, SWISS TAX HAVEN 205 (1980).

previous legislation, the foreign banks operating in Switzerland were at a severe disadvantage not only in regard to the granting of loans against real estate security, but also in the event of foreclosure and the compulsory recovery on such security.<sup>65</sup> The statute concerning the acquisition of real estate by foreign residents living abroad, which was passed by the Swiss Federal Assembly on December 16, 1983, and entered in force on January 1, 1985, brings a long awaited remedy to this situation. This new statute allows a foreign bank to acquire real estate as a result of successful recovery, either through foreclosure or out-of-court settlement, on claims secured by collateral. The real estate so acquired must be sold within a period of two years.<sup>66</sup> However, during this period foreign banks will be able now to actively influence the amount realized from the liquidation of Swiss real estate held as collateral.<sup>67</sup>

### III. Banking Secrecy Issues for Subsidiaries and Branches of Foreign Banks

Although the new regulations did not bring new developments in this field, the relevancy of banking secrecy problems for the operations of subsidiaries and branches of foreign banks in Switzerland imposes some practical considerations.

#### A. CLIENT INFORMATION

The obligation of foreign banks' branches and subsidiaries to observe the secrecy of their client's banking transactions is centered upon the notion of *client information*. First, the banking secrecy shields only each individual *client's* transactions as such, while the *foreign establishment's* (subsidiary or branch) transactions may be disclosed in their entirety to its PFB.<sup>68</sup> A client will lose this banking secrecy protection only if he conducts transactions which may damage the foreign establishment's interests.<sup>69</sup>

Second, in the Swiss doctrine, the banking secrecy is defined as the client's right to the protection of his privacy with regard to *information* concerning his business transactions. The protection offered to the client by this right encompasses: (1) an implied guarantee by the bank to maintain the secrecy of a client's transactions as against relatives and third parties;<sup>70</sup> this explains, for example, the refusal of Swiss banks, upon the death of a client, to

65. 1980/1981 Report of the Association of Foreign Banks in Switzerland 4.

66. Federal Law of 1983, art. 8 (1)(d), RO 1151 (1984).

67. 83/84 Report, *supra* note 1, at 4.

68. See Aubert, *Quelques aspects de la portée du secret bancaire en droit pénal interne et dans l'entraide judiciaire internationale*, 101 REVUE PÉNALE SUISSE 167, 174 (1984).

69. *Id.*, at 175.

70. *Id.*, at 174.

disclose certain confidential information to his successors;<sup>71</sup> (2) an interdiction against the bank disclosing client information to government agencies, particularly to tax authorities.<sup>72</sup> Only the client of the bank may waive the banking secrecy protection.

However, several limitations on the banking secrecy must be noted. Foremost, the banking secrecy cannot be used as a defense in a criminal investigation or proceeding.<sup>73</sup> In several Swiss cantons the judge, on the basis of cantonal statutes, may decide whether or not banking secrecy applies to information used in civil proceedings.<sup>74</sup> This defense cannot be used in the execution of debts and bankruptcy proceedings.<sup>75</sup>

Mention is often made that neither is banking secrecy a defense in tax fraud cases in Switzerland. However, under Swiss interpretations, tax evasion (i.e., the failure of the taxpayer to disclose certain income in his tax return) is a minor offense, not a crime. Only tax fraud involving an overt act, such as providing misleading information to tax authorities in order to avoid payment of the tax, is considered a crime. In the latter case, in a number of cantons, including those of the major banking centers of Zurich, Geneva, and Basel, the judge may deny use of the banking secrecy defense.<sup>76</sup> This difference in interpretation causes particular frustration in the United States, where government agencies cannot obtain appropriate information from Swiss banks in tax evasion cases where the income or the transactions generating the income took place in Switzerland.

In this context, the Memorandum of Understanding between Switzerland and the United States deserves attention. Signed in 1982, it concerns mutual cooperation between these two countries in pursuing violators of U.S. securities laws that prohibit insider trading.<sup>77</sup> The memorandum is not a binding agreement, but represents only an expression of intent of these governments. The parties recognized the possibility that certain uses of material non-public information could be considered offenses under some

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71. M. AUBERT, J.P. KERNEN, H. SCHÖNLE, *LE SECRET BANCAIRE SUISSE* 231 (2d ed. 1982), undertake a detailed analysis of this issue.

72. Aubert, *supra* note 68, at 174.

73. See Aubert, *supra* note 68, at 172.

74. Raifman, *The Effect of the U.S.-Swiss Agreement on Swiss Banking Secrecy and Insider Trading*, 15 *LAW AND POL'Y IN INT'L BUS.* 565, 575 (1983).

75. See Aubert, *supra* note 68, at 177.

76. 59 *RECUEIL OFFICIEL DES ARRETS DU TRIBUNAL FEDERAL LE PARTIE* 737, 748, *JOURNAL DES TRIBUNAUX LE PARTIE* 571, 582, (1971); B. Meyer, *Swiss Banking Secrecy and Its Legal Implications in the United States*, 14 *NEW ENG. L. REV.* 18, 33 (1978-1979); M. Aubert, *The Limits of Swiss Banking Secrecy under Domestic and International Law*, 2 *INT'L TAX & BUS. LAW* 273, 280 (1984).

77. Memorandum of Understanding of 1982, *reprinted in* J. Fedders, J. Harris, R. Olsen & B. Ristau, *TRANSNATIONAL LITIGATION: PRACTICAL APPROACHES TO CONFLICT AND ACCOMMODATIONS*, at 1287, and *Legal Times of Washington*, Oct. 4, 1982, at 17-19, 27.

particular provisions of the Swiss Penal Code.<sup>78</sup> Thus, the parties acknowledged the possibility of using the compulsory measures<sup>79</sup> provided for by the Treaty between the United States and Switzerland on Mutual Assistance in Criminal Matters in order to assist the Securities and Exchange Commission in obtaining information from the banks that executed securities transactions on U.S. markets.<sup>80</sup>

## B. SUBSIDIARIES—DIFFERENT ISSUES

Banking secrecy raises different issues for a subsidiary as compared with a branch. This comes from their different forms of organization. A subsidiary of a foreign bank is incorporated under Swiss law and legally is an independent entity.<sup>81</sup> Meanwhile, the subsidiary remains part of the PFB's multinational structure (i.e., on a consolidated basis); the PFB remains the lender of the last resort for the subsidiary's obligations with "parental responsibility" operating across national frontiers.<sup>82</sup> In contrast, a branch legally remains an integral part of its PFB.

According to the specific provisions of the Swiss corporate law, the banking secrecy concerning subsidiary's transactions is limited within the context of a subsidiary's relationship to its PFB. Thus, the PFB as a shareholder of the subsidiary (*nota bene* corporation under Swiss law) has the right to be informed about the *business of the subsidiary*, i.e., has access to the books, annual report, and auditors' reports.<sup>83</sup> The exercise of these rights must not, however, affect the secrecy of the subsidiary's affairs.<sup>84</sup>

In this context the Swiss authorities consider that the banking secrecy protection remains applicable to any information which directly or indirectly affects the subsidiary's *clientele*. The management of the subsidiary must ascertain, for example, whether the code numbers of the client's account within a detailed report could make possible the disclosure of client's business secrets, even though the client is not named.<sup>85</sup> In this

78. Memorandum of Understanding of 1982, § 3 (b) recognizes that transactions effected by persons in possession of material non-public information could be an offense under arts. 198 (fraud), 159 (unfaithful management), or 162 (violation of business secrets) of the Swiss Penal Code.

79. Treaty Between the United States of America and the Swiss Confederation on Mutual Assistance in Criminal Matters, 27 U.S.T. 2019, T.I.A.S. No. 8302 (1977), section 4.

80. Memorandum of Understanding of 1982, § 3(b).

81. See Müller, *Remarks at the Symposium on Regulation of Multinational Banking Institutions*, 3 J. COMP. CORP. L. AND SEC. REG. 49, 56 (1981); AUBERT, J.P. KERNEN, H. SCHÖNLE, *supra* note 71, at 289.

82. Cooke, *Evolving Techniques for Cooperation among Supervisory Authorities*, 3 J. COMP. CORP. L. AND SEC. REG. 244, 247 (1981).

83. Swiss Code of Obligations, art. 696; see Aubert, *supra* note 68, at 173.

84. Swiss Code of Obligations, art. 697 (2).

85. Federal Banking Commission Report for 1984, at 34.

situation, appropriate protective measures must be taken. Regardless of a client's citizenship,<sup>86</sup> i.e., if the client is a citizen of PFB's home country, he still enjoys the banking secrecy protection against disclosures of his particular banking transactions, made by a subsidiary to its PFB.

Nevertheless, it is recognized that the previous argument does not apply in instances where the PFB agrees to open a credit line for a client, who can use it at his choice, either in PFB's home country, or at any PFB's foreign subsidiaries. In this situation, the need for a safe credit policy at PFB's level and the need for the PFB to conform to its own legal lending limits supersede the requirements of the banking secrecy. Thus, an exchange of information between subsidiaries and PFB concerning the client's use of the line of credit is permissible.<sup>87</sup>

The Federal Banking Commission has also acknowledged that the exercise of control and supervision duties by the PFB pertaining to the management of its subsidiaries requires a certain amount of information regarding the subsidiaries' affairs.<sup>88</sup> In this regard, the recent comment of the Federal Banking Commission concerning subsidiaries' information disclosures to their PFBs deserves mention. There is an absolute prohibition against disclosing business secrets touching upon Swiss national interests, which may occur particularly in the areas of national defense and the economic sectors involved in war material production.<sup>89</sup>

Finally, where a PFB operates two or more subsidiaries in Switzerland, each one as a distinct corporate entity theoretically has the obligation to observe the banking secrecy requirement in dealing with other subsidiaries of the same PFB. However, Swiss legal scholars recognize that a hypothetical violation of banking secrecy between two subsidiaries of the same PFB would be more easily justified than in the case of disclosures between two completely different banks.<sup>90</sup>

### C. FOREIGN BANK BRANCHES

The banking secrecy protection in the case of a branch of a foreign bank is a somewhat more complicated issue. The traditional type of branch is not incorporated, thus, it is not considered a separate corporate entity. The obligations of the branch are always direct obligations of the PFB. As

86. M. AUBERT, J.P. KERNEN, H. SCHÖNLE, *supra* note 71, at 289.

87. *Id.*

88. Federal Banking Commission Report for 1978, at 18.

89. Federal Banking Commission Report of 1984, at 35, expressly mentions the scope of protection of national economic interests as defined by art. 273 of the Swiss Penal Code; this provision is basically directed against economic espionage, i.e., transmittal of information to foreigners.

90. See M. AUBERT, J.P. KERNEN, H. SCHÖNLE, *supra* note 71, at 300.

previously mentioned, a branch becomes a corporate entity, i.e., a subsidiary, only if it is incorporated and registered as such under the Swiss law.<sup>91</sup>

However, the branch is an economic entity whose operation, upon authorization granted by Federal Banking Commission, is conditioned by the terms provided for by the Swiss law.<sup>92</sup> As such, it is required to comply with a series of provisions of other Swiss statutes regulating the banking industry;<sup>93</sup> specifically, it has to comply with the banking secrecy requirement expressly provided for in the basic Swiss banking statute.<sup>94</sup> Nonetheless, it is unanimously recognized that, similar to the case of a subsidiary, the application of banking secrecy to a branch's operation is limited by the necessity of allowing the proper exercise of PFB's duties of audit and supervision.

Nevertheless, there is a divergence of opinion among Swiss authors concerning the outer limits of the banking secrecy obligation for a branch of a foreign bank. Except for the previously mentioned limitation necessitated by the PFB's duties of audit and supervision, some Swiss authors consider that the banking secrecy protects the information concerning the branch clientele to the same absolute extent as that of a subsidiary's clientele would be protected. That is, a Swiss branch must not disclose information about its clientele to its PFB, which stands in the position of a third party not subject to the Swiss banking law provisions regulating the application of banking secrecy.<sup>95</sup> Other Swiss authors, whose opinion seemingly prevailed, inasmuch as it has been adopted by the Federal Banking Commission, consider that a branch may disclose any information to its PFB because the secrecy protecting its clientele is not applicable to its relationship with the PFB.<sup>96</sup>

The main concern of Swiss authorities with respect to the extent of disclosures made by subsidiaries and branches to their PFBs regards the relationship between the PFBs and their home country supervisory authorities. Within the framework of supervision it is conceivable that a PFB will have to give information received from its Swiss establishment to its home country supervisory agency. The Swiss authorities consider that this transmittal of information to the PFB's home country supervisory agency is conditioned by the requirement that the information so acquired be used *only for banking supervision* purposes. In their opinion, this information

91. 83/84 Report, *supra* note 1, at 7, mentions the latter tendency amongst the branches of foreign banks towards converting into stock companies under the Swiss law.

92. Ordinance of 1984, art. 3.

93. *Id.*, art. 2.

94. Federal Banking Law of 1934, as modified in 1971, art. 47.

95. M. AUBERT, J. P. KERNEN, H. SCHÖNLE, *supra* note 71, at 291.

96. D. BODMER, B. KLEINER, B. LUTZ, KOMMENTAR ZUM BUNDESGESETZ ÜBER DIE BANKEN UND SPARKASSEN § 55 (1976) (comment upon art. 47 of the Federal Banking Law of 1934, as modified in 1971); Federal Banking Commission Report for 1978, at 17.



could not be transmitted to other governmental agencies or to courts to be used for other purposes.<sup>97</sup>

#### D. U.S. FEDERAL RESERVE DISCLOSURE

One can easily imagine another collision course, between the enforcement of banking secrecy provisions by the Swiss Courts and the disclosure obligations of the United States Federal Reserve System under the provisions of the Freedom of Information Act,<sup>98</sup> which is basically designed to allow *public access* to government records upon request. There are several exceptions provided for by the statute, under which a United States agency can invoke a privilege from revealing a requested document. The applicable provision in this situation would be the exception for information related to, or compiled from an examination report.<sup>99</sup> While the Federal Reserve System is not necessarily required to raise this exception, this privilege could be asserted against any request for information by a member of the public concerning the operations of Swiss establishments of an American parent member bank.

It is questionable, however, whether this exception would offer the same degree of protection against a judicial subpoena issued by a court of competent jurisdiction in a case, for example, initiated by another federal agency. The Federal Reserve System could raise the defense that the information is privileged from disclosure in a court proceeding as a matter of American law of evidence and other public policy considerations.<sup>100</sup> Nevertheless, the ultimate decision rests with the judge and as such there is no guarantee of a successful defense against a court order requiring disclosure. In any event, an American official has expressed his belief that the above mentioned defense would be successful and the Federal Reserve System could prevail on this issue.<sup>101</sup>

Finally, there are no Freedom of Information Act defenses against a congressional request for information, which may touch the matter discussed here. Hence, the Congress, a congressional committee, or an individual congressperson insisting on disclosure of this type of information could cause the issuance of a subpoena. Following the appropriate congressional procedure, the individual who refused to release the requested in-

97. See Hirsch, *Remarks at the Symposium on Regulation of Multinational Banking Institutions*, 3 J. COMP. CORP. L. AND SEC. REG. 49, 58 (1981).

98. 5 U. S.C. § 552; Petersen, *Remarks at the Symposium on Regulation of Multinational Banking Institutions*, 3 J. COMP. CORP. L. AND SEC. REG. 49, 58 (1981) (a pertinent analysis of Federal Reserve System's duties under the Freedom of Information Act).

99. 5 U. S. C. § 552 (b)(8).

100. Petersen, *supra* note 98, at 58.

101. *Id.*, at 59 (at the time he made this remark, Neal Petersen was the General Counsel of the Board of Governors of the Federal Reserve System).

formation, i.e., the official in charge of this matter at the Federal Reserve System, could be held in contempt of Congress.

It is fair to mention that this hypothetical case has not materialized with respect to American parent banks operating establishments in Switzerland; moreover, the Federal Reserve System has always observed the principle of protection of the information acquired for banking supervision purposes. This type of controversy, however, could conceivably arise in another form and in another legal setting between the Federal Banking Commission of Switzerland and the supervisory authority of any other country where a PFB is located. These types of conflicts caused by inherent differences in ways of doing business and legal systems could disturb the international banking order, but one would hope that reason and the desire to preserve international cooperation in the field of banking supervision will always prevail.

#### **IV. Conclusion**

The adoption of the new rules discussed here demonstrates the constant interest of Swiss banking authorities in maintaining their control over the operations of foreign bank establishments, while continuing to promote Switzerland as a center of international banking. Under the present legislation, the foreign bank establishments in Switzerland must carefully observe the application of the banking secrecy principle in their operations. While they may provide their PFBs with information concerning their operations, they must be cautious with regard to disclosures concerning client information.

In the last few years the Swiss financial market has lost somewhat its competitive edge compared with other financial markets less regulated, with less burdensome taxes and more competitive rates. Presently, in Switzerland there is underway a partial revision of the Federal Banking Law. While this broad statute will establish the general framework for banking operations in Switzerland, the foreign bankers expect from the Swiss banking authorities a flexible approach and appropriate attention to their needs and interests. This in turn will strengthen Switzerland's position as one of the world's most important financial markets.

