



Lifting the Veil...Offshore Banking & Swiss Banking Secrecy

The topic of offshore banking and Swiss bank accounts often conjures images of espionage and anonymous bank accounts through which unscrupulous characters siphon 'ill-got' gains from illegal activities. This may be the side-effects of too many Hollywood movies such as 'Bourne Identity', nonetheless, even those of us who know better still aren't fully au courant with the trappings of offshore banking and the Swiss banking system. First of all, the notorious 'numbered accounts' (comprised of numbers, a combination of numbers and letters, or even pseudonyms) actually exist and represent the epitome of bank secrecy. However, the notion that these are anonymous is a myth, as a few very senior bank officials must have intimate knowledge of the identity and banking needs of the associated account holder.

Simply put, an offshore bank is a bank that is in a jurisdiction other than the country in which one resides. More specifically, they typically offer strict client confidentiality, tax free transactions on the amount deposited and interest generated, as well as diverse investment solutions. Not all offshore banks are operated in exactly the same way but these are the basic tenets upon which they are typically formed. As there are a vast number of offshore banks that can be alluded to, for simplicity, focus is placed on the ever popular Swiss bank. Swiss banks are time-honoured exemplars of the offshore banking system as they have been in existence well over 300 years. Notably, all banks in Switzerland are regulated by the Federal Banking Commission and operate under the Banking Law of 1934, which codifies rules of secrecy and criminalizes any violation of them. This then raises the topic of banking secrecy, the very pillar on which Swiss banks and numerous other offshore banks stand.

The BIG deal with bank secrecy

Many of us think, "Well what's the difference? Don't all banks have to maintain client confidentiality unless required by law to divulge client information?" This is true; however, bank secrecy with respect to offshore banking is surprisingly more rigorous than that. Bank secrecy in Switzerland is the strictest in the world and is established in Swiss law. It goes so far as to protect ANY information on the client and the client's account, and any deviation from this without the client's consent can result in harsh penalties and imprisonment. Interestingly enough, under Article 273 of the Swiss Criminal Code, even if the client authorizes the bank to release information to foreign authorities, by law, the bank cannot divulge information. This is founded on the premise that the client may have been under conditions of duress or blackmail and stems as far back as the practices of the Nazi regime on Jewish clients. Bank secrecy was established in response to a period when states exhibited totalitarian tendencies, which gave precedence to State interests rather than the interests of the citizens.

Under Swiss Law, the only exceptions for which bank secrecy can be waived are on the occasion of serious crimes. Such

crimes fall under the categories of organized crime activities (which include money laundering and tax fraud), drug trafficking, and insider trading of securities. Disclosure of information is prohibited for any legal proceedings classified as 'non-criminal' behaviour, which include: divorce, inheritance disputes, bankruptcy, and tax evasion. These are all deemed private matters and banking secrecy protects the client and the respective account from legal action seeking to determine the presence of such accounts or seize the assets therein.

The lure of Swiss accounts

The two most popular and attractive features of the Swiss bank account are the aspect of complete secrecy, together with the fact that there is generally no levy of taxes on these accounts. Even the International Monetary Fund (IMF) noted the benefits of offshore banks in an IMF background paper done in the year 2000. In this paper the IMF identified that wealthy individuals and enterprises in weak economies with fragile banking systems could benefit from keeping their assets overseas in order to protect them from a potential collapse of the domestic currency, banks, and even protect them from wholesale seizure. Whilst these are all legitimate advantages of opening and operating an offshore account, there are numerous occasions where account holders seek to capitalize on Swiss bank secrecy and use the accounts for tax evasion purposes. For example, it is estimated that the US alone, loses around US\$100 billion of tax revenue per year to offshore havens. Unlike other countries, Switzerland differentiates between tax evasion and tax fraud and considers the former a civil offense whilst the latter is a serious crime. The difference for the Swiss is that tax evasion is, "...the deliberate concealing of assets" whereas tax fraud, "...involves lying on official documents."

Switzerland and the Swiss banking system has recently been placed under immense pressure to compromise its age old tradition of banking secrecy as its largest bank, UBS AG, locked horns with the United States (US) over wealthy American tax evaders. UBS recently settled a fine of US\$780 million to US authorities and released details of approximately 250 US clients suspected of tax fraud but fought vigorously against identifying 52,000 other US account holders as further cooperation would have violated Switzerland's national laws. The ensuing struggle over the last few weeks mounted fears that Switzerland would be blacklisted by the Organization for Economic Cooperation and Development (OECD). Such black listing presents the possibility of economic sanctions, which could have debilitating effects on trade and the Swiss economy. The stakes are high on both sides of the disagreement as the US, Britain and other nations are now cash-strapped and in need of tax revenue, whereas Switzerland faces threats to a major cornerstone of its economy and the very banking approach that attracts foreign deposits.

Implications for Switzerland

Given the scarcity of natural resources, Switzerland is quite dependent on trade for revenue generation. Approximately 62% of Swiss exports go to the European Union (EU) and 9.7% to the US. The Swiss economy is closely linked to Western Europe and the US and, as such, any form of economic sanction would harm the fundamental economy and exacerbate the flight of funds out of Swiss bank accounts. There is heightened potential for such cross-border fund transfers as a result of the wealthy trying to preserve secrecy. This is especially possible given the continued existence of alternative offshore banking institutions in the Caribbean, Panama and Dubai (to name a few), which would not feel the brunt of anticipated Group of 20 (G-20) actions in the short-term. Such a flight of funds would have repercussions not only in Switzerland but also in the US. To illustrate, the US is the largest foreign investor in Switzerland and, simultaneously,

the major destination for Swiss investments. It is estimated that 300,000 American jobs are dependent on over US\$150 billion of Swiss investments in the US.

The OECD recently reported that an estimated US\$11.5 trillion of assets are held in the offshore banking industry. Switzerland is the world's largest offshore banking haven with approximately US\$2 trillion of foreign assets under management and actions taken by or against the Swiss is likely to have a ripple effect on the US\$7 trillion wealth management industry that it contributes to. Additionally, the nation's two largest offshore banks, UBS AG and Credit Suisse, account for over 50% of all deposits in Switzerland and Forbes.Com reported that UBS and Credit Suisse's collective revenues are just under 9% of GDP. As such, the fate of these banks is of tremendous importance to the nation's financial stability.

Just an inch or two higher...

This is not the first time that Switzerland has come under fire for its banking secrecy and over the years this heavy veil has been lifted a few inches at a time on rare occasions. In the 1990s Swiss banks were forced to pay a US\$1.25 billion settlement to descendants of Holocaust survivors over Jewish accounts that remained unclaimed after World War II. Yet again, after 9/11, the Swiss reworked banking rules to cooperate on a global scale with anti-terrorism and anti-money laundering efforts. Currently the world is in a global economic crisis and Switzerland is acutely aware that relations with the US and EU are of paramount importance to its economy. As such, in a bid to mitigate the potentially crippling impact of being blacklisted by the OECD, Switzerland has agreed to cooperate with international tax investigations on a case-by-case basis, provided that other countries provide compelling evidence of tax evasion.

Essentially the veil has been lifted just an inch or two higher but is still far from revealing all. For Switzerland, it represents both a deeply entrenched tradition and law, and a complete unveiling would require overhauling legislation, which is no simple feat. Furthermore, the contribution that foreign investments makes to the Swiss economy on the basis of this tradition is significant and sudden shocks to this system could have a destabilizing effect on the financial system with knock on effects on the wider economy. This is not to say that the system of banking secrecy should remain untouched. The world is experiencing an economic crisis of epic proportions and changes are necessary. This is especially true in light of the open admission by UBS that the bank assisted American citizens in tax evasion, which was the basis of the USD780 million fine which they had to pay.

Some degree of transparency has become necessary but the key to balancing the need for these changes with the preservation of Switzerland's economy lies in open, diplomatic discussions and concessions on both sides. After being subjected to immense pressure, Switzerland conceded to share information on properly identified tax evaders. Rather than backing Switzerland further into a corner and potentially upsetting the economy, trade, and by extension the very OECD countries exerting the pressure; the OECD could consider providing a grace period for Swiss banks to re-strategize their revenue generating model and thereby mitigate against the negative effects of worried clients moving funds out of the country.

FINANCIAL & ECONOMIC INDICATORS

As at 19 March, 2009

<u>Exchange Rate/US\$</u>	<u>Closing Value</u>	<u>Previous Week</u>
Yen	94.51	97.72
Euro	1.37	1.29
Jamaica	88.01	88.25
Guyana	205.20	204.40

<u>Commodity Prices</u>	<u>Closing Value</u>	<u>Previous Week</u>
Crude oil (US\$/bbl)	51.61	47.03
Natural Gas (US\$/mmbtu)	3.68	3.88
Gold (US\$/Troy Ounce)	959.85	926.63

Eurobond Indices (As at 19-March-09)

Lehman Brothers Global Aggregate Index (Return % YTD)	-1.34
JP Morgan EMBI+ (Basis points)	635
JP Morgan Central America and Caribbean Index (CACI) (YTD return %)	3.81

<u>Policy Interest Rates (%)</u>	<u>Closing Value</u>	<u>Previous Week</u>
United States	0-0.25	0-0.25
Euro Zone	1.50	1.50
Japan	0.10	0.10
Brazil	11.25	11.25
Trinidad	8.75	8.75
Jamaica	17.00	17.00
Barbados	3.00	3.00

<u>Market Interest Rates (%)</u>	<u>Closing Value</u>	<u>Previous Week</u>
US 90-day T-Bill	0.19	0.19
US 10-Yr Treasury	2.60	2.85
3-month UK Libor	1.76	1.87
Japan 90-day T-Bill	0.38	0.37
Brazil 90-day T-Bill	10.45	11.08
TT 90-day T-Bill	3.58	3.94
Jamaica 90-day T-Bill	21.69	21.69
Barbados 90-day T-Bill	3.84	3.84

Sources: Bloomberg, CMMB, Central Bank of Trinidad and Tobago, Bank of Jamaica, Central Bank of Barbados, www.lehman.com

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