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Paradise Lost.
The End of Swiss Banking Secrecy
(Paradies perdu.
Vom Ende des Schweizer Bankgeheimnisses)

Sample translation
(Extracts from several chapters)

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On 19 February 2009 Switzerland was rudely awakened from its sleep by the force of the explosion. In a cloak-and-dagger operation the state had handed over to the US authorities 285 comprehensive dossiers on 255 individual clients of UBS, without allowing them the right to seek a court ruling. UBS was also punished with a record fine of 780 million dollars. The Swiss gut feeling was that something dramatic, radical and irrevocable had happened. The small nation, well able to defend itself, had yielded to the might of a super power. This seemed outrageous, irresponsible and unspeakable. And this was just the beginning.

Yet the country had been warned long ago. Looking back, the Finance Minister Hans-Rudolf Merz said: 'The first time we actually heard real alarm bells ringing was in July 2008, when we received the first application for official assistance, after the American authorities had obviously been in direct contact with UBS for several months already. Then we realised that we were now heading for federal and official involvement.' Nevertheless Switzerland sacrificed its constitution and its banking secrecy in one emergency measure. Why? One senior US official involved gave an answer. Two weeks before the Berne 'wall' came down, Barry Shott, departmental head in the US Internal Revenue Service (IRS), described to a Miami court his conversations with representatives of the Swiss Government. Namely that on 21 January 2009 when they had informed him that the competent tax authorities had decided on official assistance in just twelve cases but that the data would only be released after the current appeal period or a blanket court ruling.

Eighteen months after the investigations began, a year after formal proceedings opened and six months after the application for official assistance progress, in the eyes of the Americans, was imperceptible. The IRS departmental head concluded his testimony with the words: 'In sum, the Swiss Government has not provided any records sought under the Treaty Request, and it is not clear when, if ever, it will'.

The USA inferred that the opposite side was stalling. The Swiss tactic: say little, keep your head down, play for time. Chief lawyer Urs Zulauf of the banking watchdog contested this, saying that Switzerland and UBS had made great efforts.

The main problem of the emergency nosedive of 18 February 2009 was UBS's admission of guilt. The bank had to conclude a 'Deferred Prosecution Agreement' (DPA), in which it admitted to gross errors, accepted the record fine and promised to make improvements. The crux of the matter was that UBS had to admit to what many Swiss banks were doing on a daily basis: helping foreign clients hide away their money. The whole Swiss financial world was being pilloried.

Under 'Acceptance of Responsibility for Violation of Law' UBS confessed its sins. This spoke of 'certain private bankers and managers in the United States cross-border business [who] participated in a scheme to defraud the United States and its agency', by having helped American clients to conceal their funds; discretion was the number one priority in Switzerland. The bank had used agencies in the Caribbean and other tricks in order to conceal the true beneficiaries; this formed part of the standard repertory of Swiss fund managers as well and even had the blessing of the bankers' association. There were formulas to represent the terms of ownership and control in a 'false or misleading' light; this was not only in UBS's repertory but in that of many Swiss banks with offshore activities. And – horribile dictu – these '[UBS] bankers and managers [actively assisted

these clients] … by meeting with [them] in the United States and communicating with them … on a regular and recurring basis', in order to invest the untaxed millions in the most profitable way. Falsified travel information, meetings in hotel bars, giving investment advice without a licence and in individual cases transporting money – all that was improper, particularly risky in the USA and practised by UBS, who had a strong presence in the States, with utter recklessness and aggression. But for Swiss banking industry this conduct was not at all extraordinary.

Of course Swiss officialdom took no responsibility for this; rather, all those involved made the small UBS American team its scapegoat, condemning its activities as a reprehensible isolated case. Behind this lay the hope that it would not be noticed abroad how widespread the UBS practices were among Swiss banks and how vulnerable banking secrecy had become after it had humbled itself before the USA. A dangerous strategy. The country hoped to get its neck out of the noose by enhancing this deceitful method of banking with a further cover-up.

This made no difference to the devastating result. The old game of laundering dirty money was over, the wall had fallen and the war was lost. But that did not seem to worry the Swiss political mandarins. The Finance Minister, at any rate, held fast to his illusion that nothing fundamental had happened. Asked by a journalist at the press conference on 19 February 2009 how he would answer the German Finance Minister Peer Steinbrück, who had said that in a year's time banking secrecy would be history, Hans-Rudolf Merz's tone was covertly aggressive: 'He may be a good finance minister but he is a bad historian. Things don't go that fast.'

At that moment this upright Swiss from the little eastern canton of Appenzell may really have believed that even this storm would pass. He could hardly have expressed more clearly his misjudgement of his own position and his blindness to the imminent total and comprehensive collapse of his battle-line. Germany, France and Italy, with black holes torn in their coffers as a result of the financial crisis, would quickly grasp the opportunity and definitively seal the end of Swiss offshore activities.

The judgement in cases A-7342 and A-7426 was pronounced on 5 March 2009. Two linked UBS clients had laid a complaint against the federal tax authorities concerning official assistance to the USA. As the data on those concerned had been handed over to the USA two weeks previously, a verdict changed nothing in the fait accompli of 18 February.

But that was not the point. The USA's unilateral action had landed Switzerland in a legal quandary. More serious than the end of banking secrecy was the violation of constitutional principles. In addition, it was suddenly unclear how Switzerland was going to portray its former banking secrecy. A top-level decision was urgently needed on the question of when official assistance would be permissible and when not.

The five Federal judges addressed two basic questions, concerning form and content. As regards the first, the US clients criticised the necessity of naming a specific suspect in order to permit the Swiss tax authorities to give information to foreign countries. Otherwise, according to the law, it would be a matter of undesirable 'fishing expeditions'. The Federal judges maintained that 'the probability of an unknown person having committed a crime or an offence' was wholly sufficient to launch an investigation. Therefore whether or not the authorities knew the taxpayers' names was irrelevant;

‘concrete grounds’ were sufficient. If the accused does not succeed in ‘refuting [the initial suspicion] clearly and decisively, official assistance is permitted’. Also the fact that up to now ‘reference has always [been made] to the name of a specific taxpayer’ would make no difference. ‘That when a name is known this must be given does not exclude – according to the wording of the regulation referred to – the possibility of applying for official legal assistance without giving names’. A new chapter in Swiss official assistance had been opened: investigations without giving names were not ‘fishing expeditions’.
Then came the test of content. This was more complex. In line with the prevailing double taxation agreement (DBA) of 1996 between Switzerland and the USA an adequate suspicion of ‘tax fraud or the like’ was necessary for official assistance to be sought. In any specific case the judges must test whether the use of agencies in offshore jurisdictions represented fraudulent conduct. And they came to a clear conclusion; they ruled that UBS clients were beyond any doubt guilty of tax fraud. The court attached conclusive importance to the Qualified Intermediary System of the US tax authorities, according to which ‘essential information’ could not be scrutinised, and this, together with the ‘exploitation of this system through the declaration of false and misleading information’, was fraudulent. In short, the system of tax collection based on trust had, in the court’s eyes, been deliberately abused.
This dealt with the concrete case. But the really explosive element in the verdict was a seemingly unimportant instruction of the court which was not binding in the matter in hand, to the effect that tax evasion ‘according to purely Swiss understanding’ could be as unlawful as tax fraud where, for example, a ‘persistent evasion of substantial tax liabilities’ existed. The impartial ruling was that assessment of individual misconduct and not the ‘use of false or falsified documents’ was decisive. That fraud could be committed without falsification could indeed contravene domestic usage. ‘But the criterion is that the legislator deliberately intended general discrimination’, said the judges and referred to the Appendix to the double taxation agreement with the USA, the so-called Protocol, which defined fraudulent conduct in comprehensive terms.
Thus the judges had opened wide the door to official assistance under the old and supposedly strict bank secrecy. Firstly, official assistance was absolutely possible in accusations of ‘serious tax evasion’; secondly, the prerequisite that the accused must have falsified documents did not apply. Both were new and both were important for the UBS story. Now the Swiss could help the US authorities with evasion offences as well, provided these were not trivial. But what did ‘serious or trivial’ mean? The Federal Parliament was soon to provide the answer with reference to the verdict of 5 March 2009. This judicial decision, which seemed superfluous and superseded in view of the premature release of data, became the basis for a historic betrayal of thousands of UBS clients.

Switzerland prepared for the decisive round on 30 April 2009 with case number 09-20423. With the verdict of the Federal High Court in its pocket, promising room for manoeuvre for a comparison, the country was unreservedly shielding its largest bank and in so doing irrevocably joined its own fate to that of UBS.
In February the American tax bureau had demanded access to the accounts of 52,000 US taxpayers. To make public voluntarily such a gigantic mountain of data signalled the end of any kind of credibility for Switzerland. Its banks’ promise never to publish their

clients' names for tax purposes would become meaningless. That had to be prevented. And so the Swiss Government appealed to the competent court in Miami that American officials must also adhere to the existing cooperation agreements. '… this Court should not allow itself to be used as an instrument [of the US tax authorities] for [a breach of treaty]', wrote the Federal Government.

Afterwards Michael Leupold, head of the Federal Justice Department, said: 'So we made our first pitch. We sent a signal to the Americans that from now on they had the Swiss Government to deal with. And we made it clear what this conflict was essentially about: a clash of different justice systems and relations between two sovereign states'.

The strategy for a counterblow was drawn up in Leupold's office and his team was supported by the Swiss defence counsel in the USA. The Swiss line of defence consisted of three strands of argument. Firstly criminality. If UBS were to meet the IRS's demands and publish data on thousands of clients, it would violate Swiss law. According to Article 271 of the penal code it would be illegally providing information to a foreign authority. In addition, the bank would make itself liable to prosecution under Article 273 for giving out economic intelligence and finally, those responsible within UBS would be violating their own professional confidentiality, which prohibited them from ever revealing clients' data, as enshrined in the famous Paragraph 47 of banking law.

Secondly, Switzerland brought into play the existing tax agreement with the Americans, which had come into force in 1951, been extended in 1996 and formalised with examples in 2003. '... the treaty's standards and procedures for the exchange of information would become meaningless if a Party to the treaty pursued alternative means of obtaining information from the other', wrote the Swiss 'Amici' in their submission for Miami. Last but not least, they also introduced the subject of good manners, saying that the Americans' unilateral action ran counter to the normal relations between two sovereign states and that the US Administration could 'not expect any foreign government to provide a response if requested' to such a broadly conceived and non-specific demand as that made by the IRS.

We demand that our sovereignty be respected, even when our opponent is the world super-power, was Switzerland's attitude. The defensive structure built up in the Miami court was the visible part; what was going on behind the walls of the reconstructed Swiss fortress was invisible. For the eventuality that the USA would actually go the last mile, Justice Minister Leupold and his assistants took some spectacular precautions. In May they produced a decree for emergency use. 'Blocking Order' was the international term for it. It meant that Switzerland would prohibit out of hand any release of the client data demanded.

The Federal Government made history with its 'Blocking Order'. It was its boldest decision in the escalating conflict with its stronger opponent. Berne had put dynamite under the UBS horde of data and threatened to blow it up. Then the Americans could go on insisting on publication indefinitely; the information they sought would no longer be available to them.

Those responsible knew that the explosive charge they had primed presented them with a substantial risk. On the one hand, once the threat had been made public, it must be intended seriously, or the government would lose its credibility. On the other hand, it should be accepted by the Americans as a legitimate defence measure and not regarded as provocative. A narrow tightrope. It was important to clarify the proposed measure and the

reasons for it and as many channels as possible should be utilised to spread the message among the Americans.
A national state of emergency was declared. Anyone with influence in the USA was pressed into service on behalf of the UBS affair. On 3 June 2009 Justice Minister Leupold instructed businessmen, bankers, elder statesmen and other Swiss citizens with connections to win understanding for the Swiss position in the impending 'John Doe' summons court case (JDS). 'Diplomatic intervention in the USA in the matter of JDS proceedings against UBS in the USA' was the title of the document, which read like a military 'order of the day'. 'As discussed, you therefore have the task of making contact with … and in the name of the Swiss Government conveying the essence of the following messages', Leupold ordered the recipients. The document was marked 'confidential', because it already contained a reference to the 'Blocking Order'. In no circumstances was this information to fall prematurely into the hands of the opposite side but it was to be passed on verbally to contacts in the USA.
The Swiss strategy was aimed at persuading the proud heads of the powerful US authorities to lay down their arms, let reason prevail and take their seats at the negotiating table. The only problem was how to achieve this.
The clock was ticking more and more loudly and nowhere was a breakthrough in sight. Finally the two top officials responsible, Michael Leupold of the Justice Ministry and Michael Ambühl of the Foreign Ministry, dared to enter the lion's den. They flew to Washington.
On 22 June the team was sitting in Linda Stiff's office. Leupold explained his government's position to the second in command of the IRS, making it clear that publication of data would violate domestic law and that the Federal Government would enact a veto on UBS's cooperation with the USA. In Leupold's opinion, it would be more sensible to resolve the dispute by negotiation. Stiff listened without showing her hand. But for the first time the Swiss negotiators had the impression that a dialogue might be possible.

Then Stuart Gibson cracked the whip. With powerful rhetoric but factual precision the IRS trial lawyer, a thickset man with cropped dark hair, did a hatchet job on the UBS admission of guilt of 18 February 2009. He said that 52,000 US taxpayers had broken American law by concealing both their wealth and their income from the US fiscal authorities with the help of UBS secretive petty-mindedness. The American tax system based on self-assessment would not be viable, declared Gibson in the best populist manner, if 'a double standard of disclosure [applied]: one for the average wage-earner whose income is reported to the IRS by his employer, and another for the wealthy investor who can place his assets in a bank secrecy jurisdiction like Switzerland …'. But it was not sentiment which made Gibson's contribution inflammatory, but the vital point he made about banking secrecy.
This is absolutely not sacrosanct, he said, as the Swiss opposing side maintained in its April declaration. Both UBS and Switzerland had recently published data on US clients of their own accord. It was the bombshell of 250 disclosures on 18 February which showed that Swiss officialdom itself had been prepared to pass on protected information to the USA. 'Thus, circumstances exist under which Swiss banking secrecy gives way to

competing foreign interests, even under Swiss law' argued Gibson, so turning against his opponents their own act of desperation earlier in the year.
It would absolutely be incomprehensible, the IRS lawyer continued, if the Swiss deceitfulness would not be expiated. Firstly UBS – on its own admission – has for years been helping thousands of US taxpayers to cheat the state in grand style and now, when its conduct comes to light, hides behind its own laws which forbid it to hand over data to the IRS. 'This proposition not only defies the law, it defies logic and common sense as well.'
Shortly after Gibson's trenchant analysis the Swiss showed complete intransigence by reversing its conditional decision, and instructed its US defence counsel from the Washington law firm of Pillsbury Winthrop Shaw Pittman to inform its opponents and the court accordingly. UBS could not accede to the IRS demands without violating Swiss laws, wrote Stephan Becker on behalf of the Federal Government on 7 July 2009. 'The Government of Switzerland will use its legal authority to ensure that the bank cannot be pressured to transmit the information illegally, including if necessary by issuing an order taking effective control of the data at UBS that is the subject of the summons,' and 'if the IRS continues to pressure UBS to violate Swiss law', the USA would have to reckon with the Blocking Order being activated. Twenty-four hours later, five days before the case opened, the Miami district judge Alan Gold reacted. He gave the Swiss counter-offensive the validity which its government demanded. If the country's executive was prepared to carry this to the bitter end, the US administration would have to follow suit and declare whether it was prepared 'to proceed by way of request for enforcement, up through and including receivership and/or seizure of UBS' assets within the United States', if the Swiss actually withheld the data after a court ruling against them.

It was 8.30 p.m. when Michael Leupold picked up the telephone and dialled the agreed number. In Washington David Ogden had come back from lunch. The Swiss embassy had engineered this to taken place on 9 July, four days before the major UBS trial. Ogden had been Deputy Justice Minister since March.
The two states with their differing justice systems should resolve the conflict within the existing agreements – that was in essence the Swiss position and Leupold stated it shortly before 'high noon'. Up to now the Americans had turned a deaf ear to any such out-of-court settlement. 'The greatest problem was that the USA wanted to keep up the pressure on their own taxpayers', Leupold summarised. 'They saw a unique chance to use their dealings with UBS as a precedent. The momentum was on their side, so why should they agree to our proposal to postpone the case and work out a deal?'
In the following 48 hours David Ogden and Michael Leupold conducted three further telephonic negotiations, accompanied by countless e-mail proposals which flew to and fro on secure lines between Washington and Berne.
On Saturday 11 July 2009 they at last shook hands verbally. Leupold had finally thrown into the scales the verdict of the Federal High Court in early March. This was supposed to open the door to large-scale official assistance in the case of repeated serious tax fraud. The Americans could count on significantly more names of US taxpayers if they once more agreed to an application for official assistance. The criteria must just be laid down along these lines. Ogden took Leupold at his word, accepted a ceasefire and held out the prospect of a peace treaty over the publication of UBS client data. It was still uncertain

how many US clients had to pick up the tab for this hard-won deal. Both top officials were sure it would be in the thousands.

To prepare the case the Swiss camp had taken up its quarters in the offices of the UBS lawyers Stearns Weaver in Flagler Street and partner Eugene 'Gene' Stearns was to lead for the Swiss. In the firm's offices, only four blocks from the courthouse, the lawyers assembled a mass of documents, worked out a strategy for the decisive battle against the IRS, compiled depositions for the judges and kept up their strength with a vast quantity of tepid coffee and American junk food.

'All rise', called the usher when Judge Alan Gold, a gentleman with smooth white hair, took his seat on the Bench at 9 a.m. on Monday, 13 July 2009. Everyone present in the large courtroom followed suit. The civil case of The United States of America vs. UBS AG was opened, although after Sunday's telephonic agreement between the two Justice Ministries the opposing parties had submitted a 'Motion to Stay' application, requesting that the proceedings be suspended indefinitely.

Shortly afterwards something occurred which an inexperienced observer of the court could easily have missed. Gold asked Gene Stearns, his opposite number Stuart Gibson from the IRS and two other lawyers for the opposing parties to approach the Bench. This procedure is called 'sidebar': a short discussion out of the earshot of court reporters, the content of which is not put on record. 'Gold gave the lawyers to understand that he wanted an out-of-court settlement', said one of the participants in a confidential conversation. The judge had thus taken the wind out of Gibson's sails. 'That was a turning point', said this source. 'Without this unequivocal direction the IRS would have taken the case through to the bitter end.'

Instead, Judge Gold invited the parties to a telephone conference in two weeks' time and ended the session after five minutes. 'Then, we all wish you good luck and look forward to hearing from you soon.' There followed several rounds of negotiations behind closed doors and short, public telephone conferences, in the course of which Judge Gold was informed of how things stood. Each time the chief plaintiff Stuart Gibson described the situation as extremely problematic, while the chief lawyer for the defence Gene Stearns spoke of an imminent breakthrough. Finally on 12 August Gold asked: 'Mister Gibson, yes or no or not yet?' and Stuart Gibson, who had been mounting forceful attacks against UBS and Switzerland in the previous weeks, replied at 9.02 a.m. local time: 'The answer is yes, Your Honor.'