RS

a/m.

521.55

THE IMAGE OF THE SWISS BANKS

Remarks by Hans J. Bär
Partner in Julius Bär & Co.

at the 52nd Annual Convention
of the District of Columbia Bankers Association

Hot Springs, Virginia
June 4, 1970

The times have changed. 170 years ago, President Jefferson appointed a Swiss, Albert Gallatin, Secretary of the Treasury. Within two years, Gallatin consummated the Louisiana Purchase for $11 million. Today, the shoe is on the other foot. President Nixon would like to appoint Robert Morgenthau Tax Commissioner in Switzerland, while the Swiss bankers who are frequent visitors to New York City advocate an early return of the Island of Manhattan to the Indians. Their advice 170 years later seems to fall on deaf ears, however, especially as the Indians themselves are only interested in Alcatraz.

Today, the prestige and image throughout the world of Switzerland and its banks has become a matter of continuing concern in our country, as certain basic interests of the nation, especially as regards the field of double-taxation treaties, are being jeopardized. It is of course true that in the final analysis it is the banks themselves that must look for ways and means with which to improve their image - a task requiring considerable subtlety, as all forms of individual or perhaps even collective propaganda could immediately be interpreted as an encouragement of flight of capital to Switzerland. First and foremost, the Swiss bankers must do everything to dispel the mystery which enveils them and their activities, and it is for this reason that I have chosen to accept your gracious invitation to talk to you today on the topic of "The Swiss Banks and their Image". Let us, therefore, first look at the bone of contention and then finally re-examine the problem as a whole.

Who are the international bankers of Switzerland, and what is their real importance? The official Swiss banking statistics differentiate between seven different bank categories, but it may be fairly stated that the international importance of the Swiss banks can well be attributed for the time being to only two of these classifications, namely, the "big banks" and the

Cont'd. - 2 -

"private banks". The foreign banks in Switzerland are grouped in a third classification called "other banks", which contains quite a few internationally active institutions as well. As the foreign banks grow in importance, the image problem may well be solved automatically at some future point in time, as third countries will surely not want to discriminate against the Swiss subsidiaries of their own banks.

The five big banks of Switzerland are dominated by the three internationally well-known institutions, the Swiss Bank Corporation, the Swiss Credit Bank, and the Union Bank of Switzerland. These three banks, which are roughly equal in size, have assets of about $5 billion each, and thus rank in about the sixtieth place in the international banking hierarchy. This seems low indeed, considering their international reputation and standing, but is, in fact, high in view of the very small size of Switzerland where the largest part of their operations is located.

These banks are the typical examples of the modern universal bank, and the scope of their functions is, in fact, almost unlimited. They do not only accept deposits and grant commercial and mortgage loans, but they are members of the various Swiss stock exchanges, and usually handle the largest part of the local brokerage business. They act not only as custodians for securities, but they are also very active in the investment advisory field as well as in the administration of discretionary investment accounts. These banks also run, through special subsidiaries, the largest Swiss investment trusts with a multitude of geographical and industrial investment objectives. It thus follows that, taken as a group, they are also the most important underwriters, not only for Swiss stock and bond issues, but also for the even more sizeable issues on the Euro-capital market. The "big three" maintain a well-developed network of about 300 branches throughout Switzerland. Moreover, they have, taken together, established 5 branches, 5 subsidiaries, and 32 representative offices in other countries encircling the entire globe.

The second category, the "private bankers", are defined as those firms which are not incorporated - those houses whose partners are fully liable to the extent of their entire fortune for the commitments of their firms. These do not normally publish their statements of condition, but the largest ones are known to have assets in the neighbourhood of $150 million. As long as a private banker does not publicly advertise for deposits, there is no legal requirement for him to publish a statement of condition. This is then the reason why the figures of this category are not contained in the official banking statistics, even though they are of course regularly reported to the Swiss National Bank.

While most of the large incorporated banks were founded during the second half of the 19th century, the history of the private banking houses marks its beginning a long time before that. The leading firms date back to the second half of the 18th century, and they were even then an outgrowth of the typical merchandising and forwarding business of the day. The private bankers, of course, do not represent a statistically very significant part of the credit structure of Switzerland. Their position of importance is rather to be found in the world of international investment banking - in the tremendous amount of wealth which they control and supervise - in the securities portfolios which have been entrusted to their care by their clients throughout the world. It is estimated that the larger houses control about $1.5 billion each in investment accounts, which naturally leads them to be important underwriters not only within Switzerland, but much rather also internationally, primarily today in the Euro-capital market. Mostly, they do not even appear in the Swiss syndicates in name inasmuch as they have formed for this purpose two Groupements des Banquiers Privés, one each in Geneva and in Zurich.

Cont'd. - 4 -

The Swiss Code of Obligations requires the style of a partnership to contain no names other than those of at least one unlimited partner - primarily as creditors' protection. It is thus quite natural that private banking firms, whose names are after all their principal stock in trade, go out of business with the death of the principal owner in the absence of suitable heirs bearing the family name. Of the 500 banks in Switzerland, there are today 47 private bankers registered with the Swiss Banking Commission, of which 30 comprise the membership of the Swiss Private Bankers Association. No more than a dozen of these have any more than purely local significance, however. Now, from where do the larger houses, few as they are, derive their importance on the international financing scene?

These men and their banks owe their international importance primarily to the reputation and standing of Switzerland as an international financial center, and only secondarily to their own specific activities and abilities. Let us, therefore, first look at Switzerland as a financial center as such. Switzerland disposes of a network of no less than 4300 banking offices belonging to 1600 banks and rural cooperatives, with combined total resources of about $33 billion, which is close to twice the gross national product of our country. To the banks we must add the well-known Swiss insurance companies, which collect $2 billion in premiums each year and which, therefore, make an important contribution to the capacity of the Swiss capital market. Last but not least, there are established in Switzerland no less than 7800 holding companies with a combined capital of roughly $2 billion and an annual taxable income of $300 million.

These, then, are obviously not unimportant elements in the development of the Swiss stock markets, of which Zurich is to be found among the leading exchanges of Europe. The foreign exchange as well as the gold market have thus also attained international proportions.

The entire explanation to the unique standing of our financial community cannot be found in statistics alone. The Vienna Congress recognized in March 1815 that the permanent neutrality of Switzerland was in the interest of Europe as a whole. Moreover, the geographical trusteeship which Switzerland exercised as the guardian of the mountain passes gradually found its material metamorphosis. The democratic tradition, the solution of the minority problem as well as a unique history of labour peace contributed to an atmosphere of confidence. Finally, a kind fate has kept Switzerland out of the turmoils of the past century. A careful and sometimes misunderstood foreign policy of neutrality and an innate shyness of fiscal experiments and financial extravagance on the domestic front have, of course, also been important elements which contributed to the unequalled reputation of stability that Switzerland today enjoys abroad.

Our conservative attitude towards all fiscal affairs has always forced the government to generally adhere to a pay-as-you-go policy. This has kept the long-term federal debt within very reasonable bounds and has made a short-term government indebtedness practically unknown. This is the main reason why Switzerland does not dispose of a well-developed short-term money market. The total absence of short- and medium-term government obligations, which are ideally suited for the investment of short-term funds, as well as a typical Swiss dislike for the acceptance business, have left us without a really functioning money market. While in the other financial centers of the world the short-term money market plays the domineering rôle, it is the long-term capital market which lends truly international importance to Switzerland and its banks. And thus it is

Cont'd. - 6 -

long-term rather than short-term money which has been traditionally attracted to the Swiss money center. The recent explosive involvement of our "big three" in the Euro-currency market would not seem to alter this basic conclusion, especially since many of the so-called Euro-deposits are in fact handled on a fiduciary basis.

The total lack of a short-term money market is of significance not only to the outside world, but also to the Swiss banks themselves, who are thus forced to reinvest those foreign short-term funds which are entrusted to them abroad in order to earn a fair return. While this can of course only be done to the extent that the added political and economic risks can reasonably be assumed, the Swiss economy thereby is automatically spared the inflationary implication of the investment of these funds in Switzerland.

After this basic analysis of the national background, let us now look at the banking community and some of the figures in order to appreciate the true proportions which are often misrepresented.

The foreign exchange traders of the Swiss banks are, today, in charge not only of the actual currency dealings, but also of the short-term money market investments of their banks and their clients in what has become known as the Euro-dollar or more generally the Euro-currency market. In this market, which the BIS estimates to amount to approximately $40 billion, the Swiss banks report the largest assets of approximately $10 billion, including their claims upon the United States. It not only follows that the Swiss commercial banks are the most important lenders to the international money markets, but also considering the $8.5 billion foreign claims upon the Swiss banks, that Switzerland's status of liquidity with net deposits abroad

Cont'd. - 7 -

of $1.5 billion is in a most satisfactory state. The fact that these deposits can be shifted often at very short notice from market to market and from country to country, depending upon a very personal interpretation of the political and economic risks involved, naturally makes the Swiss bankers factors to contend with.

So much for the short-term activities of the Swiss banks. The long-term or investment banking aspect bases not only upon the Swiss capital market, but also upon the international capital markets, where the Swiss banks are playing an ever more important rôle. It has been reliably estimated that the portfolios managed and controlled by the Swiss banks amount to something like $50 billion or roughly the size of the total American mutual fund industry, whereby the lion's share of this amount, or about 40%, is to be attributed to the so-called "big three". The leading private banking houses together are estimated to control about $8 billion thereof. This investment banking activity has made Switzerland a most powerful factor in the capital markets not only of Western Europe, but even of the United States. Under the influence of various, mainly domestic political factors, the international importance of the domestic Swiss capital market as an exporter of long-term capital has remained stationary at about $250 million per year. The "big three" have recently announced the temporary suspension of the underwriting of new issues for foreign borrowers because of the tight Swiss capital market. The Swiss banks have, however, played an ever bigger rôle in the European capital market and have managed to absorb, without - until recently - ever appearing in name in the underwriting syndicates, about 1/2 of the total offerings, amounting to about $2.7 billion per year in new bond issues in 1969. The present rate of issues is, of course, much smaller.

The reason why the Swiss banks were not ever allowed to participate in name in these transactions is to be sought in the peculiar Swiss tax legislation, which has, however, recently been at least somewhat amended. Shortly before the abolition of the coupon tax three years ago, the 18 leading Swiss investment bankers, comprising the traditional syndicate for the underwriting of foreign bond issues in Swiss francs, have constituted a similar syndicate in order to participate in the international issues in foreign currencies. While the Swiss National Bank has, of course, retained its legally prescribed veto right over such transactions, and while the Swiss new issue tax still has to be paid on that part of a loan underwritten by the Swiss banks and placed with Swiss residents, this new syndicate has been permitted to participate in at least a few of the large international underwriting operations. Experience has shown, however, that the large international syndicates could not tailor their time-table to the ideas of the Swiss National Bank and thus the three large banks as well as two or three other institutions have now formed Bahamian underwriting subsidiaries in order to avoid the Swiss obstacles. Only a few years ago, the Swiss authorities would certainly not have tolerated this typically "off-shore" concept, a recent American contribution to the scene. In order to avoid this difficulty, our own house established some years ago already subsidiaries both in London and New York - bases where both a domestic and an international activity can be developed autonomously. It is interesting to note that despite all legal and other obstacles, the foreign income of the Swiss financial community, amounting to about $400 million per year, equals the foreign earnings of the City of London, the sole difference being that in London the insurance companies make the larger contribution and in Switzerland the banks.

Now no descritpion of the Swiss banking scene would be complete without the coverage of the Swiss banking secret and the infamous numbered accounts. It has recently been stated that the word "secrecy" is somewhat unfortunate, because it gives the im-

Cont'd. - 9 -

pression of a situation which cannot stand the light of day. Perhaps it is true that a word such as "privacy" or "discretion" would be more fortunate, because the relationship between a client and his bank is being treated in confidence throughout the world, and certainly not only in Switzerland. The mysticism, however, surrounding a Swiss numbered account, has become almost grotesque. Indeed, the numbered account has become a status symbol.

At the risk of repeating what I am sure has been pointed out to you many times before, it must be stated again that the banking secrecy, which is a national law, applies to every account with a Swiss bank, whether carried in the name of the client or under the heading of a number. For an American citizen, at least, there is simply no such thing as an illegal account with a Swiss bank. It goes without saying that income and capital gains derived from assets in such Swiss accounts by an American tax payer, are subject to United States taxes, and it is of course the responsibility of each tax payer to file a proper return. Let me make it quite clear that it cannot be the responsibility of a Swiss banker to obtain assurance from his client that the assets in his particular bank account are reported to the client's tax authorities. No American banker, surely, asks this question of a domestic American client, and no Swiss banker will ask this question of a Swiss client. There is, therefore, no discernible reason why a Swiss banker should ask an American client for assurance that his tax affairs are in order. The question, after all, is much more basic. No reputable bank in Switzerland will open an account in the first place for anyone who has not presented proper documentation, including his full name, legal domicile, indication of citizenship, and references. The prevalent idea that anyone can walk into a responsible bank in Switzerland and ask for a number under which he can deposit money without due identification, is simply absurd, but admittedly romantic.

One is tempted to say, "so far so good", but the situation becomes vastly different for a foreigner who is prohibited by his own law from having any funds at all abroad. This was the case, of course, with Nazi Germany, which led to the creation of the numbered accounts in the first place. Whenever such laws apply, the situation becomes naturally infinitely more difficult for the banker involved. Here again, the Swiss banks are, however, not alone. Throughout the world, banks and brokers will accept accounts from nationals of countries which basically do not allow such an account to exist. Banks and brokers in America will not only accept but even solicit such accounts, whereby again no hard and fast rule can be set down for such cases. When it comes to promotional literature mailed abroad, other financial communities are considerably more aggressive than the Swiss. Twenty-five years of boom-conditions in most countries, including Switzerland, have made it difficult to place into each position of responsibility a bank manager fully qualified, both morally and technically, to assure sound policies and adequate controls in his department at all times. It is, therefore, unavoidable that wrong decisions are taken at various levels under continuously shifting circumstances, but it must be realized that many of these decisions require a degree of judgement, a quality of moral fibre, and a degree of sophistication, which simply cannot be expected of the average bank manager in these hectic times. To extrapolate, however, from any mistakes which are bound to occur with an individual institution to the banking industry of an entire country, would surely appear to be entirely unwarranted.

Another cause célèbre is that many Americans try to use Swiss banks to circumvent regulations of the Federal Reserve Board regarding margin requirements in connection with stock purchases. It is, of course, true that the jurisdiction of the Federal Reserve Board does not extend to Switzerland, where a

Cont'd. - 11 -

roughly 50% margin basis has always been the standard for good banking practice. Here, however, the moral question appears to be quite clear and the Swiss Bankers Association has laid down the recommended rules of behaviour accordingly, by asking its members to abstain from such transactions. First of all, the Swiss bank sees quite clearly, without invading the client's privacy, if its loan is used for the purpose of purchasing American stocks in America for account of an American, so that there can be no other plausible reason for opening an account in Switzerland except in order to circumvent American regulations. No Swiss bank with an international business worthy of the name could have an interest in helping Americans to get around the law in their own country, and it is today undoubtedly very difficult to borrow funds from a reputable Swiss bank against collateral of American securities on a margin other than that described by the Federal Reserve Board. The provision in Representative Patman's Bill concerning foreign secrecy laws extending the U.S. margin requirements to borrowers as well as lenders should finally serve to clear the air in this hitherto somewhat hazy area.

In general one ought to differentiate between active and passive participation by the foreign banks in the transactions of a client. Accepting passively the account of a reputable party on an unsolicited basis can surely not be compared to granting margin loans, selling unregistered stocks, executing insider transactions, if this is obvious, or even participating in take-overs or proxy fights. In this and other areas, the boundary of prudence and good taste has certainly often been overstepped, seldom, however, intentionally by the top management of a bank.

Finally, let it be pointed out once more that the Swiss banking secret does not hold in cases where the offence is punishable

Cont'd. - 12 -

under Swiss law. The Swiss banks must furnish information to the Swiss courts when the accusing party, Swiss or foreign, is directly involved, and when the Swiss authorities see fit to cooperate with the foreign court desiring assistance. Even without a special treaty such as is presently being negotiated between Switzerland and the United States, the courts of Switzerland will willingly cooperate with a foreign request for assistance, provided the court has satisfied itself that the particular offence will also be considered as such under Swiss law. Even the already existing treaty for the avoidance of double-taxation between Switzerland and the United States makes adequate provision in its Paragraph 16 for mutual assistance in certain well-defined cases.

Swiss law makes an important distinction between simple tax evasion and tax fraud, which is an aggravated form of tax evasion. Whereas individuals guilty of simple tax evasion under Swiss law are not considered to have committed "crimes", and thus are not subject to jail sentences, tax fraud in connection with the Swiss federal withholding tax on interest and dividends and the income tax laws of sixteen of the twenty-five Swiss cantons, including the economically more important cantons, is deemed a criminal offense which can result in the imposition of jail sentences and which is handled in criminal rather than administrative proceedings.

This distinction between tax evasion and tax fraud becomes of essential importance, because under Swiss law the obligation of a bank to observe secrecy about the affairs of its depositors is superseded by the duty to furnish information, give testimony, or produce documents in criminal proceedings which include tax fraud proceedings.

This, then, is a short summary of the real bone of contention between Switzerland and not only the United States, but other

Cont'd. - 13 -

active trading partners of ours as well. Differences in both law and customs have often lead to unfortunately too-well-publicized incidents involving Swiss banks. But as the international integration of the banking world continues, a modicum of tact and understanding on all sides should undoubtedly help to overcome the difficulties. But America should remember that the dollar must be a universally acceptable lead currency, which implies an attitude of "noblesse oblige", without which true leadership is unthinkable. After all, one should not forget that the blocking incidents in 1952 were instrumental in creating the Euro-dollar market, because the Iron country banks and others became afraid of depositing their dollar balances with American banks in the United States, where their payments would be open to scrutiny by the authorities and where these balances were subject to the danger of blocking.

The dollar balances were then transferred to Western European banks, and the story has been told that the Euro-dollar market derives its name from the cable address of the Communist bank in Paris, the Banque Commerciale pour l'Europe du Nord (Eurobank), whose dollar deposits were first being traded among European banks to augment their liquidity. The case can thus be made that if it had not been for these American actions, or at least the threat thereof, the Euro-dollar market would not exist in today's form. The lawmakers of today should be careful not to simply drive business "off-shore", where it is even more difficult to control - a lesson which has been painfully learned by many countries in the investment-trust sector. As a matter of fact, Switzerland is also just about to make the same mistake, by passing laws not tailored to the realities of the market place.

Now it could well be that the impending American legal changes proposed by Senator Proxmire and Representative Patman will

Cont'd. - 14 -

further strengthen the Euro-dollar and the off-shore market in U.S. securities. To that extent, the American economic obligation to the Western world will become even stronger. It must be made quite clear that America is today the one major problem facing the Western monetary system, and that is internally because of the frightening rate of inflation and externally because of the truly confusing and also alarming state of its balance of payments. The United States accumulated the biggest external accounts deficit in history - almost double that of the preceding record. On the now used "liquidity" basis (which includes the dollars owed to all foreigners), the United States have lost \$7 billion in 1969, as compared to the previous record deficit of \$3.9 billion registered in 1960. By the so-called "official settlements" computation, however (this includes only the amounts owed to foreign Central banks and international financial organizations), the United States reported a surplus of \$2.8 billion up from \$1.6 billion in 1968. Both figures are absolute records and it must be recalled that only as little as five years ago, the "official settlements" computation was discarded in favour of the liquidity method because of its inadequacies. The deficit for the first quarter of 1970 of \$1.7 billion (liquidity) and \$3 billion (official settlements) respectively, is in any case staggering.

Several conclusions emerge from this statistical confusion. First of all, it is clear that all types of book-keeping procedures have their flaws. Secondly, with today's distortions in the international money markets, which are entirely unnecessary and are only due to a set of outmoded laws in most relevant countries, it has become practically impossible for an orthodox accountant to compile any meaningful set of figures. Much of the \$10 billion differential between the two 1969 figures is represented by dollars borrowed by foreign branches of US banks and repatriated to America in order to ease the consequences of the credit squeeze. These funds naturally count as part of the liquidity deficit even though a large part thereof, i.e. an estimated $2 billion, belongs - at least indirectly - to American beneficial owners. Most important of all is, however, the fact that this huge deficit did not cause any upheaval on the foreign exchange markets, because for the time being the dollar remains reasonably strong and therefore the monetary situation stable. The slowly rising price of gold is, however, an unmistakable warning signal.

For the first time since 1962, the US gold stock rose by 9% to almost $12 billion - a record level since that year. Today, foreigners are watching another set of statistics, however - the budget figures, which may be just slightly more meaningful. It is, of course, difficult for the outside observer to gauge the accuracy of the budget figures which have been presented by the Nixon administration, but the fact that the country is headed for another significant deficit is truly alarming.

The present anti-inflationary measures taken by the US government (provided they are really anti-inflationary) might well depress the American economy to a point where the repercussions on world trade could become extremely serious. Already Britain's exports to North America in the last quarter of 1969 were 7% below the preceding three-month period. But the real danger in America's present anti-inflationary and tight-money policy is, of course, that the country could conceivably drop into a real recession with unemployment rising for a longer period to 5%, 6% or even 7%. While this is not very likely, because today's economists should have the tools in hand to guide the economic ship of state more accurately, the risk of such a development must at least be clearly recognized, if only because the administration is undoubtedly sailing very close to the wind. In other words, the whole world today has an interest in the re-

Cont'd. - 16 -

establishment of an equilibrium in the American economy, and from there an orderly progress back to controlled growth.

The Euro-currency market is often suspected by a whole array of experts to be an institution wrought with danger, and these critics never tire to predict a series of banking failures and subsequent chaos. The real danger seems to lie someplace else. The irresponsibility of much of the new-issue industry, which often operates without sufficient heed for the legitimate interests of the investor, must result in more extensive controls. The IOS lesson goes far to show to the authorities of several countries that problems and unsavory practices will not simply disappear by driving them "off-shore". But we must again and again revert to the Euro-market's central point of weakness - the stability of the U.S. dollar. While one might be tempted to ignore the statistical puzzle of the American balance of payments, the balance of trade is a phenomenon which cannot be interpreted into a more favourable light. The bitter truth remains that an average $5 billion surplus in the middle sixties has now fallen to about $500 million, with no improvement in sight. While imports have increased by almost 90% since 1964, the inflationary price spirals have held the increment in exports to only 40%.

The rôle of gold as an international reserve medium declines steadily. While in 1950, gold still accounted for 69% of international reserves, by 1969 this percentage had declined to 49%. Extrapolating this trend, it is estimated that by 1980 gold will still account for only about 30% of international reserves. It is therefore imperative that the restoration of an internally sound and externally stable and undoubted dollar be considered the free world's prime concern. It is only unfortunate that the achievement of this aim is wrought with great dangers, as the ship must be guided between the Scylla of unemployment and social disorder and the Charybdis embodied by the ravages of inflation.

*   *   *