

RECENT DEVELOPMENTS IN SECURITIES REGULATION

SECRET SWISS BANK ACCOUNTS AS A MECHANISM FOR VIOLATING UNITED STATES SECURITIES LAWS: AN ANALYSIS OF PROPOSED SOLUTIONS

In recent years there has been increasing concern about the widespread use of the secret Swiss bank account by United States citizens seeking to evade United States securities statutes and regulations.¹ Several court cases,² news articles,³ and other reports⁴ have prompted speculation that the use of Swiss accounts to evade securities laws is increasing. The possession of a Swiss bank account is apparently quite fashionable,⁵ and advertisements in financial newspapers offering information regarding their acquisition and use are not uncommon.⁶ United States citizens familiar with the use of the secret Swiss bank account are even selling their knowledge to others.⁷ The

¹ See generally Hearings on SEC Enforcement Problems Before a Subcomm. of the Senate Comm. on Banking and Currency, 85th Cong., 1st Sess., pt. 1 (1967) [hereinafter cited as SEC Enforcement Hearings]; Hearings on S. 594, S. 1168, and S. 1601 Before a Subcomm. of the Sen. Comm. on Banking and Currency, 85th Cong., 1st Sess. (1957) [hereinafter cited as SEC Legislation Hearings]; Hearing on Legal and Economic Impact of Foreign Banking Procedures on the United States Before the House Comm. on Banking and Currency, 90th Cong., 2d Sess. (1968) [hereinafter cited as Foreign Banking Hearing].

Secret Swiss bank accounts are also being used by United States citizens for other illegal purposes not discussed in this comment, including tax evasion, gold speculation, and the "cleansing" of stolen money. The latter activity is accomplished by depositing illegally acquired funds in a Swiss bank. The bank may then "lend" the money back to the depositor. Such a loan is termed a "window dressing" loan. See *id.* at 10.

It should also be noted that banking secrecy is not unique to Swiss banks. Countries such as Panama, Curaçao and the Crown Colony of Hong Kong have secrecy laws; however, it appears that the Swiss banks are more widely used by persons engaged in illegal activities. See *id.* at 31-32 (remarks of Robert Morgenthau, U.S. Att'y, S.D.N.Y.).

² See, e.g., *United States v. Kelly*, 349 F.2d 720 (2d Cir. 1965); *United States v. Coggeshall & Hicks*, 69 Crim. 431, Indictment (S.D.N.Y., filed May 16, 1969); *United States v. Dolin*, 69 Crim. 336, Indictment (S.D.N.Y., filed April 11, 1969); *United States v. Arzi Bank, A. G.*, 68 Crim. 1011, Indictment (S.D.N.Y., filed Dec. 19, 1968).

³ See, e.g., *N.Y. Times*, Dec. 1, 1969, at 42, col. 1; *N.Y. Times*, Nov. 30, 1969 at 1, col. 8; *Nobody Here But Us Foreigners?*, *Forbes*, May 1, 1969, at 24; *Plugging a Dollar Drain*, *Business Week*, Dec. 21, 1968, at 78; *Wechsberg, Banking by the Numbers*, *Playboy*, Aug., 1968, at 79; *McInnes, Haven for Capital*, *Barron's*, June 17, 1963, at 9.

⁴ See, e.g., 115 Cong. Rec. 875 (daily ed. Feb. 6, 1969) (remarks of Representative Patman); 115 Cong. Rec. 1459 (daily ed. Mar. 5, 1969) (remarks of Representative Patman).

⁵ See, e.g., T. Fehrenbach, *The Swiss Banks* 5 (1966) [hereinafter cited as *Fehrenbach*]. "Switzerland and its banks hold a great fascination. No one can deny that the anonymous or numbered account has become both the most subtle and the most sophisticated status symbol in the modern world." *Id.*

⁶ See, e.g., *Barron's*, Aug. 11, 1968, at 10, col. 4.

⁷ See, e.g., A. Gibson, *Swiss Bank Accounts and Financial Survival in Inflation and Devaluation* (1969) [hereinafter cited as *Gibson*]; F. Pick, *The Numbered Account* (2d

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holding of such accounts is no longer confined to wealthy financiers and investors; ordinary businessmen also possess Swiss bank accounts.⁸ The problem has reached such proportions that Congress is currently considering the enactment of remedial legislation,⁹ and the State Department is presently engaged in treaty negotiations with the Swiss Government.¹⁰

Statistics indicate that Swiss financial institutions have purchased American securities quite beyond what one would expect from a nation with a relatively small population and limited financial resources. Data compiled by the banks and brokers in the United States and forwarded to the Treasury Department and Federal Reserve Board for tabulation and evaluation shows that Swiss activity in American securities markets is far greater than that of any other foreign nation.¹¹ For example, 31 percent of the total gross purchases in long-term securities¹² made in the United States by foreigners¹³ in 1968 were attributable to Switzerland.¹⁴ Also, 49 percent of the total European gross purchases of long-term securities in the United States were made by Switzerland.¹⁵ This latter figure compares with 18.4 percent for the United Kingdom,¹⁶ the second largest purchaser, and 8.3 percent for France,¹⁷ the third largest purchaser. Switzerland also led all other nations in gross sales of long-term securities made in the United States by foreigners in 1968 with 27.4 percent of the total.¹⁸

ed. 1969) [hereinafter cited as Pick]. Although Pick's book is only fifty pages, its retail price is \$35. However, it is instructive in that it exhibits typical contractual forms and agreements that the Swiss Bank and depositor execute when an account is being opened.

⁸ Foreign Banking Hearing 11 (remarks of Robert Morgenthau).

⁹ See *id.* at 44-45 (remarks of Representative Patman).

¹⁰ Letter from Robert M. Beaudry, Country Director, Italy-Austria-Switzerland, Department of State to B.C. Ind. & Com. L. Rev., October 9, 1969, on file in the Review office.

It is a fact that discussions are under way between the Swiss and the United States Government for the purpose of determining whether we can develop a Judicial Assistance Agreement to facilitate the gathering of evidence in certain criminal cases before the U.S. courts.

Id.

¹¹ See, e.g., Treasury Bull., July, 1969, Capital Movements Section, at 90-126.

¹² "Long-term securities" are defined as obligations with no maturity date or an original maturity greater than one year. *Id.* at 90.

¹³ The term "foreigner" covers all institutions and individuals domiciled outside the United States including United States citizens domiciled abroad and the foreign branches, subsidiaries, and offices of United States banks and business concerns. It also includes the central governments, central banks, and other official institutions of foreign countries, wherever located. Finally, it includes persons in the United States to the extent that they are known by reporting banks and brokers to be acting on behalf of foreigners. *Id.*

¹⁴ *Id.* Table 10, at 124. This table is partially reproduced on p. 196.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

CAPITAL MOVEMENTS
SECTION V.—TRANSACTIONS IN LONG-TERM SECURITIES BY FOREIGNERS REPORTED BY BANKS AND BROKERS IN THE UNITED STATES
TABLE 10.—FOREIGN PURCHASES AND SALES OF LONG-TERM SECURITIES, BY TYPE AND COUNTRY, DURING CALENDAR YEAR 1968
(In millions of dollars)

Country	Gross purchases by foreigners					Gross sales by foreigners				
	Domestic securities					Domestic securities				
	Marketable					Marketable				
	Total purchases and sales	U.S. Gov. bonds and notes	Corporate and other	Foreign securities	Total sales and notes	U.S. Gov. bonds and notes	Corporate and other	Foreign securities	Bonds	Stocks
<i>Europe:</i>										
Austria	65	—	3	54	8	*	44	1	36	7
Belgium-Luxembourg	637	*	179	339	102	18	417	1	58	259
Denmark	47	*	19	5	23	*	36	1	7	3
Finland	14	1	*	13	13	*	5	*	5	*
France	1,152	1	240	781	69	62	758	1	45	580
Germany	976	*	319	551	65	41	528	1	71	382
Greece	13	—	5	5	3	*	8	—	1	7
Italy	385	*	107	190	81	7	257	3	43	147
Netherlands	806	1	83	622	22	78	414	1	44	324
Norway	90	18	27	14	29	1	96	31	26	14
Portugal	27	—	1	13	12	1	26	1	25	1
Spain	68	*	2	58	4	3	87	1	2	61
Sweden	95	2	60	16	15	3	110	20	44	76
Switzerland	6,753	8	1,456	4,860	336	92	5,344	12	846	4,038
Turkey	2	—	—	2	*	*	1	*	1	*
United Kingdom	2,545	297	915	893	228	211	2,212	245	392	921
Yugoslavia	3	—	*	*	3	—	3	—	1	1
Other Western Europe	121	17	20	73	10	1	106	31	4	59
U.S.S.R.	—	—	—	—	—	—	—	—	—	—
Other Eastern Europe	2	1	—	1	*	—	1	1	*	—
Total Europe	13,802	347	3,436	8,476	1,024	520	10,453	349	1,683	6,885
Total foreign countries	20,709	415	4,119	13,087	1,843	1,245	18,293	743	2,277	10,830
<i>International and regional:</i>										
International	797	21	322	30	423	*	1,069	161	204	18
European regional	1	—	—	*	1	—	*	—	—	*
Latin-American regional	45	7	—	—	38	—	134	29	—	105
Total international and regional	843	29	322	30	462	*	1,204	190	204	18
Grand total	21,553	443	4,441	13,118	2,506	1,245	19,496	932	2,481	10,848
										1,562

* Less than 1/2 million dollars.

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Fifty-one percent of the European total gross sales in long-term securities were Swiss.¹⁹

The 1968 statistics also reveal that most of the Swiss investments in the United States were concentrated in corporate stocks.²⁰ Switzerland's gross purchases of United States corporate stock were 57 percent of the European total,²¹ while the United Kingdom was second with 10.5 percent of the European total.²² Fifty-nine percent of the European total of gross sales of corporate stock was attributable to Switzerland,²³ while only 13.5 percent was attributable to the United Kingdom.²⁴ The foregoing statistics do not merely reflect a situation unique to 1968. It appears that the amount of Swiss activity in United States securities markets has remained at a remarkably high level for the past decade.²⁵

While these statistics indicate a large Swiss investment in United States securities, they do not necessarily indicate that this investment is beneficially owned by United States citizens who are attempting to evade the securities laws. Swiss banks are renowned for their stability and are universally considered safe depositories for large sums of money.²⁶ Swiss banking officials are reputed to possess a great deal of investment expertise.²⁷ Finally, the United States securities markets are very attractive to the Swiss banks, and they have undoubtedly chosen to invest a large amount of their own funds in American securities. Taking into consideration these factors, Switzerland's percentage of foreign investment in the United States is still extraordinarily high. Other reasons have been posited to account for these statistics, and the conclusion has been reached

¹⁹ Id.

²⁰ Id.

²¹ Id.

²² Id.

²³ Id.

²⁴ Id.

²⁵ See, e.g., Treasury Bull., April, 1968, Table 8, at 103; Treasury Bull., Dec., 1967, Table 8, at 108; Treasury Bull., Dec., 1966, Table 8, at 113. These sources set forth the figures for purchases and sales of long-term securities made by foreigners in the United States for the calendar years 1967, 1966, and 1965. Swiss activity in United States securities markets during these years was consistently higher than other European nations. Only Canada approached the Swiss totals on occasion, but, unlike the Swiss, most Canadian investment was not concentrated in American corporate stocks. Moreover, it may be of some significance to note that the 1968 statistics show a marked increase over the 1967 statistics in Swiss purchases and sales of long-term securities in the United States. In 1967 Swiss purchases and sales were approximately 3.5 and 3 billion dollars respectively. Treasury Bull., April, 1968, Table 8, at 103. In 1968 the respective figures were approximately 6.7 and 5.3 billion dollars. See notes 11 & 14 *supra*. Swiss investment activity in the United States was also disproportionately high in 1957. SEC Legislation Hearings 129 (remarks of M. Joseph Meehan, Director, Office of Business Economics, Dept. of Commerce).

²⁶ Pick 32-33. Pick also notes that "freedom from persecution," "hedging against nationalism" and "protection against arbitrary taxation and/or confiscation" are prime advantages of maintaining a Swiss account. Id. at 34-35.

²⁷ Gibson at 37-38 (by implication).

that United States citizens are utilizing Swiss banks' accounts to violate United States securities laws.²⁸

It is not difficult for a United States citizen to open a Swiss bank account. A Swiss account can be opened by a United States citizen in Switzerland,²⁹ the United States³⁰ or in other countries in close proximity to the United States.³¹ Some Swiss banks have representatives in the United States who can confidentially arrange for the opening of a Swiss account, including the transfer of funds to Switzerland.³² Some Swiss bank representatives, cognizant of the fact that Swiss accounts are being used for illegal purposes, have openly solicited United States citizens with criminal records.³³ The relative ease of opening a Swiss bank account, when considered with the statistical data evidencing the large investment by Swiss banks in United States securities, and a number of recent court cases showing actual abuses, indicate that United States citizens are using Swiss accounts for illegal purposes.

The fact that United States citizens are violating the securities laws by using Swiss bank accounts is in itself troublesome, but the serious impact which such violations have on the United States securities markets and economy is alarming. The confidence of the investing public in these markets is being diminished, and market stability is being affected as a result of stock manipulation, fraud and evasion of registration requirements made possible by transactions through secret accounts. As legitimate investors recognize the inability of law enforcement officials to solve this problem, they might find the United States securities markets a less attractive medium for making investments. This lack of confidence may seriously weaken the viability of the economy. The attainment of the primary objective of the securities laws, establishment of a free and open market for trading in securities, will be thwarted as long as these violations continue. It is manifest that present legal resources of the SEC and the Justice Department are insufficient to curb these abuses.

This comment will explore the current abuses of United States securities statutes and regulations³⁴ resulting from the use by United States citizens of the anonymous Swiss bank account.³⁵ The nature

²⁸ Foreign Banking Hearing 11-17 (remarks of Robert Morgenthau); *id.* at 7 (remarks of Fred M. Vinson, Jr., Ass't Att'y Gen., Dep't of Justice); *id.* at 18 (remarks of Irving M. Pollack, Director, Div. of Trading and Markets, Securities Exchange Commission).

²⁹ Pick 15.

³⁰ Gibson 41.

³¹ Foreign Banking Hearing 15 (remarks of Robert Morgenthau). These countries include the Bahamas, Mexico and Canada.

³² Gibson 41-43.

³³ Foreign Banking Hearing 11 (remarks of Robert Morgenthau).

³⁴ See pp. 203-11 *infra*.

³⁵ Most Swiss bank accounts are not truly anonymous. Generally, a few top officials of the bank know the name of the holder of a secret account. Although it is possible for a Swiss bank to legally accept deposits from an unknown person, only rarely

of Swiss banking secrecy³⁶ and the resulting enforcement problems of the SEC and the Justice Department³⁷ will also be discussed. Finally, various responses and solutions to the problems presented by the Swiss account will be considered and evaluated.³⁸

I. SWISS BANKING LAWS

In order to fully understand the use by United States citizens of Swiss bank accounts, it is instructive to examine the origin and applicability of Swiss banking secrecy laws.³⁹ Swiss banking laws protect the owner of a Swiss bank account from disclosure to third parties by the bank of information concerning the account.⁴⁰ The Swiss have historically considered the privacy of bank accounts a fundamental right.⁴¹ By 1912 a custom had firmly developed whereby Swiss banks were refusing to divulge any information regarding their clients' accounts.⁴² In 1934 this practice was codified by Article 47 of the Swiss Banking Law,⁴³ which provides as follows:

Whosoever as agent, official, employee of a bank, or as accountant or accountant's assistant, or as a member of the Banking Commission, or as a clerk or employee of its secretariat, violates the duty of absolute silence in respect to a *professional secret*, or whosoever induces or attempts to induce others to do so, will be punished with a fine of up to 20,000 francs, or with imprisonment of up to six months

will a bank accept large deposits without knowing the owner's name. See Friedrich, The Anonymous Bank Account in Switzerland, 79 Banking L.J. 961, 970 (1962).

³⁶ See "Swiss Banking Laws."

³⁷ See pp. 211-14 *infra*.

³⁸ See pp. 215-27 *infra*.

³⁹ For a thorough explanation of Swiss banking secrecy, see Friedrich, *supra* note 35; Meyer, The Banking Secret and Economic Espionage in Switzerland, 23 Geo. Wash. L. Rev. 284 (1955); Comment, Swiss Banking Secrecy, 5 Colum. J. of Transnat'l L. 128 (1966); Union Bank of Switzerland, Swiss Federal Banking Law (1968); Swiss Credit Bank, Banking Secrecy in Switzerland.

⁴⁰ Friedrich, *supra* note 35, at 961.

⁴¹ *Id.* at 964.

⁴² Fehrenbach 54.

The custom of banking secrecy which has developed in Switzerland is basically attributable to the Swiss penchant for personal independence in financial and political matters. During the 17th, 18th, and 19th centuries, Switzerland's neutrality was a great attraction to many refugees fleeing from the political and social turmoil of neighboring European countries. To insure the protection of these refugees, the custom of banking secrecy was strengthened.

⁴³ Swiss Credit Bank, *supra* note 39, at 1-2; Friedrich, *supra* note 35, at 964. In 1934 several factors influenced the Swiss to codify banking secrecy: (1) pressure from Nazi agents seeking to recover assets of German and Jewish refugees; (2) the private remedy available to an account holder for breach of banking secrecy was considered insufficient, for the evidence uncovered by this breach often led to a criminal conviction of the account holder; and (3) the high regard for financial privacy shared by the Swiss. See Comment, Swiss Banking Secrecy, *supra* note 39, at 128 n.1.

The codification was not motivated by commercial considerations, "e.g., protecting the valuable business of administering foreign 'hot money,'" Friedrich, *supra* note 35, at 964.

or both. If such an act is due to negligence, the penalty shall be a fine not exceeding 10,000 francs.⁴⁴ (Emphasis added.)

Although this statute does not specifically refer to Swiss bank accounts, the words "professional secret" have been interpreted to cover matters involving the banker-client relationship.⁴⁵ Article 47 prevents all banks from providing any information to third parties, including Swiss revenue authorities, concerning the financial affairs and business connections of their clients.⁴⁶ The proscription also applies to foreign governments, such as the United States, seeking information from Swiss banks concerning their nationals.⁴⁷ A banker who fails to abide by this obligation is not only subject to criminal sanctions but is also subject to civil liability.⁴⁸

Anyone who attempts to induce banking personnel to violate the duty of professional secrecy also becomes subject to the sanctions of Article 47, including, it would seem, agents of foreign governments. In fact, it has been asserted that the primary purpose behind the enactment of Article 47 was to protect Swiss banks from foreign espionage.⁴⁹

Article 273 of the Swiss Penal Code provides additional protection to owners of Swiss bank accounts. It states:

Whosoever explores *trade secrets* in order to make them accessible to foreign governments or foreign enterprises or foreign organizations or their agents, and whosoever makes such *trade secrets* accessible to foreign governments or or-

Another commentator gives the following reasons for the enactment of secrecy laws:

First, it put Switzerland on record before the world and its governments: foreign deposits would be protected. Second, it protected the banker, and gave him a legal as well as moral code to stand by: he was ordered not to talk, and punished if he did. Third, and too many outsiders overlooked this, the codification of bank secrecy satisfied many fears among native Swiss about their own government as well. Few Swiss ever really trusted the bureaucrats they employed in Bern.

Fehrenbach 62.

⁴⁴ This translation of Article 47 appears in Fehrenbach at 64. For other translations with only minor variations, see Comment, Swiss Banking Secrecy, *supra* note 39, at 129; Union Bank of Switzerland, *supra* note 39, at 17-18; Meyer, *supra* note 39, at 289-90. Until the enactment of Article 47, professional secrecy was considered

the secrecy of the classical professions, namely, those of the clergy, the lawyers and the physicians . . . The use of that term in Article 47 of the Banking Act together with the introduction of criminal sanctions seemed to justify the conclusion that the legislature intended to guarantee the clients of a bank full protection against violation of their secrets.

Id.

⁴⁵ Meyer, *supra* note 39, at 290.

⁴⁶ Union Bank of Switzerland, *supra* note 39, at 1-2.

⁴⁷ Meyer, *supra* note 39, at 290.

⁴⁸ Comment, Swiss Banking Secrecy, *supra* note 39, at 130. Civil liability is provided by Article 28 of the Swiss Civil Code.

⁴⁹ Meyer, *supra* note 39, at 290.

ganizations or private enterprises or to agents thereof, will be punished by imprisonment . . .⁵⁰ (Emphasis added.)

Article 273, unlike Article 47, is concerned only with the disclosure of information to foreign governments. While Article 47 applies only to banks, Article 273 applies to commercial, manufacturing and industrial enterprises as well as banks. The term "trade secret" has been interpreted by the Swiss judiciary to include "any fact which the person in possession of it considers worth keeping secret."⁵¹ Moreover, the Swiss courts have ruled that all information concerning bank accounts is included within this definition.⁵²

It is apparent, therefore, that these two provisions of Swiss law tend to inhibit United States law enforcement officials seeking to collect evidence concerning violations of United States securities laws. Moreover, the experience of the SEC and the Justice Department clearly demonstrate that Swiss banking laws are often the only obstacle preventing the indictment and prosecution of United States citizens using the banks for illegal purposes.⁵³

There are, however, limitations to the Swiss banking secrecy laws.⁵⁴ The Swiss Constitution has reserved to the Swiss cantons the exclusive right to decide procedural questions.⁵⁵ Since the cantonal courts try most cases,⁵⁶ and since the competency of witnesses is considered a procedural matter,⁵⁷ the cantonal procedural codes will generally determine if a banker must testify in court regarding an account.⁵⁸ It must be noted, however, that these cantonal procedural codes are effective only to the extent they do not conflict with Swiss Federal substantive law.⁵⁹ While some of the cantonal codes disqualify bankers from testifying, most of the codes leave the question of com-

⁵⁰ Fehrenbach 64. Another translation of Article 273 states:

Whoever, through searching, secures a *manufacturing or business secret*, in order to make it accessible to a foreign official agency, or to a foreign organization, or to a private enterprise, or to their agents,

whoever makes accessible a *manufacturing or business secret* to a foreign official agency, or to a foreign organization, or to a private enterprise, or to their agents,

shall be punished by imprisonment, in serious cases in the penitentiary. In addition a fine may be imposed. (Emphasis added.)

Letter from Rudolph Stettler, First Secretary, Embassy of Switzerland, Washington, D.C. to B.C. Ind. & Com. L. Rev., Oct. 3, 1969, on file in the Review office.

⁵¹ Friedrich, *supra* note 35, at 964.

⁵² Fehrenbach 64; Friedrich, *supra* note 35, at 964.

⁵³ Foreign Banking Hearing 9 (remarks of Fred M. Vinson, Jr.).

⁵⁴ See generally Comment, Swiss Banking Secrecy, *supra* note 39, at 132-35; Swiss Credit Bank, *supra* note 39, at 4-6.

⁵⁵ Meyer, *supra* note 39, at 291-92. Despite the exclusive reservation of power in procedural matters, the Swiss federal system operates similarly to the United States federal system in that inconsistent cantonal law is superceded by federal law. *Id.* at 291.

⁵⁶ *Id.*

⁵⁷ *Id.* at 292.

⁵⁸ *Id.*

⁵⁹ See note 55 *supra*.

petency to the discretion of the cantonal court.⁶⁰ In the latter situation, the cases in which a banker may be required to testify are usually limited to those involving violations of Swiss criminal law or those which concern bankruptcy proceedings, debt collection, family law and the law of inheritance.⁶¹ The disclosure of banking information in these types of cases is not considered a violation of Swiss banking secrecy legislation. In criminal cases the banker may disclose only information concerning the defendant. Information concerning persons indirectly affected by criminal judicial proceedings may not be disclosed.⁶²

These same limitations on banking secrecy laws extend to foreign governments with which Switzerland has judicial assistance treaties.⁶³ When the banking information is being sought in connection with a criminal case, however, no legal cooperation will be forthcoming unless the offense involved is identifiable with and punishable under a provision of the Swiss criminal legislation.⁶⁴ Furthermore, the requested assistance must not violate Swiss constitutional principles.⁶⁵

When foreign governments, such as the United States, seek banking information in connection with a criminal investigation, they are often denied assistance by Swiss banking authorities. The Swiss will not cooperate in such investigations unless the matter, had it occurred in Switzerland, would be considered a violation of Swiss criminal law. For example, the Swiss treat domestic tax matters and currency regulations as fiscal matters; such questions are handled administratively and are not prosecuted under Swiss criminal law.⁶⁶ In these administrative proceedings the Swiss banks are obliged to refuse information to Swiss tax and exchange control authorities.⁶⁷ Consequently, the Swiss Supreme Court has directed that a foreign government also may not be assisted in investigations concerning tax and currency matters despite the fact that the foreign government deems the offense involved a crime.⁶⁸

When the United States, therefore, seeks information from Swiss banks concerning a violation of United States laws, the Swiss courts must be satisfied that the information sought is not merely a fiscal matter.⁶⁹ When rejecting requests by foreign governments to examine bank records or during negotiation of a legal cooperation treaty, the Swiss have explained their refusal to cooperate in fiscal

⁶⁰ Meyer, *supra* note 39, at 292.

⁶¹ Swiss Credit Bank, *supra* note 39, at 5-6.

⁶² *Id.* at 6-7.

⁶³ Comment, Swiss Banking Secrecy, *supra* note 39, at 134. Although experience has shown that the existence of a treaty will expedite judicial assistance, Switzerland has extended assistance to countries with which it has no treaty. *Id.*

⁶⁴ Swiss Credit Bank, *supra* note 39, at 7.

⁶⁵ *Id.*

⁶⁶ Friedrich, *supra* note 35, at 963 (tax matters); Foreign Banking Hearing 23 (remarks of Fred M. Vinson, Jr., on currency regulations).

⁶⁷ Friedrich, *supra* note 35, at 963.

⁶⁸ Fehrenbach 65; Friedrich, *supra* note 35, at 963.

⁶⁹ Friedrich, *supra* note 35, at 963.

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matters by stating that if they did so, foreign governments would have powers within Switzerland not even possessed by Swiss authorities.⁷⁰

In light of the administrative treatment of tax and currency matters in Switzerland, the question arises whether violations of United States securities laws would also be considered fiscal matters. If so considered, the Swiss banking laws will apply and the banks and courts will not cooperate. This is a difficult question because only one of many aspects of a fact situation may be fiscal in nature. Whether that aspect alone is sufficient to make the entire case a fiscal matter under Swiss law is unclear and has not been answered by the Swiss courts. Conversely, if only one aspect of a foreign case is considered criminal under Swiss law, it is uncertain whether this is sufficient to bring the case within the judicial exception to Articles 47 and 273. In order for the SEC and the Justice Department to obtain assistance from Swiss banking authorities, it appears that the securities statute or regulation violated would have to be identifiable with a similar provision under Swiss law. Since Switzerland does not presently have criminal securities laws,⁷¹ it is unlikely that a violation of United States securities law would be identifiable with another Swiss criminal statute. However, if the investigation concerns both a violation of the United States securities laws and a violation of another criminal statute which would also be considered a violation of Swiss criminal law, it is possible that this latter identity would be considered sufficient to enable Swiss authorities to divulge banking information. Unfortunately, most situations in which the United States has sought information from Swiss banks have involved circumstances where there has not been an analogous criminal statute in Switzerland.⁷²

II. SWISS BANKS AND THE UNITED STATES SECURITIES LAWS

As a result of the enactment of Swiss banking secrecy laws, United States citizens who wish to conceal transactions which constitute violations of the securities statutes and regulations have found Swiss banks an attractive medium for masking their transactions. Although it is theoretically possible for a United States citizen to violate many sections of the securities laws and regulations, it appears that Sections 5 and 17 of the Securities Act of 1933,⁷³ Sections 7, 10,

⁷⁰ *Id.* at 962.

⁷¹ *N.Y. Times*, Nov. 30, 1969, at 62, col. 1.

During the 1968 congressional hearings on foreign banking practices, the question arose whether margin requirements would be considered fiscal matters in Switzerland. "As to margin requirements, that is in a gray area. I am sure there would be some who would take the position that that is fiscal and administrative and not criminal, even though it is criminal under our laws." Foreign Banking Hearing 23-24 (remarks of Fred M. Vinson, Jr.).

⁷² The possibility of a treaty being negotiated which would exempt some United States securities laws violators from the protection of the "fiscal matters" concept will be discussed at p. 215 *infra*.

⁷³ 15 U.S.C. §§ 77a et seq. (1964).

14 and 16 of the Securities Exchange Act of 1934,⁷⁴ and certain regulations passed pursuant thereto, have been, or could be, subject to the greatest abuse.

Section 5 of the Securities Act of 1933⁷⁵ prohibits a person from using the mails or other instruments of interstate commerce to sell or to offer to sell securities unless a registration statement has been filed. Section 17 of the Securities Act of 1933⁷⁶ makes it unlawful for any person to utilize the instruments of interstate commerce to defraud, make untrue statements, omit material facts, or to otherwise deceive a purchaser with respect to any security offered for sale. By

⁷⁴ 15 U.S.C. §§ 78a et seq. (1964).

⁷⁵ 15 U.S.C. § 77e (1964) provides:

(a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments or transportation, any such security for the purpose of sale or for delivery after sale.

(b) It shall be unlawful for any person, directly or indirectly

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this subchapter, unless such prospectus meets the requirements of section 77j of this title; or

(2) to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 77j of this title.

(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 77h of this title.

⁷⁶ 15 U.S.C. § 77q (1964) provides in part:

(a) It shall be unlawful for any person in the offer or sale of any security by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

(b) It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective of such consideration.

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using Swiss banks to shroud their illegal transactions, American principals have been able to violate Sections 5 and 17 of the Securities Act and to realize large profits at the expense of the investing public. For example, in *United States v. Kelly*⁷⁷ the defendants were tried and convicted of crimes relating to the sale of millions of dollars worth of unregistered securities of Gulf Coast Leaseholds, Inc., an oil company "engaged in limited exploratory and development work."⁷⁸ Gulf Coast's income was derived, and its expenses were incurred, mainly from the purchase and sale of non-producing properties. Two of the defendants were American promoters who owned controlling interests in the oil company. They, with others, including members of an investment newsletter service, were charged with conspiracy to sell Gulf Coast stock in violation of Sections 5 and 17 of the Securities Act.⁷⁹

The American promoters established "Liechtenstein trusts"⁸⁰ to conceal the fact that they were involved in the stock fraud. The trusts purchased large blocks of Gulf Coast stock at very low prices through secret Swiss bank accounts. Subsequently, the investment newsletter service made fraudulent advertisements which greatly exaggerated the resources, income and potential of Gulf Coast.⁸¹ As a result of such fraudulent manipulation, Gulf Coast stock rose from less than \$1 per share to approximately \$16, whereupon the American promoters, through their "Liechtenstein trusts" and the secret Swiss bank accounts, liquidated their holdings. Shortly thereafter, the stock fell drastically in price and the innocent purchasers of Gulf Coast suffered heavy losses.

Although it eventually became apparent that Sections 5 and 17 of the Securities Act were violated, it was exceedingly difficult for United States authorities to discover that American citizens were the promoters of the transactions.⁸² In fact, if one of the conspirators had

⁷⁷ 349 F.2d 720 (2d Cir. 1965), cert. denied, 384 U.S. 947 (1966). This case, popularly known as the *Gulf Coast Leaseholds* case, was mentioned before the Foreign Banking Hearing by Robert Morgenthau as a prime example of how Swiss banks have been utilized by Americans to conceal illegal securities activities. Foreign Banking Hearing 12-13. See also Fehrenbach 120-22.

⁷⁸ 349 F.2d at 730.

⁷⁹ Specifically, the defendants were charged with violating 18 U.S.C. § 371 (1964).

⁸⁰ For the characteristics and advantages of Liechtenstein trusts and foundations, see Gibson 43-48. One of the features of transacting business in Liechtenstein is that its banking laws closely resemble the secrecy laws of Switzerland. Id. at 44.

⁸¹ One bulletin falsely advertised "that each of the 1.4 million shares outstanding is backed by over \$35 of oil; a truly amazing sum for so young a producer" and that "Gulf Coast Leaseholds is believed capable of climbing to as high a price as \$50 per share within the intermediate period." 349 F.2d at 744.

⁸² Speaking before a congressional committee, Robert Morgenthau pointed out the difficulties encountered in investigating the Gulf Coast stock conspiracy:

[B]efore the indictment, the Swiss lawyer who ran two of the trusts, filed affidavits with governmental authorities conducting the investigation, stating that these trusts were not owned or controlled by Americans, even though he knew that these affidavits were false. When cross-examined about the affidavits at trial, he took the position that his duty to his American clients obligated him to make these false statements. As a result, the promoters of the stock fraud, during the period of the SEC's initial investigation, were able to use the Swiss

not divulged the details of this fraudulent activity, it is unlikely that the Government could have successfully convicted the two United States citizens.⁸³

Section 10(b) of the Securities Exchange Act of 1934⁸⁴ and Rule 10b-5⁸⁵ adopted thereunder make it unlawful for any person by the use of the mails or interstate facilities to commit a fraudulent act in connection with the purchase or sale of any security.⁸⁶ As in *Kelly*, secret Swiss bank accounts could be used to shield the identity of United States citizens who violate section 10(b) and rule 10b-5.⁸⁷ Another regulation adopted under section 10(b) which is subject to abuse is rule 10b-6.⁸⁸ This rule prohibits trading in a security by persons interested in its distribution and deems such an act a "manipulative and deceptive device" contrary to the provisions of section 10(b).⁸⁹ Persons interested in a distribution of securities include an

secrecy laws as a shield behind which they could operate anonymously. By the time the secrecy had been dispelled, the public had been bilked of millions of dollars.

Foreign Banking Hearing 13.

⁸³ *Id.* at 12.

⁸⁴ 15 U.S.C. § 78j (1964) provides in part:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or the mails, or of any facility of any national securities exchange

....
(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

⁸⁵ 17 C.F.R. § 240.10b-5 (1968).

⁸⁶ Section 10(b) and rule 10b-5 differ from Section 17 of the Securities Act of 1933 in that the former apply to fraudulent purchases and sales while the latter applies only to fraudulent sales.

⁸⁷ See, e.g., *United States v. Dolin*, 69 Crim. 336, Indictment (S.D.N.Y., filed April 11, 1969), where the defendants use Swiss banks to conceal a scheme to defraud the Realty Equities Corporation of New York and its stockholders. Defendant-Deutsch was an officer of the corporation and conspired with defendant-Dolin to arrange the assignment and transfer to a Swiss bank of the corporation's rights in a certain promissory note and warrants at a price much lower than market value. The defendants arranged for the Swiss bank's repurchase of the note and warrants from the promisee. The defendants then arranged for the Swiss bank to sell the notes and warrants to another corporation at a price substantially higher than the price which the Swiss bank had paid. The profits of the sale accrued to one of the defendants who had owned a secret Swiss account. Swiss banking secrecy enabled the defendant to camouflage his interest in the transactions. Both defendants were eventually indicted for a violation of rule 10b-5. *Id.* at 7.

⁸⁸ 17 C.F.R. § 240.10b-6 (1968).

⁸⁹ Rule 10b-6 provides in part:

(a) It shall constitute a "manipulative or deceptive device or contrivance" as used in section 10(b) of the act for any person,

(1) Who is an underwriter or prospective underwriter in a particular distribution of securities, or

(2) Who is the issuer or other person on whose behalf such a distribution is being made, or

(3) Who is a broker, dealer, or other person who has agreed to participate or is participating in such a distribution, directly or indirectly, by the use of

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underwriter, an issuer, broker, and a dealer. Such persons easily evade rule 10b-6 by channeling their purchases through secret Swiss bank accounts.

Another section of the Securities Exchange Act which has been abused by means of the secret Swiss bank account is Section 14.⁹⁰ Section 14(a) makes it unlawful to solicit proxies in violation of the SEC's proxy rules.⁹¹ Rule 14a-11,⁹² established pursuant to section 14, requires participants⁹³ other than the issuer in proxy contests to file with the Commission and the appropriate securities exchange on which the stock involved is registered a statement, Schedule 14B,⁹⁴ in which certain information must be included. The identity and background of the participant must be disclosed as well as any legal or beneficial interests which the participant has in the issuing corporation.⁹⁵ Also, rule 14a-3⁹⁶ states that no solicitation subject to the proxy rules may be made unless each person solicited is furnished concurrently or previously a written proxy statement containing the information specified in Schedule 14A.⁹⁷ This schedule requires, among other things, disclosure of any "substantial" interest of the solicitors.⁹⁸ In an election of directors, the solicitor must list the nominee's beneficial holdings in the issuer or a parent or subsidiary of the issuer.⁹⁹ The purpose of section 14(a) and the regulations is to prevent a person from gaining or maintaining control of a corporation unless he discloses his interests in the corporation. In order that the stockholder may have adequate knowledge as to the manner in which his interests are being served, it is essential that he be enlightened with respect to the person or persons who are seeking control of the corporation. Solicitors in proxy contests have evaded these regulations by concealing, through secret bank accounts, their interests in the issuer corporation.¹⁰⁰ Often, a Swiss bank will hold record ownership of the securities, and, on authorization of the account owner, solicit and vote proxies on his behalf.

any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, . . . to bid for or purchase for any account in which he has a beneficial interest, any security which is the subject of such distribution, . . . or to attempt to induce any person to purchase any such security or right until after he has completed his participation in such distribution. . . .

Id.

⁹⁰ 15 U.S.C. § 78n (1964).

⁹¹ 15 U.S.C. § 78n(a) (1964).

⁹² 17 C.F.R. § 240.14a-11(c)(1) (1968).

⁹³ For the definition of a participant, see 17 C.F.R. § 240.14a-11(b) (1968).

⁹⁴ 17 C.F.R. § 240.14a-102 (1968).

⁹⁵ 17 C.F.R. § 240.14a-102, items 2 and 3 (1968).

⁹⁶ 17 C.F.R. § 240.14a-3 (1968).

⁹⁷ 17 C.F.R. § 240.14a-101 (1968).

⁹⁸ 17 C.F.R. § 240.14a-101, item 4 (1968).

⁹⁹ 17 C.F.R. § 240.14a-101, item 6 (1968).

¹⁰⁰ SEC Legislation Hearings 178 (remarks of Senator Frank J. Lausche). In the past Swiss banks have been used by financiers secretly attempting to gain control of American corporations. However, it is generally true that the larger Swiss banks do not

Section 16 of the Securities Exchange Act¹⁰¹ has also been evaded through the use of secret Swiss accounts. Section 16(a)¹⁰² requires "insiders" (directors, officers, and certain principal shareholders of a corporation) to file with the Commission and with the exchange on which the securities are registered statements concerning their beneficial ownership in the issuer corporation. A statement is required when a person initially becomes an insider, or when a corporation in which a person is already an insider registers on an exchange. Finally, an insider is required to report monthly any changes in his beneficial ownership of stock in a corporation in which he is an insider.¹⁰³ Section 16(b) of the Securities Exchange Act¹⁰⁴ further requires that, in order to prevent the unfair use of inside information, any profit realized by an insider from the purchase and sale of securities involved within six months thereof shall inure to the benefit of the issuer corporation. Civil suits to recover such profits not returned to the issuer may be instituted by the issuer or by a stockholder on the issuer's behalf.¹⁰⁵

The foregoing provisions of the Securities Exchange Act can easily be evaded by an insider who conceals beneficial ownership of his securities in a secret Swiss bank account. In *United States v. Orovitz*,¹⁰⁶ the defendant was the director and treasurer of a corporation and exercised control, through his own holdings and those of his wife, over nearly 10 percent of one of its debenture issues worth over \$12 million. At trial it was established that the defendant himself was the beneficial owner of \$250 thousand of these debentures, and that he had taken advantage of his inside information, which included knowledge of an impending change in management, to effect a sale of his interests. He was able to conceal his beneficial ownership of the securities by maintaining their record ownership in the name of a Swiss bank. The Government was able to prove that Orovitz owned the securities despite the fact they were held in a Swiss account. Orovitz was convicted for violating Section 16(a) of the Securities Exchange Act by wilfully failing to file a monthly report.

willingly allow themselves to become engaged in American proxy fights. In fact, the Swiss Banker's Association has advised the Swiss banks to vote stock held by them only in favor of management proposals. Comment, *Swiss Banking Secrecy*, *supra* note 39, at 135; Fehrenbach 125.

¹⁰¹ 15 U.S.C. § 78p (1964).

¹⁰² 15 U.S.C. § 78p(a) (1964). This section provides in part: Every person who is directly or indirectly the beneficial owner of more than 10 percentum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, or who is a director or an officer of the issuer of such security, shall file . . . a statement with the exchange (and a duplicate original thereof with the Commission). . . .

¹⁰³ To comply with this requirement, the insider must submit Form 4. 17 C.F.R. § 240.16a-1(a) (1968).

¹⁰⁴ 15 U.S.C. § 78p(b) (1964).

¹⁰⁵ 15 U.S.C. § 78p(b) (1964).

¹⁰⁶ *United States v. Orovitz*, 66 Crim. 485, Indictment (S.D.N.Y., filed 1968). A partial transcript and the sentence appear in *Foreign Banking Hearing* 55-61.

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Section 7 of the Securities Exchange Act¹⁰⁷ has been subject to abuse not only by United States citizens but also by the Swiss banks themselves. Section 7, in order to prevent the excessive use of credit for the purchase or carrying of securities, authorizes the Federal Reserve Board to prescribe margin requirements.¹⁰⁸ The Federal Reserve Board adjusts the margin requirements periodically and has promulgated Regulations T,¹⁰⁹ U,¹¹⁰ and G,¹¹¹ which stipulate the amount of credit that brokers, banks, and others who extend credit on certain securities may supply on a retail level.¹¹² Presently the margin rate is 80 percent of the purchase price.¹¹³ United States citizens have utilized Swiss banks to evade these margin requirements.¹¹⁴

Swiss banks and other foreign financial institutions, unlike banks in the United States, perform for their customers many services which are handled only by brokers in this country.¹¹⁵ Because of the brokerage functions they perform, the Swiss banks come within the definition of "brokers" and "dealers" as set forth in the Securities Exchange Act of 1934.¹¹⁶ As a result, Swiss banks, like other American brokers, have been able to transact their securities business in the United States using the "special omnibus account."¹¹⁷ This account provides for an exemption from the general margin requirements of Regulation T, and allows a member of a securities exchange to make wholesale transactions¹¹⁸ for other brokers, including Swiss banks, without regard to margin requirements. Brokers and Swiss banks utilizing this type of account must certify that they are not extending credit to their customers except in accordance with Regulation T.¹¹⁹ Thus, at present,

¹⁰⁷ 15 U.S.C. § 78g (1964).

¹⁰⁸ 15 U.S.C. § 78g(a) (1964). "Margin" refers to the minimum amount of cash which a customer must supply when purchasing securities on credit. The purpose of margin requirements is to restrict the aggregate amount of national credit resources directed into stock market speculation and to thereby insure a balanced use of credit resources in commerce, industry, and agriculture. See 2 CCH Fed. Sec. L. Rep. ¶ 22,011, at 16,052; H.R. Rep. No. 1383, 73d Cong., 2d Sess. 8 (1934).

¹⁰⁹ 12 C.F.R. § 220 (1969).

¹¹⁰ 12 C.F.R. § 221 (1969).

¹¹¹ 12 C.F.R. § 206 (1969).

¹¹² Retail level refers to transactions between a broker and any ordinary customer. This is to be contrasted with transactions between broker-dealers and members of a national securities exchange which would constitute business on a wholesale level. Some wholesale transactions, those involving the use of the special omnibus account, are exempt from margin restrictions imposed on the retail level.

¹¹³ SEC Reg. T, 12 C.F.R. § 220.8(a) (1969); SEC Reg. U, 12 C.F.R. § 221.4(a) (1969); SEC Reg. G, 12 C.F.R. § 207.5(a) (1969).

¹¹⁴ See Foreign Banking Hearing 13 (remarks of Robert Morgenthau); *id.* at 18-19 (remarks of Irving M. Pollack).

¹¹⁵ Foreign Banking Hearing 19 (remarks of Irving M. Pollack).

¹¹⁶ *Id.* Section 3 of the Securities Exchange Act of 1934 defines the terms "broker" and "dealer." 15 U.S.C. § 78c(a)(4), (5) (1964).

¹¹⁷ Foreign Banking Hearing 19 (remarks of Irving M. Pollack). The original definition of "special omnibus account" is found in 12 C.F.R. § 220.4(b) (1969). This definition has, however, been changed. See 12 C.F.R. § 220.4(b) (1970), and pp. 220-22 *infra*.

¹¹⁸ See note 112 *supra*.

¹¹⁹ See Foreign Banking Hearing 19 (remarks of Irving M. Pollack).

any broker using the "special omnibus account" who extends more than 20 percent credit to a customer on any transaction violates the Regulation.

Most American brokers who abused the "special omnibus account" by violating the retail margin requirements could be detected since they were registered with the SEC.¹²⁰ Swiss banks, however, have not had to register with the SEC, and this fact, coupled with their banking secrecy laws, gave them the ability to ignore the margin requirements at the retail level.¹²¹ The fact that margin requirements have been relatively high in recent years has led to speculation that Americans might be obtaining excessive and illegal credit from Swiss banks.¹²²

In *United States v. Coggeshall & Hicks*¹²³ it was established that Americans were evading margin requirements. Coggeshall & Hicks, a New York brokerage firm, was indicted for participating in a scheme with the Arzi Bank of Zurich¹²⁴ enabling customers to purchase securities on a margin as low as 20 percent. The Arzi Bank had opened a "special omnibus account" with the brokerage firm. It then conspired with Coggeshall & Hicks to permit customers and members of the firm who had secret accounts with the bank to escape margin restrictions. Knowledge of the customers' identities and the transactions made on their behalf were kept secret by placing and executing securities orders in the name of the Arzi Bank. It was estimated that nearly \$20 million worth of registered securities were purchased on the basis of illegal credit extensions through the Arzi Bank's "special omnibus account." These undermargined transactions enabled the brokerage firm to earn over \$250 thousand in commissions. Coggeshall & Hicks was charged with, and eventually pleaded guilty to, violations of Regulation T.

On July 8, 1969, Regulation T was revised in an effort to prevent such schemes as perpetrated by the Arzi Bank and Coggeshall & Hicks.¹²⁵ The prerequisites for using the "special omnibus account" were changed by this revision. The probable effectiveness of the new regulation in preventing Swiss and other foreign banks from allowing United States citizens to avoid margin requirements will be discussed later in the comment.¹²⁶

The current and potential abuses of the securities statutes and regulations resulting from the use of secret Swiss accounts by United

¹²⁰ In fiscal 1959, for example, 170 brokers were found to be violating the margin provisions of Regulation T. See 25 SEC Ann. Rep. 107 (1959).

¹²¹ See Foreign Banking Hearing 19 (remarks of Irving M. Pollack).

¹²² Foreign Banking Hearing 10.

¹²³ 69 Crim. 431, Indictment (S.D.N.Y., filed May 16, 1969).

¹²⁴ See *United States v. Arzi Bank, A.G.*, 68 Crim. 1011, Indictment (S.D.N.Y., filed Dec. 19, 1968).

¹²⁵ 12 C.F.R. § 220.4 (1970). For a detailed explanation of this amendment, see Current CCH Fed. Sec. L. Rep. ¶ 77,717, at 83,639-645 (press release of the Board of Governors of the Federal Reserve System, June 6, 1969).

¹²⁶ See pp. 220-22 *infra*.

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States citizens are evident. They have been used to violate or evade the registration, antifraud, insider and margin provisions of United States securities statutes and regulations. Congress therefore is clearly justified in concerning itself with the influence of Swiss banking practices on the American economy and in increasing the law enforcement capabilities of the SEC.

Once it has been recognized that securities laws are being violated, the problem becomes one of detecting the violators. Considering the impact of these illegal activities on the stability of and public confidence in United States securities markets,¹²⁷ effective detection and prosecution of violators becomes essential. Measures must be taken to prevent such injuries to the investing public as came to light in *United States v. Kelly*.

III. ENFORCEMENT PROBLEMS

The ability of the SEC and the Justice Department to enforce the securities laws is affected by two factors. The first factor is the impediment presented by the Swiss banking secrecy laws themselves. Second, the continuing attractiveness of Swiss banks to some United States citizens may outweigh any deterrent effect which the conviction of other citizens might have.

The usual and the easiest way for the SEC to detect a securities law violation is to trace the series of transactions that transpire when a customer purchases stock.¹²⁸ If, however, a Swiss financial institution is involved in one or more of the transactions, the identity of those persons beneficially owning or illegally profiting from the transactions cannot be determined.¹²⁹ Thus, the evidence necessary for a successful prosecution is, in effect, withheld by Swiss secrecy.

The records maintained by United States brokers are often not very helpful in tracing transactions involving Swiss banks. In many cases the banks will buy securities without disclosing for which account it is acting. It is not only impossible to determine the identities of persons using Swiss bank accounts, but it is also impossible to ascertain whether or not the Swiss banks may be buying or selling securities for a coded account.¹³⁰

Also complicating the SEC's job in obtaining competent evidence concerning transactions involving Swiss banks is the ease with which money can be transferred to a secret account.¹³¹ False names are often given by depositors and the identity checks of depositors by United States banks transferring money to Swiss accounts are generally not very rigid.¹³² Thus, a United States citizen attempting to violate the securities laws could easily deposit a large sum of money in a Swiss

¹²⁷ See p. 198 *supra*.

¹²⁸ See SEC Enforcement Hearing 44-45 (remarks of SEC Chairman J. Sinclair Armstrong); Foreign Banking Hearing 9 (remarks of Fred M. Vinson, Jr.).

¹²⁹ *Id.*

¹³⁰ Foreign Banking Hearing 12 (remarks of Robert Morgenthau).

¹³¹ *Id.* at 15. See p. 198 *supra*.

¹³² *Id.*

bank by using an American bank as a conduit. By merely giving a false name to the American bank, a person often will prevent his identity from being ascertained in a later investigation. As mentioned earlier, Swiss banking secrecy laws prevent the extraterritorial discovery of evidence. On occasions when the SEC and Justice Department have sought to elicit information from the Swiss, either directly or through the State Department, these federal agencies have been informed that Swiss law prohibits the disclosure of information by Swiss banks in fiscal matters.¹³³ This inability to obtain Swiss bank records often renders prosecution arduous or even impossible.¹³⁴ As the origin, codification, and significance of banking secrecy in Switzerland clearly indicate, Swiss refusal to cooperate with American investigators is not motivated by malice toward the United States.¹³⁵ Nonetheless, without Swiss cooperation, the SEC can determine the identities of violators of the securities laws only by inference, circumstantial evidence or through a confession of one of the parties involved in the transaction.¹³⁶

The SEC and Justice Department occasionally overcome the problem of obtaining evidence when Swiss banks are involved, thus increasing the chances of securing a prosecution and conviction. However, these cases are believed to represent a very low percentage of the violations perpetrated through secret accounts.¹³⁷ Such a belief is well founded considering the many advantages of Swiss banks to the pursuit of unlawful profits in securities. Not only can unlawful activities be screened behind the banking secrecy laws, but also profits emanating from these activities are easier to hide from the IRS.¹³⁸ Further-

¹³³ SEC Enforcement Hearings 45 (remarks of J. Sinclair Armstrong).

¹³⁴ Even in cases where we can successfully prosecute, it is necessary to spend thousands of man hours in piecing together complex and seemingly unrelated transactions in order to obtain indirectly information that banks will not directly furnish us. But naturally, we have received virtually no cooperation from the foreign banks which hold the evidence of crime. Often we have had very complete information on criminal activity, but have been unable to prosecute because the foreign bankers would not furnish witnesses competent to introduce their banking documents into evidence. As a result it should be obvious that the increasing number of successfully prosecuted criminal cases represents only a small fraction of crimes committed by Americans through secret foreign accounts.

Foreign Banking Hearing 11-12 (remarks of Robert Morgenthau).

¹³⁵ See pp. 199-203 *supra*.

¹³⁶ Foreign Banking Hearing 13 (remarks of Robert Morgenthau); SEC Enforcement Hearings 45 (remarks of J. Sinclair Armstrong).

¹³⁷ See note 134 *supra*.

¹³⁸ It should be noted, however, that Americans do not completely escape United States taxation by using Swiss accounts. The 1951 Tax Agreement between Switzerland and the United States imposes a tax of 15% on dividends received from American corporations. If the holder of the securities is an American citizen, the Swiss bank withholds another 15% which is forwarded to the I.R.S. Significantly, however, capital gains are not subject to withholding by Swiss banks. Convention with the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, May 24, 1951, [1951] 2 U.S.T. 1753, T.I.A.S. No. 2316 (effective October 1, 1951). See also p. 216 *infra*.

more, these profits may then be used to speculate in precious metals, a practice which is severely restricted in the United States. As a result of such speculation, the securities laws violator would have a hedge against continuing inflation in the United States and the possibility of future devaluation of the dollar.¹³⁹ When these considerations are added to the safety and stability of Swiss banks and the expertise of their investment managers, it is apparent that the few prosecutions and convictions which have taken place will have limited deterrent effect.

In order to better understand the problem of enforcement, it is instructive to examine a case involving Swiss banking secrecy which was settled only after protracted litigation. *Société Internationale pour Participations Industrielles et Commerciales, S.A. v. Rogers*¹⁴⁰ illustrates the problems of obtaining competent evidence and bringing a case to a speedy conclusion when a Swiss bank is used to conceal the beneficial ownership of securities. I.G. Farbenindustrie (Farben), a giant German chemical and dye company, cognizant of the poor German image among Americans following World War II decided to disguise its holdings in a United States corporation, General Aniline and Film. To conceal its ownership of General Aniline stock, Farben created a Swiss holding company, I.G. Chemie (Interhandel), to which it transferred its holdings in General Aniline. Interhandel thereby acquired record ownership of 90 percent of the stock of General Aniline.¹⁴¹ During World War II, the Alien Property Custodian of the United States, suspecting that General Aniline was owned by German nationals, seized pursuant to Section 5(b) of the Trading With the Enemy Act¹⁴² assets of the company consisting of \$100 million cash and about 90 percent of its capital stock.

In 1948, Interhandel¹⁴³ brought suit against the Attorney General as successor to the Alien Property Custodian¹⁴⁴ to recover the seized assets of General Aniline on the ground that these assets were owned by nationals of Switzerland, a neutral country during the war, and not by nationals of Germany. Upon the motion of the Attorney General the district court ruled, pursuant to Rule 34 of the Federal Rules of Civil Procedure,¹⁴⁵ that Interhandel must produce a large number of

¹³⁹ For arguments why investments made through Swiss banks provide protection against inflation and devaluation, see Gibson 10-29.

¹⁴⁰ 357 U.S. 197 (1958), noted in 46 Calif. L. Rev. 836 (1958); 107 U. Pa. L. Rev. 103 (1958).

¹⁴¹ See Fehrenbach 213-36 for a detailed account of the expansion of Farben and the behind the scenes activities of its directors which led to the formation of Interhandel.

¹⁴² 40 Stat. 415 (1917), as amended, 50 U.S.C. App. § 5(b) (1964).

¹⁴³ In 1945 I.G. Chemie, in an effort to improve its image abroad, changed its name to French-Société Internationale pour Participations Industrielles et Commerciales, S.A. The new French name translated in German as Interhandel, and it was by this name that the Swiss holding company became more commonly known. See Fehrenbach 229.

¹⁴⁴ Suit was initiated pursuant to Section 9(a) of the Trading With the Enemy Act. 40 Stat. 419 (1917), as amended, 50 U.S.C. App. § 9(a) (1964).

¹⁴⁵ Fed. R. Civ. P. 34 provides in part:

Upon motion of any party showing good cause therefor and upon notice to

banking records held by H. Sturzenegger and Cie, a Swiss banking firm alleged to have collaborated with I.G. Chemie and Farben in camouflaging the ownership of General Aniline.¹⁴⁶ The records were seized, however, by the Swiss Federal Attorney to prevent violation of Swiss banking laws which would have occurred if the bank had divulged the information. The District Court for the District of Columbia then dismissed the case for non-compliance with its production order.¹⁴⁷ After the Court of Appeals for the District of Columbia affirmed,¹⁴⁸ the Supreme Court reversed and held that Interhandel had made a good faith effort to comply with the production order, and that a trial on the merits was possible.¹⁴⁹ Meanwhile, Switzerland, acting on behalf of Swiss minority stockholders who had never known that Interhandel had been controlled by Farben, sought a decision on the case in the International Court of Justice.¹⁵⁰ The International Court refused to hear the case because remedies in the United States had not been exhausted.¹⁵¹ The case was eventually settled in 1964, the settlement providing that Interhandel and the United States would share the proceeds from a public sale of the General Aniline stock.¹⁵²

Although this case involved a Swiss company attempting to recover assets the beneficial ownership of which was concealed by utilizing Swiss banks, instead of the usual case of the United States Government seeking to pierce Swiss secrecy to obtain evidence of a securities law violation by a United States citizen, it exemplifies the protracted and internationally sensitive character litigation involving Swiss banks can assume. It further demonstrates the difficulties encountered by the United States when its discovery orders conflict with Swiss banking secrecy laws, and shows the lengths to which the Swiss Government will go to maintain the integrity of banking secrecy laws. Thus, the differences between the Swiss and United States legal systems are a major obstacle to the SEC's efforts to successfully prosecute United States securities laws violators.

other parties, . . . the court in which an action is pending may (1) order any party to produce and permit the inspection and copying or photographing, by or on behalf of the moving party, of any designated documents, papers, books, accounts, letters, photographs, objects, or tangible things, not privileged, which constitute or contain evidence relating to any of the matters within the scope of the examination permitted . . . and which are in his possession, custody, or control. . . .

¹⁴⁶ *Société Internationale, etc. v. Clark*, 9 F.R.D. 263, 267 (D.D.C. 1949).

¹⁴⁷ *Société Internationale, etc. v. McGranery*, 111 F. Supp. 435, 448 (D.D.C. 1953). The dismissal, however, was stayed for three months. *Id.*

¹⁴⁸ *Société Internationale, etc. v. Brownell*, 243 F.2d 254 (D.D.C. 1957).

¹⁴⁹ 357 U.S. at 212-13. On remand, however, the case never came to trial. *Fehrenbach* 233.

¹⁵⁰ *Fehrenbach* 233.

¹⁵¹ *Interhandel Case*, [1959] I.C.J. 6.

¹⁵² For details of the settlement, see *Société Internationale, etc. v. Kennedy*, Civil No. 4360-48 (D.D.C., filed April 15, 1963) as cited in 3 Int'l Legal Materials 428 (1964). The public sale was finally held in March, 1965. *Fehrenbach* 235.

IV. PRIOR PROPOSALS

Several recommendations have been made to increase the power of the SEC to prevent violations of securities laws by United States citizens using secret Swiss bank accounts. These recommendations include the negotiation of a judicial assistance agreement facilitating the collection of evidence in criminal matters pending before United States courts, amending the present securities laws, and changing domestic banking practices to aid the SEC in obtaining evidence.

A number of factors must be considered in the evaluation of the potential success of any solution. First, it is necessary that the proposal be effective in aiding the SEC and the Justice Department obtain evidence of securities laws violations while reflecting practical consideration of the problems of enforcement. Second, any proposal should attempt to mitigate untoward international political and economic effects. Third, the costs and time required to implement and administer the plan should not be prohibitive.

A. *Treaty*

When congressional committees in 1957 and 1968 investigated the effect of Swiss financial institutions on the ability of United States citizens to violate securities laws, hopes were expressed for a treaty with Switzerland providing for cooperation in the detection of United States securities laws violations.¹⁵³ Preliminary negotiations with Switzerland regarding this problem occurred in April, 1969;¹⁵⁴ additional discussions with the Swiss are currently taking place.¹⁵⁵ As of September, 1969, little progress has been made toward the affectuation of a treaty.¹⁵⁶

This reported lack of progress is understandable. The Swiss will not compromise their banking secrecy laws in order to help the United States detect violations of its securities laws. When the Swiss Federal Council¹⁵⁷ was questioned in June of 1969 with regard to measures

¹⁵³ See SEC Legislation Hearings 16, 53 (remarks of J. Sinclair Armstrong); Foreign Banking Hearing 23 (remarks of Fred M. Vinson, Jr.).

¹⁵⁴ Letter from Rudolph Stettler, First Secretary, Embassy of Switzerland, Washington, D.C., to B.C. Ind. & Com. L. Rev., October 3, 1969, on file in the Review office with enclosure in which the Swiss Federal Council answered a question of Mr. Ziegler, member of the Swiss National Council, concerning treaty discussions.

¹⁵⁵ Letter from Robert M. Beaudry, Country Director, Italy-Austria-Switzerland, Dept. of State, to B.C. Ind. & Com. L. Rev., October 9, 1969, on file in the Review office.

¹⁵⁶ "Representatives of State, Justice and the Securities and Exchange Commission are involved in these negotiations and it is reported that little progress was made." Letter from Representative Wright Patman, Chairman, Comm. on Banking & Currency to B.C. Ind. & Com. L. Rev., Sept. 8, 1969, on file in the Review office.

¹⁵⁷ The Federal Council is the executive body of the Swiss national government. It is composed of seven members elected for four-year terms by the national legislature. No more than one member can be from the same canton. One member of the Council is chosen annually to act as president of Switzerland. The other two major organs of the Swiss government are the Federal Assembly (or national legislature) and the Federal Tribunal. 26 Encyclopedia Americana 147-48 (1961).

which the Federal Council intended to take to facilitate legal cooperation between the United States and Switzerland, that governmental body's reply included the affirmation that "[t]he principle that Switzerland will not render assistance in fiscal matters will be adhered to."¹⁵⁸ The Federal Council also simplistically observed that the United States is principally responsible for the prosecution of crime in its own territory,¹⁵⁹ thereby implying that too much reliance should not be placed on the Swiss government to assume what was essentially an internal duty of the United States.

In 1951 the United States executed a treaty with Switzerland for the avoidance of double income taxation.¹⁶⁰ One article of this treaty provides for the mutual exchange of information.¹⁶¹ Its provisions are limited, however, by the following clause: "No information shall be exchanged which would disclose any *trade*, business, industrial or *professional secret* or any trade process."¹⁶² (Emphasis added.) It should be noted that the terms "trade" and "professional secret" are used both in the treaty and in the Swiss banking laws. The foregoing treaty provision was obviously insisted upon by the Swiss to insure the inviolability and integrity of Article 47 of the Swiss Banking Law and Article 273 of the Swiss Penal Code.

Another clause in the 1951 treaty restricting mutual exchange of information provides:

In no case shall the provisions of this Article be construed so as to impose upon either of the contracting States the obligation to carry out administrative measures at variance with the regulations and practice of either contracting State or which would be contrary to its sovereignty, security or public policy or to supply particulars which are not procurable under its own legislation or that of the state making application.¹⁶³

This clause prevents the United States from obtaining information from Swiss banks where the disclosure of such information violates the laws and policy of Switzerland. The administrative handling of fiscal matters in which banking secrecy is applicable is, as previously mentioned, a basic policy in Switzerland. This clause, then, insures that this practice is not varied by the treaty. Since Swiss authorities are unable to procure banking information in "fiscal matters," the clause prevents the United States from obtaining banking information.

Despite the strict Swiss banking secrecy laws, international legal cooperation is still possible. Since there are exceptions to the secrecy

¹⁵⁸ Letters from Rudolf Stettler, *supra* note 154 (enclosure).

¹⁵⁹ *Id.*

¹⁶⁰ Convention with the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, May 24, 1951, [1951] 2 U.S.T. 1753, T.I.A.S. No. 2316 (effective October 1, 1951).

¹⁶¹ *Id.* at 1760 (art. VXI(1)).

¹⁶² *Id.*

¹⁶³ *Id.* at 1760-61 (art. XVI (3)).

laws in criminal and certain civil cases,¹⁶⁴ a treaty solution to the problem of securities law violations should not be ruled out. In a 1936 case the Swiss cooperated with a foreign government seeking banking information. There, a Viennese prosecutor was allowed, pursuant to a mutual cooperation treaty executed in 1896 between Switzerland and Austria-Hungary, to visit Switzerland to investigate a citizen of Austria-Hungary who had become bankrupt and had removed his assets from his own country and concealed them in a Swiss bank to defraud Austrian creditors.¹⁶⁵ In order to trace the assets, authorization was given to the prosecutor by a Zurich Cantonal Court to examine the records of the bank in which the assets were secreted. The Zurich Procedural Code did not consider the business secrets of bankers in the same category as those of doctors, lawyers, and clergymen. Therefore, the banker in whose institution the bankrupt had his account was required to testify. It is likely, however, that the facts of this case fall within one of the exceptions to Swiss banking secrecy laws, because defrauding creditors was a criminal offense in Switzerland as well as in Austria.

Whether the Swiss can be induced to negotiate a legal assistance treaty in which at least some violations of securities laws would not be protected by the "fiscal matters" concept is uncertain. However, while it is unlikely that they will compromise their secrecy laws, the Swiss also have an interest in preventing stock fraud and diminished confidence in the United States securities markets which accompany such defalcations. As the 1968 statistics reveal,¹⁶⁶ the Swiss investment on Wall Street is considerable. Much of that investment undoubtedly results from honest transactions, some of it representing funds owned by the Swiss banks for their own accounts. These legitimate investments are jeopardized when United States citizens utilize Swiss banks for illegal purposes. Because the Swiss have a substantial interest in the stability of the American stock market, the possibility exists that they might agree to treaty provisions allowing some exchange of information when securities violations take place. While the Swiss might not agree to limit the "fiscal matters" principle in cases where insiders conceal their beneficial ownership of securities in Swiss banks, they might cooperate in detecting notorious securities violations, such as those involving fraud or the issuance of bogus stock. In any event, it is doubtful that the Swiss will agree to cooperate in all situations where United States securities laws have been violated.

Because of the Swiss desire to insure the integrity of their secrecy laws, however, a treaty as the immediate solution to the problem seems unlikely. The lack of progress in negotiations now taking place indicates that the execution of a treaty is not imminent. This is unfortunate because it would reduce the costs associated with the lengthy and piecemeal investigations now resorted to by United States law

¹⁶⁴ See pp. 201-02 *supra*.

¹⁶⁵ Meyer, *supra* note 39, at 327 n.125.

¹⁶⁶ See *supra* note 14.

enforcement agencies. Moreover, a treaty, being a bilateral agreement, would probably not disrupt United States-Swiss relations to the extent that unilateral action by the United States might. Finally, one definite disadvantage of a treaty is that it cannot be enforced. The success of the treaty depends entirely upon the good faith of the signatory countries.

B. *Amending the Securities Laws*

Amending the securities laws to deal with some of the problems presented by Swiss secret accounts is another possible solution that has been proposed.¹⁶⁷ For example, in 1957 congressional attention focused on proxy contests in which some industrialists were using Swiss banks to conceal illegal transactions.¹⁶⁸ These industrialists were attempting to control domestic corporations by directing Swiss banks to purchase stock for their secret accounts. This procedure prevented management and the investing public from knowing if and by whom a change of management was being sought. Several congressmen thought that shareholders had a right to know the identities of those seeking to acquire control of their corporations,¹⁶⁹ and, as a result, a bill was proposed to amend Section 14 of the Securities Exchange Act of 1934,¹⁷⁰ which regulates the solicitation and giving of proxies. The bill proposed to require disclosure of the beneficial ownership of securities as a prerequisite to voting them in a proxy contest.¹⁷¹ If enacted, Swiss banks would have been prevented from voting shares held in a secret account without disclosing the identity of the owner.

Strong objections to the bill were voiced. It was contended that its passage would present American brokers with a tremendous administrative burden.¹⁷² American brokers customarily retain record ownership of stock for many of their clients in order to perform such legitimate services as transferring stock, collecting dividends, and voting shares. It was argued that requiring these brokers to publicly reveal the names of beneficial owners would not only be a hardship on the brokers, but would also erode the legitimate confidential relationship between broker and client.¹⁷³ Furthermore, it was asserted that its passage might also lead to competition among brokers for certain customers whose names would otherwise have been held in confidence.¹⁷⁴ Opponents of the bill also stated that the administration of

¹⁶⁷ See, e.g., SEC Legislation Hearings 1 (remarks of Senator Lausche on proxy rules); Foreign Banking Hearing 19 (remarks of Irving M. Pollack on margin regulations).

¹⁶⁸ See SEC Legislation Hearings 13-37.

¹⁶⁹ SEC Legislation Hearings 30 (remarks of Senator Capehart).

¹⁷⁰ 15 U.S.C. § 78n (1964).

¹⁷¹ See SEC Legislation Hearings 7 for the text of the proposed bill, S. 1601, introduced by Senator Capehart to amend section 14.

¹⁷² *Id.* at 191 (remarks of Edward T. McCormick, President, American Stock Exchange); Fehrenbach 125.

¹⁷³ S.E.C. Legislation Hearings 176 (remarks of Frank L. Reissner, Chairman, Board of Governors, Federal Reserve Board).

¹⁷⁴ *Id.* at 195 (remarks of Edward T. McCormick).

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trusts would become unwieldy, for it might be difficult for trustees to ascertain the names of all the trust beneficiaries.¹⁷⁵ Another argument in opposition to the bill was that many beneficial owners might refuse to execute proxies if they realized their names would be disclosed.¹⁷⁶ Thus, corporate meetings might not be convened for lack of a quorum.¹⁷⁷ It was also considered doubtful that the rule could be enforced with respect to foreigners.¹⁷⁸ For example, foreign banks might falsify the beneficial owner or owners of stock that they vote in proxy contests. Since the bill could not confer any new jurisdictional power on the SEC, the verification of information received from foreign financial institutions would still be impossible. For the foregoing reasons, and because earlier congressional fears that Communists were gaining control of American defense industries proved unfounded, the bill was never enacted.¹⁷⁹

During the 1957 Senate hearings on this amendment to section 14, one of the objectives stressed by the State Department was that any legislation attempting to cope with the Swiss banking problem should not discriminate against foreign nationals.¹⁸⁰ The State Department rightfully did not wish to jeopardize existing treaty agreements or to inhibit the "freest possible movement of private capital across international boundaries."¹⁸¹ The Department felt that the amendment would lead to such a result, and that it might prompt economic and political retaliation by foreign governments.¹⁸²

It is submitted that amending section 14 would be ineffective to

¹⁷⁵ Id. at 14 (remarks of J. Sinclair Armstrong).

¹⁷⁶ Id. at 13.

¹⁷⁷ Id.

¹⁷⁸ Id.

¹⁷⁹ Commenting on the congressional view in 1957 that Communists could infiltrate American industry through the use of Swiss banks, Fehrenbach stated:

Several facts were presented which cooled Congress off considerably. One was that exactly one third of 1 percent of all U.S. industrial and rail securities were held by Swiss banks. This did represent a large amount of money, but it was a real indication that if the Russians had picked buying control of U.S. industry as the way to subvert the United States, they still had a long way to go. A Swiss newspaper blandly pointed out that it might be possible soon for the Communists to blow up the United States but never to buy it. No Communist had that kind of money.

Fehrenbach 124.

¹⁸⁰ SEC Legislation Hearings 81 (remarks of Thorsten V. Kalijarvi, Ass't Sec'y of State for Economic Affairs).

It is apparent that Congress would still abide by this policy today. Representative Wright Patman, Chairman, Comm. on Banking & Currency, has stressed that discrimination against foreign nationals is not the intention of those trying to deal with the problems presented by the secret bank account.

[O]ur activity is confined to prohibiting U.S. citizens and others subject to our jurisdiction from using secret foreign banking facilities as an element in illegal schemes. We have constantly emphasized that we are not seeking to interfere with the domestic policies or statutes of any country.

Letter from Representative Wright Patman to the B.C. Ind. & Com. L. Rev., Sept. 8, 1969, on file in the Review office.

¹⁸¹ SEC Legislation Hearings 81 (remarks of Thorsten V. Kalijarvi).

¹⁸² Id.

deal with the problem. Aside from the international political ramifications and anticipated difficulty of enforcement, it would also be an administrative burden upon the SEC. Finally, it is unlikely that the present Congress would pass such an amendment which it cursorily rejected in 1957.

It could be argued that the securities laws should be amended to prohibit Swiss banks and other foreign financial institutions with secrecy laws from purchasing and selling shares in United States securities markets for Americans unless they disclose on whose behalf they are acting. Such an amendment would entail subjecting those foreign institutions who are transacting legitimate business to all the administrative difficulties previously discussed in connection with the proposed amendment to section 14. Moreover, the SEC would also be unable to enforce such an amendment. Even if the Swiss banks were willing to cooperate in this respect, United States citizens could create secret foreign trusts to act as their agents for the purpose of affecting securities transactions through Swiss banks. The Swiss banks probably would not investigate to determine if Americans were the principals behind such trusts. To require the Swiss banks to undertake the administrative burdens associated with such an amendment would constitute discrimination against Switzerland for maintaining a national policy thoroughly supported by the Swiss people.

It has been suggested that legislation should be passed to prohibit Swiss banks which have secret accounts from transacting business for owners of such accounts on United States stock exchanges.¹⁸³ Such legislation would be difficult to implement because Swiss banks transact business with American brokers in their own name rather than for a numbered bank account or accounts.¹⁸⁴ To be effective such legislation would necessarily exclude legitimate Swiss business as well as any illegal business conducted through a secret account. Such legislation which would place burdensome restrictions on Swiss investments in the United States, must take into account the substantial influence of Swiss banks in international monetary affairs and the balance of payments position of the United States. The Swiss banks, for example, lent money to the United Kingdom in 1967 in order to support the British pound.¹⁸⁵ Swiss banks could likewise sustain confidence in the dollar. Furthermore, substantial Swiss investment in this country, as evidenced by the 1968 statistics reviewed earlier, improves the United States' balance of payments. Thus, such discriminatory legislation would also have adverse effects on the economy generally.

In some restricted situations, such as where the disclosure of beneficial ownership of Swiss accounts is not the objective of the legislation, amending the securities laws, on balance, would prove more advantageous than harmful. For example, the July 8, 1967 revision of

¹⁸³ Foreign Banking Hearing 37 (remarks of Representative J. William Stanton).

¹⁸⁴ *Id.* (remarks of Irving M. Pollack).

¹⁸⁵ Wechsberg, *Banking by the Numbers*, *Playboy*, Aug., 1968, at 90.

the "special omnibus account" section of Regulation T¹⁸⁶ may have a salutary effect. The new regulation was designed to cope with the problem of foreign banking institutions extending credit to United States citizens in excess of the margin requirement of Regulation T. This amendment, in contradistinction to other proposed statutory and regulatory solutions, does not discriminate against foreign banks; it applies to United States brokers as well as foreign banks. The new regulation requires registration with the SEC as a prerequisite for using the "special omnibus account." This will not affect the vast majority of American brokers who have been using the account because they are already registered with the SEC.¹⁸⁷ It will not bar any foreign financial institution from obtaining the privilege of using the "special omnibus account."¹⁸⁸ But, since registration with the SEC is now required, and registration would subject Swiss banks to the scrutiny of the SEC, those Swiss banks previously willing to ignore margin requirements with respect to United States customers might prefer to remain unregistered and to forego the privilege of using the "special omnibus account." The unregistered foreign banks would no longer get unlimited credit, and would be required, as are ordinary customers, to comply with margin requirements on the retail level. As a result, it is unlikely that unregistered Swiss banks would be financially capable of extending the amount of credit to United States citizens which they have in the past.

Registration of brokers with the SEC is required by Section 15 of the Securities Exchange Act of 1934.¹⁸⁹ Pursuant to this statute the SEC has established rules governing registration.¹⁹⁰ A foreign bank wishing to be registered would be required by the rules to submit statements of financial condition,¹⁹¹ and to designate the SEC as the agent upon whom process may be served in an action brought in a

¹⁸⁶ 12 C.F.R. § 220.4(b) (1970). This section provides:

Special omnibus account. In a special omnibus account, a member of a national securities exchange may effect and finance transactions for another member of a national securities exchange or a broker or dealer *registered with the Securities and Exchange Commission* under section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o) from whom the member receives (1) written notice, pursuant to a rule of the Securities and Exchange Commission concerning the hypothecation of customers' securities by brokers or dealers (Rule 8c-1 (17 C.F.R. 240.8c-1) or Rule 15c2-1 (17 C.F.R. 240.15c2-1)), to the effect that all securities carried in the account will be carried for the account of the customers of the broker or dealer and (2) written notice that any short sales effected in the account will be short sales made in behalf of the customers of the broker or dealer other than his partners. No substitutions of collateral securing credit extended to a broker or dealer not described in the preceding sentence shall be permitted after October 6, 1969, and no such credit shall be maintained after July 8, 1970. (Emphasis added.)

¹⁸⁷ Current CCH Fed. Sec. L. Rep., ¶ 77,717, at 83,640-41 (press release of the Board of Governors of the Federal Reserve System, June 6, 1969).

¹⁸⁸ Id. (by implication).

¹⁸⁹ 15 U.S.C. § 78o (1964).

¹⁹⁰ See 17 C.F.R. § 240.15b1-1 to 15b10-7 (1968).

¹⁹¹ 17 C.F.R. § 240.15b1-2 (1968).

United States court.¹⁹² Certain records would also have to be maintained.¹⁹³ It is doubtful if any of the less reputable Swiss banks, or even those that have in the past voluntarily adhered to United States margin regulations, would choose to become registered, as this would provide the SEC greater control over them. Failing registration, margin requirements must be met on the retail level. If the margin accounts maintained by these unregistered Swiss banks become undermargined, margin calls¹⁹⁴ will prevent excessive forced selling. The rules of the stock exchanges require a broker to sell undermargined securities if the shareholder's equity drops below a certain minimum and if the customer has not provided additional collateral.¹⁹⁵ Therefore, Swiss banks refusing to register with the SEC would, being subject to the aforementioned rules in most cases, have to put up additional collateral when their accounts became undermargined. They probably would not tie up their own capital as such an unregistered status would necessitate, but would require their customers to more closely adhere to United States margin regulations. Thus, United States citizens using Swiss banks will probably be required by these banks to adhere to the existing margin requirement. Consequently, the dangers from undermargined accounts of pyramiding credit in a rising market and of forced sales in a falling market will be mitigated.

This amendment to the "special omnibus account" regulations will not solve the basic problem confronting the SEC regarding secret Swiss bank accounts—the determination of the identity of the account holder when a securities violation is suspected or known to have been committed. Amending the securities laws does not appear to be an effective, practical or diplomatic approach to the problem of ascertaining the beneficial owners of Swiss bank accounts. The securities laws, by and large, are effective as presently structured, and can protect the investing public if discovery processes are available to the SEC so that the identities of violators can be determined. The basic problem is investigatory and evidentiary in nature; it is a problem which cannot be solved by amendments to the statutes.

C. Enforcing and Amending Domestic Banking Regulations

It has been indicated that in many of the crimes perpetrated through the secret Swiss account, 75 percent of the transactions are carried out in the United States, and that information relating to these domestic transactions, such as bank and brokerage records, are very helpful to law enforcement officers.¹⁹⁶ Several ways of procuring more domestic information have been proposed.

First, it has been observed that many United States banks are lax in administering monthly reports required by Treasury Regula-

¹⁹² 17 C.F.R. § 240.15b1-5 (1968).

¹⁹³ 17 C.F.R. § 240.15b10-6 (1968).

¹⁹⁴ For discussion of "margin calls," see 2 L. Loss, *Securities Regulation* 1266 (2d ed., 1961).

¹⁹⁵ N.Y.S.E. Rule 431.

¹⁹⁶ Foreign Banking Hearing 27 (remarks of Robert Morgenthau).

tions.¹⁹⁷ As a result, persons have been able to deposit large amounts in United States banks to the credit of Swiss bank accounts without being adequately identified by the banks.¹⁹⁸ False names have been given to the banks by depositors thereby frustrating subsequent investigations.¹⁹⁹ It has been suggested that the feasibility of demanding closer adherence by banks in the administration of the required monthly reports be investigated.²⁰⁰

These Treasury Currency Reports must be filed by each financial institution in the United States with the district Federal Reserve Bank.²⁰¹ Deposits or withdrawals effected by or through such financial institutions must be reported under the following circumstances:

- a. Transactions involving \$2500 or more of United States currency in denominations of \$100 or higher;
- b. Transactions involving \$10,000 or more of United States currency in any denominations; and
- c. Transactions involving any amount in any denominations, which in the judgment of the financial institution exceed those commensurate with the customary conduct of the business, industry or profession of the person or organization concerned.²⁰²

An additional requirement imposed on the reporting institutions is that of identification:

No financial institution shall effect any transaction with respect to which a report is required unless the person or organizations with whom such transaction is to be effected has been *satisfactorily identified*.²⁰³ (Emphasis added.)

Noncompliance with these regulations subjects the institutions to criminal sanctions.²⁰⁴ Nevertheless, some banks have failed to follow these regulations, thus eliminating an opportunity to obtain information that could be helpful to the SEC in tracing securities laws violators.

Moreover, if depositors know that they will be required to produce adequate identification, they may be deterred from using the secret Swiss account for illegal purposes. They could, of course, still go to neighboring countries to place money in Swiss accounts or could employ a Swiss bank representative to transfer money for them. However, stricter enforcement of the Treasury Currency Reports would make evasion of the securities laws from within the United States more difficult.

¹⁹⁷ Id. at 28.

¹⁹⁸ Id. at 15.

¹⁹⁹ Id.

²⁰⁰ Id. at 28.

²⁰¹ See 31 C.F.R. § 102.1 et seq. (1969).

²⁰² 31 C.F.R. § 102.1 (1969).

²⁰³ 31 C.F.R. § 102.3 (1969).

²⁰⁴ 12 U.S.C. § 95a (1964).

In conjunction with demanding stricter compliance with the administration of these reports, it has been suggested that persons transferring substantial funds to secret Swiss accounts through United States banks be photographed.²⁰⁵ Thus, even if a false name or identification were presented to the bank, some evidence would still be available. This procedure would again make using the secret account for illegal purposes more difficult and might therefore further deter potential violators.

Another aid for the SEC and the Justice Department in securities violations' investigations has been the utilization of microfilmed copies of checks.²⁰⁶ Most American banks ordinarily microfilm checks; however, because of the administrative burden and expense involved, some banks have abandoned this practice,²⁰⁷ thus eliminating a potential source of evidence. Since many of the transactions associated with the use of the secret Swiss account take place in the United States, the microfilmed copies of checks are useful to government investigators in tracing these transactions.²⁰⁸ Without these microfilmed copies available, the SEC's job will be more difficult. Consideration has therefore been given to the practicality of requiring all banks to microfilm checks.²⁰⁹ Aside from considerations of added cost, this proposal warrants implementation, at least in cases where the bank is required to include a record of the transaction in its Treasury Currency Report.

Insuring greater compliance by the banks with the Treasury Currency Reports regulations and passing regulations requiring banks to microfilm checks and photograph depositors, at least in cases where transactions involving Swiss accounts might be involved, appear to be the most practical solutions to the Swiss banking problem.²¹⁰ The mon-

²⁰⁵ Foreign Banking Hearing 28 (remarks of Robert Morgenthau).

²⁰⁶ *Id.* at 27.

²⁰⁷ *Id.*

²⁰⁸ *Id.* at 27-28.

[If microfilming] is stopped it is going to be a problem in being able to trace transactions even to the extent we have already been able to do, because . . . in many cases as soon as the money goes over to Switzerland it comes right back. It may go into a New York depository of a Swiss bank and then will go to a brokerage firm and so forth, and we can pick up a great deal of that transaction through American records. But if microfilming every check is no longer continued it will be a serious disadvantage to the Government and the public interest.

Id.

²⁰⁹ *Id.* at 28.

²¹⁰ Legislation designed to overcome some of the difficulties presented to law enforcement officers investigating activities in which the secret foreign account is involved and to deter those who illegally utilize such accounts was introduced in the House of Representatives on Dec. 3, 1969 by Representative Wright Patman, Chairman, Comm. on Banking & Currency. This bill, H.R. 15073, 91st Cong., 1st Sess. (1969), would require banks in the United States to maintain certain records, would provide additional authority to the Secretary of the Treasury for the purpose of requiring reports concerning transactions in United States currency, and would also require that United States citizens or persons doing business in the United States with foreign financial agencies report such transactions.

Title I of the bill concerns itself with bank records in the United States. Chapter

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etary cost of these proposals and the administrative burdens which they may entail bear examination. If a survey reveals that these proposals are economically feasible and could be implemented without

1 would amend the Federal Deposit Insurance Act for the purpose of aiding authorities conducting lawful investigations. It would prevent the premature destruction of certain types of evidence highly useful in criminal and civil actions by granting authority to the Secretary of the Treasury to issue regulations requiring each insured bank to maintain records relating to the identities of account holders, to make photocopies or other copies of checks and drafts presented for payment or received for deposit, and to keep records with respect to the identity of the party for whose account checks are to be deposited or collected. The banks would also be required to record the identifications of persons making deposits or withdrawals when such transactions involve foreign banks or stipulated amounts of United States currency. Based on congressional findings that regulation of the banking industry by the federal government is necessary and proper, Chapter 2 of Title I would extend the record-keeping requirements to uninsured banks. To insure compliance, the Secretary is authorized to seek injunctive relief. Additionally stiff civil and criminal penalties are provided for violations.

Title II of the bill is named the "Currency and Foreign Transactions Reporting Act." Among its purposes is aiding "duly constituted authorities in lawful investigations" and in collecting statistics helpful in formulating monetary and economic policy. Chapter 2 of Title II authorizes the Secretary of the Treasury to require from banks, brokers, and other financial institutions, reports of transactions involving United States currency. Such reports as the Secretary may require are to be submitted both by the financial institution involved and other parties participating in the transaction. These reports must identify the names of the person or persons involved in the transaction.

Chapter 3 of Title II requires persons transporting, whether as principal, agent, or bailee, certain amounts of currency into or out of places subject to United States jurisdiction to file reports. Persons receiving certain amounts of currency in places subject to United States jurisdiction directly from places not subject to United States jurisdiction are also required to file reports. The amounts requiring reportage are: (1) amounts greater than \$5000 on any occasion, or (2) an aggregate amount of \$10,000 per calendar year. The reports are to contain such information as: (1) the legal capacity of the filer, (2) the origin, destination, and route of the currency, (3) the identities of the persons to whom the currency is delivered and/or from whom the currency is received, and (4) the amounts involved. Failure to report or misstating or omitting information may result in forfeiture and seizure of the funds.

Chapter 4 of Title II requires United States citizens, residents, or persons doing business in the United States, who engage in transactions directly or indirectly with foreign financial agencies which do not make their records available to United States law enforcement officials with respect to transactions involving United States citizens, residents, or persons doing business in the United States, to file reports including the following information in such detail as required by the Secretary of the Treasury: (1) the identities of the parties to the transaction; (2) their legal capacities and, if applicable, the real parties in interest, and (3) a description of the transaction.

The penalties for failing to comply with the requirements of Title II are listed in Chapter 1. These include the availability of injunctive relief to the Secretary of the Treasury and criminal penalties of a fine of \$1000 or one year imprisonment, or both. If the violation is committed in furtherance of another violation of Federal law or is part of a pattern of illegal activity involving transactions of \$100,000 or more within a year, the fine and prison sentences authorized are \$500,000 and five years. Immunity from prosecution as a result of self-incrimination for witnesses is also granted.

The fact that this proposed bill requires the microfilming of necessary checks and expands the requirements for currency reporting should provide more evidence of illegal activity involving secret accounts. The measures which require more stringent identifications of persons involved in depositing sums to the credit of secret accounts and the stiffer penalties involved in the failure of both individuals and financial institutions to make required reports should deter many potential violators of the securities

lengthy delay, regulations should be promulgated. The advantage of these proposals is that they are unlikely to cause any international political problems. The Swiss, understandably, would not welcome outside interference with their banking practices; by the same token, they could not justifiably object to the United States taking action within its jurisdiction to strengthen its own banking affairs.

CONCLUSION

Improving evidence-gathering techniques in the United States is the best short-term step that can be taken to reduce securities laws violations encouraged by Swiss banking secrecy. Evidentiary measures, such as greater adherence by banks to the proper standards for administering Treasury Currency Reports, are capable of being implemented without much delay. Such measures can be taken by the United States without the acquiescence of foreign governments and with little likelihood of provoking retaliatory action. Not only will such measures aid the SEC and the Justice Department investigations by providing a potential source of evidence of securities violations, they will also tend to make it more difficult for persons to employ the secret account for illegal purposes.

Changing the securities laws through amendments would be of only limited effectiveness, since the problem is basically evidentiary. Any such legislation would probably require treating foreign nationals in a discriminatory fashion and might result in undesirable diplomatic and economic effects.

The outlook for securing an effective treaty to aid the SEC also appears dim. If one is negotiated, it probably will be only after considerable delay and may not be effective against all types of securities laws violations. Since Switzerland will sign no treaty requiring it to provide assistance in "fiscal matters," the possibility that any negotiated treaty would be fully effective is doubtful. Nevertheless, negotiations should not be abandoned, as some areas may be established in which the Swiss will cooperate. Swiss interest in the stability of American securities markets, coupled with United States diplomatic pressure, might encourage Switzerland to pass legislation exempting certain securities transactions from the umbrella provided by the "fiscal matters" doctrine.²¹¹ Such considerations might also induce the Swiss

laws. But, whether this proposed bill will deter one who is determined to make illegal use of the secret account, such as a person who does not use United States' financial institutions as a conduit, is debatable. If such an individual manages to get money out of the country and into a secret Swiss account without detection, the bill will be of little help to law enforcement officials in their efforts to penetrate the secrecy of the Swiss bank. By and large, however, this bill should have a salutary effect if enacted into law.

²¹¹ Diplomatic pressure and publicity about the illegal use of Swiss accounts could reduce violations. For instance, after the widely publicized proxy battles that took place in 1957, the Swiss Banker's Association attempted to protect their image from damage by American corporate raiders. Fehrenbach states:

But the hearings, acrimony, and extremely bad publicity taught the Swiss Banker's Association something. It took steps to keep its members from being used by American stock manipulators. It further made a hard-and-fast rule that all Swiss

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to make it more difficult for foreign banks to become established in Switzerland. Such banks have generally been less circumspect in accepting deposits from unreliable sources than the older, firmly established Swiss owned banks. Therefore, the negotiations for a treaty could be an important long-term factor in solving the many faceted problems generated by the secret Swiss bank account.

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banks voting American shares in proxy fights would invariably vote for management unless specifically instructed otherwise. After 1957, no Swiss bank knowingly allowed itself to become involved in an American corporate proxy battle. Fehrenbach 125.