Credit Suisse collapse put banking secrecy at risk

By Elisa Barwick

When Credit Suisse teetered on the brink of collapse in March a nervous tension gripped bank and company boardrooms across the world. It was not only the risk to infamous "Swiss bank accounts" afforded to the elite that had them worried; nor was it the collapse of a banking system that allows big players to avoid tax. Or that Credit Suisse had US$39 trillion in derivatives which could detonate the global bubble. It was the potential loss of a sheltered haven of *secrecy*—a sacred citadel where bankers' secrets are inviolable.

Global Headquarters of Credit Suisse at Paradeplatz, in Zurich's financial district. Photo: Credit Suisse

The *Wall Street Journal* acknowledged these facts in a 24 March article by four senior and decorated financial journalists, headlined, "It Wasn't Just Credit Suisse. Switzerland Itself Needed Rescuing." The kicker elaborated that the "Crisis threatened an economic model and national identity built on safeguarding the world's wealth".

It went on to warn that for Switzerland the stakes were beyond a financial emergency, they "verged on existential". Its coveted financial status as a global banking centre, "cultivated over centuries", itself needed rescuing. The political and financial masters swung into action, ordering the takeover by UBS, even changing the law to get it done.

Political leaders are cited by *WSJ*, warning of the immense "reputational damage" to the nation if CS collapsed. Even after the rescue however, it is clear the risk remains. The two banks that controlled around 50 per cent of the country's banking system have become one, spelling a dangerous concentration of assets in one edifice. "If Swiss banking means one huge bank, what if something goes wrong with that?" asked one expert from the OECD. "Then the entire country and its financial stability is at stake. It's very un-Swiss."

As *WSJ* reviews, the country's "banking system is five times the size of its gross domestic product and larger than in most economies. UBS combined with Credit Suisse has a balance sheet twice the size of the Swiss economy." This developed because the nation carved out a unique and indispensable role for itself in the banking world.

Bail-in—the confiscation of depositor and bondholder money to save collapsing banks—was rejected when the rescue of CS commenced. It was considered too risky in a rescue operation that was non-negotiable. *WSJ* reported that "the government, which had vowed after the 2008 crisis never again to use public money to save a bank, hastily used emergency laws to do exactly that." Theoretically, the "Swiss authorities had a plan to handle big banks if they fell under stress. To avoid tapping taxpayer money, the country's financial regulator would swiftly impose losses as needed on shareholders and bondholders." But so dicey was the situation, that "That solution was discarded for Credit Suisse, as authorities feared it would cause panic among bank investors around the world". In the end, after the white-knuckle moment subsided, it was indeed deployed, with US$17 billion of riskiest bonds liquidated.

In order to pull off the bank rescue, the government ushered through a rapid legal change allowing a deal to be made without consulting shareholders. A quarter of the shares of Credit Suisse were held by three big Gulf investors: Qatar Investment Authority, Olayan Group, and the Saudi Public Investment Fund, which is part-owner of Saudi National Bank. Worried they were about to lose everything, these funds had called up government ministers and the central bank governor. The Saudi National Bank had refused to pour more money into CS, with limits on bank ownership part of the reason. This rattled the markets more. The Swiss government went all in for its UBS buy-up solution, also waiving antitrust laws "on the grounds that financial stability was at stake", wrote *WSJ*.

The Swiss middleman: a history of neutrality and secrecy

Switzerland has a history of protecting secrecy in banking stretching back to at least the early 1700s. Rules adopted by the Grand Council of Geneva (the legislature of the canton of Geneva) in 1713 bound bankers to maintain the confidentiality of their clients.

Even before today's "spiderweb" of offshore tax havens, the Swiss operation was inseparable from City of London financial networks. One clear example is the British utilisation of Swiss banking and political networks to press France into a financial crunch to prevent the French Revolution resulting in actual independence, like America. Playing on the economic crisis, thus exacerbated, British intelligence director Lord Shelburne's network of agitators, included an extensive roster of Swiss bankers and political hacks, inciting the population of France to bloody instead of noble ideas. ("Freedom, and lessons from the French Revolution", *AAS*, 31 Aug. 2022.) Meanwhile, aristocrats fleeing the devastation moved their money into Swiss accounts.

The political neutrality of Switzerland was formally acknowledged at the 1815 Congress of Vienna, which harked from the fact that Switzerland was sandwiched between France, Germany and Italy. Home to citizens from all language groups, taking sides in any war would see the nation ripped apart.

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As a politically neutral state, in the early 1900s Switzerland attracted Europeans fleeing other states that were either politically unstable or had imposing tax regimes, who utilised Swiss banks and vaults to stash their wealth. In 1924 the Swiss Federal Council noted that it had "decided strictly to reject … any measure combating this evasion". At that time, capital flight to Switzerland was depriving Germany and others of the cash they needed to pay World War I reparations obligations.

In 1932, French politicians attempted to crack the Swiss secrecy regime, revealing the names and accounts of numerous French elite, from senators to bishops, who were utilising the Swiss regime. British investigative journalist Nicholas Shaxson, in his 2011 book *Treasure Islands: Tax Havens and the Men Who Stole the World*, details an operation by the French to root out tax evasion estimated to be robbing the country of four billion francs each year at a time when economic austerity programs had the population, and therefore politicians, attuned to such thievery. The Swiss refused to cooperate in any way as the French judicial system attempted to prosecute the individuals. In a confidential document, Swiss authorities admitted it "might have very unfavourable repercussions on the substantial business accruing to our banks from foreign deposits".

When the French imprisoned two bank officials from the Paris office of Swiss bank Basler Handelsbank for refusing to cooperate, it was a bridge too far. In retaliation, Swiss bankers drew up a new banking law, to enshrine Swiss secrecy for ever more. Until then, Swiss secrecy was protected only by civil and commercial codes; now breaching secrecy would be a criminal offence punishable by law.

Soon Germany would make it illegal to keep foreign capital in Swiss banks, on penalty of death. However, the story that Swiss banks enforced secrecy in order to protect the funds of German Jews from Nazi confiscation is nothing more than a conveniently perpetrated myth, exposed by Shaxson, which appears to have originated with a 1966 Credit Suisse (then under a different name) bulletin. In fact it worked the other way. German authorities were able to force the handover of Swiss funds precisely because the Swiss banks were known never to interfere. This was certainly the case with the Swiss-based Bank for International Settlements (BIS), which opened in 1930. In the name of following technical rules to a "t", the BIS confiscated the gold held by the central banks of nations invaded by the Nazis, all the way through World War II.

The Swiss people, also affected by the Great Depression, were demanding greater control over the banks too. This also propelled the bankers' push to enshrine the status of Swiss banking secrecy into law. Shaxson reported that "By August 1931, the highly influential right-wing daily *Neue Zurcher Zeitung* was attacking government oversight of the banks, and in February 1932 a top banker sent the government draft legislation with a clause making it a crime to violate bank secrecy." The French arrests spurred it on and the law demanding the "duty of absolute silence" was adopted in 1934, almost unchanged from the original bankers' draft.

Riot police prepare for protests after the UBS takeover of Credit Suisse, announced 20 March. Photo: AFP/Fabrice Coffrini

After the war, the British defended Swiss secrecy because they were afraid that outing its operations would inevitably expose Britain's own. British investigative journalist Tom Bower, in his 1997 book *Blood Money,* noted that US Treasury Secretary Henry Morgenthau, who was intent on cleaning up the whole mess including by pushing to shut down the BIS at the 1944 Bretton Woods conference, suspected that "London's influence should not be underestimated" in the whole picture. Any rollback of Swiss secrecy, said Bower, "was greeted in the British Treasury as 'explosive stuff' requiring 'great wariness'". A senior Treasury official warned, "We don't want to be forced to reveal British banking secrets". Another London player told his lawyer, "You are not (repeat not) doing anything which would lead to requests for disclosure of information by British banks."

Challenges since 2008

After 2008, the *WSJ* reports, "the US enacted laws requiring Swiss banks to transfer information about American clients to the Internal Revenue Service, a hammer blow to its banking secrecy." The bank paid US$2.6 billion in a 2014 settlement with the US Justice Department, acknowledging it had helped sideline US wealth to avoid taxes. Bankers took bribes, forged client signatures and destroyed documents. That same year, over 50 countries and territories agreed to participate in a global exchange of information regarding taxpayers' financial information, with a new common reporting standard (CRS). This included Switzerland. Swiss secrecy laws have been raised again in recent years as more revelations about Swiss banks, particularly Credit Suisse, turning a blind eye to criminal activity emerged. In 2022, "a leak of Credit Suisse data revealed its clients were involved in torture, drug trafficking, money laundering, corruption and other serious crimes", reported the *Guardian* in February of that year. Among other things, it was found guilty by the Swiss Federal Court of money laundering for a Bulgarian cocaine trafficker.

The Swiss model is still under threat; it can be demolished. Even after the CS rescue, noted the *WSJ,* many foreign investors are rethinking where they keep their money. And in Switzerland itself there is renewed interest in real bank regulation and oversight, starting with rules modelled on the *1933 US Glass-Steagall Act* that protects commercial banking from speculative bubbles.