11. Reflections on The Swiss-U.S. Non-Prosecution Agreement Program

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In January 2016, the U.S. Department of Justice ("DOJ") executed the final Category 2 NPA that was part of the Swiss-U.S. Non-Prosecution Agreement Program ("Swiss Bank Program" or "Program"). It is four months later, which allows sufficient time for reflection. Last year, I wrote about the rules of the U.S. Program. This year, I share some reflections on the Program.

Was this a Swiss or U.S. Program?

In the first six months, depending on whom you asked, you received a different approach to the Program. One reason for this was that it was the first time a foreign authority had negotiated with the U.S. government to have some form of global resolution for addressing outstanding tax issues. This led to a fair amount of confusion because it was a negotiated program between two sovereigns, rather than a single government announcement like a self-disclosure program. The reason for this confusion was the fact that, on the one hand, the Program, as announced, clearly contained elements that gave due consideration to Swiss law, but on the other hand, it was administered by the DOJ[1]. In the final analysis, however, it is clear that this was a U.S. program, under U.S. law, with Swiss elements. Once the initial negotiations were completed, the Program was administered by the DOJ with very limited influence from the Swiss authorities.

1. The Penalties: Any Logic?

USD1.4 billion was collected in penalties directly from the banks[2]. This figure omits the taxes, interest and penalties from self-disclosures ("OVDP"). While there is no official figure for the total amount including OVDP, the Program probably collected approximately USD3 billion in assets for the U.S. government (in terms of OVDPs and bank penalties).

The range of the NPA had a delta of 21,313 size difference between the highest and the lowest penalties. The highest penalty was USD211 million and the lowest penalty was USD9,900, while the average penalty was approximately USD17.1 million and the median penalty was about USD4 million. Thus, although the highest penalties are significant, most of the penalties were not as impressive.

The penalties under the Program were determined by an objective formula. This formula was based on the highest aggregate value of the various U.S. accounts held by the bank in the given period. Depending upon when the account was opened, a base penalty of between 20–50% of the maximum amount of assets under management was imposed. Misconduct was not a standard to be considered[3]. Penalty reductions were available on the condition that the bank could prove that the account holder had been tax compliant or had come into compliance by participating in an OVDP program. Accordingly, the penalty primarily reflects the bank's ability to produce records that demonstrate the tax compliance of its account holders and/or its ability to convince clients to enter into the OVDP program.

Convincing clients to regularize the account could have been particularly difficult, especially in the case of older accounts where key clients were no longer with the bank. I am aware of certain banks that received penalties, more than half of the amount of which was attributable to a single account that had been previously closed and whose holder could not be reached.

Additionally, the penalty structure had unusual and unintended results. For example, a large international bank that exited all of its U.S. clients in 2008–2009 would have had no contact with these clients for at least four years by the time the Program started. Consequently, that bank would have no leverage over those former clients when requesting that they provide documentation of U.S. tax compliance. However, if a financial institution was taking in U.S. clients as late as 2013, that bank would still have those clients with the institution. It would have far more leverage to request documentation or convince a client to participate in self-disclosure and, thus, to reduce its own penalty under the Program.

The penalty scheme also favored small private banks versus larger universal banks. There is a misperception that all banks in Switzerland are the same, that they are all servicing ultra-high net worth clients, many institutions do not. The reality is that many banks service relatively small clients and many service a large number of clients. For a larger universal bank with a private banking element and many smaller U.S. clients, the penalty was necessarily going to be higher. This is because the mitigation offered under the Program required convincing clients to provide documentation of U.S. tax compliance or to become U.S. tax compliant. Obtaining records on thousands of clients—many of whom lived in Switzerland, Germany, Austria, France and Italy and were fully compliant with their home country tax obligations—was much harder than doing so with a small number of clients. There were institutions in the Program that, practically speaking, just could not mitigate a large number of smaller accounts. Institutions that had a small number of larger accounts were more easily able to mitigate their penalty.

Ultimately, there was no nexus between the size of the penalty and the underlying conduct of the bank. Rather, the penalty had everything to do with the bank's willingness and ability to mitigate the penalty.

2. FINMA Role

In hindsight, there were many institutions that probably did not need to enter the Program, and many either later withdrew or stayed in the Program and incurred a relatively small penalty as a consequence. While the Program was ongoing, FINMA took the approach that their job was to ensure that institutions were acting reasonably. On November 29, 2013, a month before the banks had to decide whether or not to participate, the then head of the Swiss financial market's regulator wrote in the preeminent Swiss newspaper, the Neue Zürcher Zeitung, that when in doubt, a bank should go into the Program as a Category 2 bank[4]. There was some initial backpedaling on this message by FINMA after the article first appeared. Then, ten months later, FINMA appeared to have completely backed away from this position. When there were problems between Switzerland and the U.S., the ability (or at least the desire) of FINMA to help facilitate resolution was rather limited.

3. Almost 25% of the Banks Withdrew, Why?
In January 2014, then-Assistant Attorney General for the Department of Justice, Tax Division, Kathryn Keneally, announced that 106 banks had elected to participate in the Program[5]. By the end of the Program, there were only 80 participating. The question is why did almost 25% of the banks withdraw? While there is no one answer, the following are some common elements:

1. *Timing*

Banks had a small window of time to evaluate the ability to enter the program. The Program was announced on August 29, 2013, and the last day to enter was December 31, 2013. Many banks entered because they had inadequate information to determine if there was sufficient criminal conduct to justify participating in the Program, but could not afford to take the risk of not participating.

2. *FINMA pressure and the treatment by the DOJ*

On the basis of FINMA's statement on November 29, certain banks entered because they thought they had to. Many banks perceived they were faced with additional requirements from the DOJ that differed from what the Program had initially listed. This fact and the manner in which they were being treated by the DOJ created a situation where many institutions decided to withdraw. These institutions concluded that the risk of an indictment or other punishment for bad behavior was just not proportional to the difficulties they were facing under the Program.

3. *Some viewed there to be a bait-and-switch*

The Program had a set of rules which participating institutions were required to follow. The descriptions given by the DOJ to those outside of the Program included lists of information that had to be collected and provided, and certain requirements that had to be complied with. Many thought that the Program was more or less a straightforward, objective arrangement—if an institution did "x," it would receive an NPA. However, once banks started their participation in the Program, many perceive that the DOJ forgot that there was actually a program framework. Some institutions felt there had been a "bait-and-switch." These banks entered the Program on the assumption that there would be a definite resolution as long as they followed the rules as listed on August 29, but they then felt they were being asked for more onerous requirements.

4. The Complexity of Swiss Data Protection Laws
The Swiss government, by entering into a Joint Statement with the DOJ announcing the Program on August 29, 2013, represented that applicable Swiss law would "permit effective participation by the Swiss Banks on the terms set out in the Program."[7] Pursuant to the Swiss Civil Data Protection Law, third parties and employees could, however, block the disclosure of their data to U.S. authorities by applying for provisional relief from competent Swiss courts, preventing the participating banks from providing part of the information required under Parts II.D.1 and/or II.D.2 of the Program. However, this had not been understood in the same manner by the DOJ. There were probably different understandings of the concept of "effective participation" by both sides. From the U.S.'s perspective, the whole concept of data protection (as opposed to bank secrecy) was something that was difficult to understand, which led to some of the confusion that ensued.

5. What was the Value of the NPA?
While important for the U.S. authorities, the real value of the NPA was what it meant for the Swiss institutions. For the next 10 to 15 years, anytime someone wants to acquire a financial institution, they will clearly ask a list of questions, including: Did the bank participate in the U.S.-Swiss Program? Did they receive an NPA? The failure to have an NPA will make it much more difficult to sell the institution in the future. Moreover, there were insular concerns that a financial institution that did not participate in the Program might find it harder to deal with custodians in the future.

6. Was it Worth it?
Not all banks entered the Program. This means that there are institutions that could still have problems. The primary purpose of the Program was to move the DOJ out of Switzerland. This failed. Many institutions are worried that certain employees and others may still have problems with the DOJ.

Did the Program have the desired effect of resolving issues for many financial institutions? Yes. Did it resolve issues for employees, something that is extremely relevant for many institutions? No. Will the U.S. government leave Switzerland and move elsewhere? Only time will tell.

1) See "Joint Statement between the U.S. Department of Justice and the Swiss Federal Department of Finance," Aug. 29, 2013.
2) U.S. Dept. of Justice, "Justice Department Announces Final Swiss Bank Program Category 2 Resolution with HSZH Verwaltungs AG," Jan. 27, 2016, available at www.justice.gov.
3) See Program for Swiss Banks, Part II.H.
4) *Neue Zürcher Zeitung*, Patrick Raaflaub, "Entscheidende Phase für Schweizer Banken," Nov. 29, 2013, available at http://www.nzz.ch/meinung/debatte/entscheidende-phase-fuer-schweizer-banken-1.18194436.
5) http://www.reuters.com/article/usa-tax-swiss-banking-idUSL2N0KZ0DZ20140125.
6) See 2. of the Joint Statement (https://www.justice.gov/iso/opa/resources/753201382916464664074.pdf).

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