

A solution for the toxic after-effects of undeclared funds held in banks must be found

In conversation with Professor Dr. Teodoro D. Cocca

Prof. Dr. Teodoro Cocca, who was born in Switzerland of Italian parentage, holds the post of Professor for Asset & Wealth Management at Johannes Kepler University in Linz, Austria. His previous activities include Investment and Private Banking at Citibank, research at the Stern School of Business in New York and teaching at the Swiss Banking Institute in Zurich. He is also a lecturer in Banking and Finance at Zurich University, and teaches MBA program courses in St. Gallen, Geneva, Madrid and Vienna.

In an exclusive interview for the March issue of Insider, this likeable, intelligent and committed banking specialist reveals his forecasts and assessments of the situation in which Switzerland as a banking center currently finds itself in light of the offensive on banking secrecy of recent weeks.

What is your take on the current situation in which Switzerland as a banking center finds itself?

There is an urgent necessity for Switzerland to make concrete proactive proposals to find a definitive solution to the banking secrecy controversy. More detrimental even than the erosion of banking secrecy is the massive negative publicity suffered by the financial marketplace. Switzerland must now finally stop hitting the negative headlines in order to concentrate on business again. A concerted effort by the major organizations involved (the Swiss Federal Council, the Association of Bankers) would be desirable. However, regrettably, there appears to be neither the vision, nor a strategy for the immediate future of the financial marketplace, not to speak of the lack of any personalities with the required leadership qualities. It seems as if Switzerland is simply marking time at the moment, with nobody willing to take on the responsibility. Instead, criticism is continually aimed at Federal Council member Merz, and this is just too simplistic.

What is the contribution of Swiss banking secrecy to the success of Switzerland as a financial marketplace?

Without a doubt, banking secrecy plays – and has played – a very dominant role in Swiss private banking. Of course, it would be wrong to reduce the success of the Swiss banks to this factor alone, since after all, there are other countries with highly developed banking secrecy, but which have not been able to achieve Switzerland's dominant position in cross-border private banking. Rather more, it is down to a combination of the numerous strengths of the Swiss financial marketplace which has made the Swiss cluster so unique and so powerful. This cluster cannot simply be copied and is the reason why even with somewhat weakened banking secrecy, Switzerland is set to remain the private banking location par excellence.

How do you see the current persistent arguments surrounding banking secrecy? And what do you believe the future holds for banking secrecy?

The pressure coming from the EU is very strong and is likely to remain so, since the national budgets of many of the EU member states are well-known as ranging from poor to disastrous. In order to elude the full extent of the EU demands – direct information exchange – Switzerland will have to make further concessions. The more it is ready to compromise in

the short term, the greater the longer term gain. In my opinion, the most important aspect is that Switzerland must now put forward concrete proposals as a sign of goodwill to counter the political and media onslaught and emerge from its defensive position at long last. In a legal context, banking secrecy has a clear future, since the law protects the elementary rights of citizens to privacy. In terms of any changes, only the circumstances under which banks must provide confidential information have been relaxed. However, the situation looks to be entirely different from a business policy perspective. A system allowing banking business with undeclared funds carries a very high risk factor to reputation and in legal terms for a bank in today's world, and so the importance of this area of business is bound to diminish.

In your opinion, what would be a good resolution to the current debate?

A solution for the toxic after-effects of undeclared funds held in banks must be found. Perhaps this could involve an inverse tax amnesty, in other words, Switzerland could negotiate an amnesty for clients. The advantage of this solution would be that it represents an attempt to ensure that funds are kept in Switzerland. On the other hand, looking to the future, it is also important to ensure that new money arriving in Switzerland does not lead to further controversy with foreign authorities. Two possible solutions to this would be a withholding tax, or an obligation agreement to accept only declared funds (as, for example, is the case between Liechtenstein and the UK). The withholding tax seems to me to be the better solution. Switzerland should not allow itself to be misled by the initial antipathy of the EU to such a tax, a stance which is all just tactics.

You and your family live in neighboring Austria, which is allied with Switzerland in terms of banking secrecy. How do Austrians see the debate surrounding banking secrecy?

They are much more relaxed about it. But of course, this is understandable, since banking secrecy does not carry anything like the same importance in Austria as it does in Switzerland. Compared with Switzerland, the proportion of undeclared assets of foreign clients in Austria is so small as to be virtually negligible. The primary strategic focus of Austrian banks is onshore business in Eastern Europe, where banking secrecy is of minor importance. However, for those few private banks that do engage in business with German clients, the debate takes on a different significance and in this respect, Austria has adopted a strategy of following the Swiss lead: only such concessions as are made by Switzerland will be made. In this way, Austria is banking on the skill and strong self-interest Switzerland has in defending banking secrecy.

Switzerland is proposing a withholding tax as the solution to the tax issue: what is your assessment of this as a means?

I believe it to be the only realistic solution which will preserve the interests of all those involved. And if it can do so skillfully, Switzerland should be able to assert itself.

Do you think that the current debate represents a real and pronounced danger to the relationship between Germany and Switzerland?

No, the current German government has adopted a much more moderate tone than some of the representatives of the previous government. It seems clear to everybody that the dispute between neighbors must not be allowed to escalate. The economic interest vested in an easy relationship between the two countries is very great. It's a calming factor.

Will Switzerland be able to refuse the information exchange which is automatic between EU member countries in the long run?

Yes, since the application of direct information exchange outside the EU is absolutely inconceivable. It is unthinkable that the USA or Singapore would also agree to such a solution. As a result, Switzerland will be able to pursue a strategy of “follow my leader” and take the stance that while major competitive financial marketplaces have not introduced direct information exchange, Switzerland will not agree to this either, for reasons of competition. Although irrespective of this, Switzerland should not shirk the moral and ethical aspects of the debate and should position itself firmly against the – mainly German – nightmare of “the glass citizen”. From the point of view of hard-fought citizens’ rights, direct exchange of information is unacceptable. Switzerland has an absolute duty to defend itself against this. I am certain that the discussion concerning the protection of personal privacy will take an entirely new direction in the foreseeable future. The current overriding influence of and belief in the state is soon likely to trigger a counter reaction demanding less state intervention. And with this will come Switzerland’s moment, as the last bastion of moderate state intervention in the economy, of a liberal national approach and of the stringent protection of personal privacy.

How much longer can Switzerland withstand the international pressure?

Not as long as most representatives of the financial marketplace are secretly hoping. The quicker a solution is found, the better for the financial marketplace. The longer the wait, the stronger the mounting pressure on Switzerland – with potentially fatal results. Surely, the lesson of the turmoil surrounding dormant accounts – and here, the parallels are frightening – should have been learned.

Why is the EU gunning for Switzerland, but not for other tax havens, such as the Canaries, or individual states in the USA (Delaware, Nevada)?

There is no doubt that the controversy surrounding banking secrecy is all about vested interests and power politics. This is the revenge for Switzerland’s lack of political alignment. In fact, its insular geopolitical situation is Switzerland’s greatest strategic problem. Normally, Switzerland would be supported, in particular, by its direct neighbors, but in this case, the situation is exactly reversed. Of the five adjacent countries, the biggest three are among those mounting the offensive, and in this case, no help has come from the USA either – in fact, quite the reverse. The truth is that neither politics nor the financial markets have recognized the greatest strategic risk developing since the fall of the Iron Curtain. The policy of neutrality pursued by Switzerland is regarded as perversity. A country which is not actively involved in the global community should not be surprised that it stands alone in a crisis. A financial marketplace with a strong overseas focus but without the political security of an international network of strong partners is not built on solid foundations. This should have been recognized.

What changes are likely in other international markets? And where?

I think it is a little premature to assess this. One potential scenario might be that Singapore will profit as a financial marketplace. Although it has also undertaken to apply the OECD model tax convention, it does seem to me that Singapore is unlikely to be subjected to the same pressures as Switzerland. Singapore’s geopolitical configuration is also fundamentally different (for instance, its close association with the USA makes it virtually untouchable).

International clients will also be aware of these geopolitical considerations and direct the placement of their funds accordingly.

In your opinion, how closely related is the crisis in the financial markets to the attack on banking secrecy?

Certainly, it's bound to have "coordinated" the desires of many countries and strongly supported the formation of a common front against Switzerland. However, in this connection, I feel it important to point out that the escalation of a conflict between UBS, the major Swiss bank, and the American tax authorities, which arose at roughly the same time, and during the course of which some extremely negative statements were made by former bankers and clients of the bank, caused grave damage to the regard in which Swiss banking secrecy is held. In the Senate Committee hearings, the bank had to apologize – a unique occurrence – for misuse of banking secrecy for the active support of tax evasion. As a result, Swiss banking secrecy lost its innocence, since this was the first time that there was evidence of illegal dealings. This caused a significant change in attitude, to the considerable detriment of Switzerland. The change of administration in the USA further accelerated this, as Obama is well-known to be hugely opposed to tax havens. The mix of all these developments led to an explosive cocktail.

It is estimated that approximately 80% of the foreign money held by Swiss banks is undeclared. In round figures, this comes to a sum of around EUR 1,600 billion. Are these funds likely to migrate from Switzerland to remote and more discrete tax havens?

Probably not, since first and foremost, undeclared money is not very mobile. Large money movements leave tracks. The only way to try and circumvent this is to move cash, but there again, this is not really feasible when it comes to large amounts. At the moment, what is interesting to observe is what happens if clients choose to take the path of self-declaration. Will they withdraw the money or refuse repatriation? I have heard that some of the funds will be left in Switzerland, but other tax havens will surely profit from the influx of new funds.

Banks have been rescued by untold amounts of taxpayers' money. There is an impression that the banks have not learned the lessons of the crisis to any extent. How do you feel about the bonus payments, which have again reached record levels in recent weeks?

It is disappointing to see that many banks (although not all) have not met their otherwise much vaunted public responsibilities in any shape or form. Nor does lapsing back into old habits exactly inspire confidence in the leadership, to use a key word. It is a pity that these banks have not recognized that now is the time for bankers and banks to set the signals. Modesty and sound judgment are the order of the day now. If the banks do not take the furious public outcry seriously, they will lose the last spark of legitimacy which remains. Without public validation, they will not be able to win back trust or do well in business. It would be in their own best interests to remain sensitive to the mood of the wider public. If they fail to do this, the mood will reverberate in the political and parliamentary arena with the backlash from even more serious consequences resulting from stringent legislation in most areas hitting the banks.

Many countries throughout Europe and the USA are highly indebted, finding themselves trapped by debt as a result of their bank rescue packages and economic support measures. What form might the consequences of this take?

The irony of all this might be that speculation in high finance will ultimately lead to cuts in the social system. One aspect is clear: that debilitated public finances can only be brought back into line by rigorous savings plans. This might well be at cost to the public social services. Other consequences will be debt defaults or speculation concerning these, with Dubai and Greece just the beginning. A gradual reduction of debt could be accomplished by a tolerant stance towards higher rates of inflation. The recent discussions are the first alarm signals. One certain fact is that, contrary to all the government assurances, taxes will rise.

Do you believe that the often-quoted economic recovery is sustainable?

Economic recovery, yes, but stock market growth, no. The stock markets were and are still too euphoric. A reversal of the trend is now looming, and from a structural perspective, the rise in share prices has faltered since the beginning of December 2009. My opinion is that the stock markets are facing a difficult year ahead. The economy has now begun a slow recovery, but we shall not be seeing high growth rates for some time yet. This stagnation is toxic to the stock markets: they just don't know it yet.

Did I miss out any questions?

Yes, but you've asked it now.

What is your personal recipe for success?

There is no recipe for success. I just try to approach things with as much passion and commitment as I can, in business as well as in my private life.