

SECURITIES REGULATIONS INVESTIGATIONS—UNITED STATES-SWISS TREATY ATTEMPTS TO INCREASE COOPERATION IN RELEASING NAMES OF SWISS-BASED ACCOUNT HOLDERS INVOLVED IN UNITED STATES SECURITIES AND EXCHANGE COMMISSION INVESTIGATIONS

Secrecy laws of Switzerland, which protect the names of account holders from release, present a major obstacle to the efforts of the Securities and Exchange Commission (SEC)¹ in investigating alleged insider trading² on the United States securities markets through Swiss-based accounts.³ The most recent problem involves interpretation of the scope of a 1977 treaty⁴ between the United States and Switzerland, and a 1982 memorandum of understanding⁵ that clarified and expanded investigatory cooperation between the two nations under the 1977 treaty. These two documents are the vehicles for diplomatic cooperation between the two countries in SEC investigations of insider trading alleged to have occurred via Swiss accounts.⁶ In July 1984, the SEC successfully relied on the treaty and memorandum of understanding to persuade the Swiss government to order five banks to divulge the identities of

¹ The Securities and Exchange Commission was established by the Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. § 78 (1982)). Its primary function is the protection of investors in securities. *Quinn & Co. v. SEC*, 452 F.2d 943, 947 (10th Cir. 1971), *cert. denied*, 406 U.S. 957 (1971).

² "Insider trading" describes the act of purchasing or selling securities while in possession of material, non-public information about an issuer or the trading market for an issuer's securities. See 2 LOSS, *SECURITIES REGULATION* 1037 (2d ed. 1961); Cary, *Insider Trading in Stocks*, 21 BUS. LAW. 1009 (1966). Insider trading is illegal under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78(j) (1982) and 17 C.F.R. § 240.10b-5 (1984) (rule 10b-5), promulgated by the SEC.

³ In 1981, total foreign trading on American stock markets was \$75 billion, approximately \$14.8 billion of which came from Swiss banks. *N.Y. Times*, Sept. 1, 1982, at 34, col. 6.

⁴ Treaty on Mutual Assistance in Criminal Matters, May 25, 1973, United States-Switzerland, 27 U.S.T. 2019, T.I.A.S. No. 8302, *reprinted in* 12 I.L.M. 916 [hereinafter cited as Treaty].

⁵ *U.S.-Swiss Memorandum on Insider Trading*, 14 SEC. REG. & L. REP. (BNA) 1737 (Oct. 8, 1982) [hereinafter cited as *Memorandum*].

⁶ These instruments are the means for voluntary cooperation by the Swiss. The SEC also has the option to attempt to get information by court-ordered discovery procedures. See *infra* note 34 and accompanying text. The primary emphasis of this Recent Development is the viability of the treaty and memorandum for investigatory cooperation when the alleged illegal trading was done through a Swiss brokerage house rather than a bank.

certain account holders⁷ suspected of insider trading on Kuwait Petroleum Corporation's purchase of Santa Fe International, an oil and gas drilling concern.⁸ The SEC is currently conducting another investigation of alleged insider trading involving more than twenty Wall Street individuals, law firms, and securities firms.⁹ The SEC suspects that this alleged insider trading may be the largest ever encountered, involving over forty million dollars of illegal trading profits.¹⁰ As part of this investigation, the SEC is attempting to obtain the identities of several account holders at Zurich-based Ellis Ag.¹¹ Ellis is a brokerage-concern affiliate of the major private Swiss bank, A. Sarasin & Cie. of Basel, and the SEC believes much of the alleged inside trading was done through accounts handled by Ellis.¹²

Issues relating to the scope of the treaty and memorandum of understanding surfaced in April 1984, when the Swiss Federal Office of Police refused to grant the SEC's first request,¹³ made pursuant to the treaty and memorandum, that Swiss authorities instruct Ellis to reveal the names behind the accounts involved in the investigation.¹⁴ The SEC then made a second request, also pursuant to the treaty and memorandum, on July 10.¹⁵ As of October 1, the Swiss had made no decision on this second request, and it was uncertain when their response to the SEC would be forthcoming.¹⁶ When the Federal Office of Police denied the April request, Swiss authorities took the position that the treaty and memoran-

⁷ Swiss banks maintain "omnibus accounts" with brokerage houses in the United States, which allow them to trade for their customers in the banks' names. Kelley, *United States Foreign Policy: Efforts to Penetrate Bank Secrecy in Switzerland from 1940 to 1975*, 6 CAL. W. INT'L L.J. 211, 237 (1976).

⁸ SEC v. Certain Unknown Purchasers of the Common Stock, and Call Options for the Common Stock of Santa Fe Int'l Corporation, FED. SEC. L. REP. (CCH) ¶ 99, 424 (S.D.N.Y. July 25, 1983) [hereinafter cited as Santa Fe Case].

⁹ Metz, *SEC Investigates Insider Trading on Takeover Bids*, Wall St. J., July 23, 1984, at 2, col. 1.

¹⁰ *Id.*

¹¹ *Id.* SEC Enforcement Director, John M. Fedders, first publicly confirmed the Ellis investigation on Sept. 19, 1984, but reports in the *Wall Street Journal* have stated that the investigation has been underway for more than two years. Metz, *supra* note 9.

¹² *Id.*

¹³ The United States Department of Justice formally made the request on behalf of the SEC, as required by article 28 of the treaty. Treaty, *supra* note 4, ch. VII, art. 28.

¹⁴ Jorg Kistler, spokesman for the Swiss Federal Office of Police, characterized this request as "broad and informal." Wall St. J., Aug. 1, 1984, at 7, col. 2.

¹⁵ *Id.* Mr. Kistler characterized the second request as more formal than the first; he also stated that it "covers less ground" than the first request. *Id.*

¹⁶ *Id.*

dum applied only to banks and, therefore, a bank affiliate such as Ellis was not subject to the provisions of the two agreements.¹⁷ Ellis has since stated that it will cooperate with the SEC probe, but only insofar as such cooperation complies with Swiss secrecy law and the firm's responsibilities to its clients.¹⁸ In effect, this statement indicates that any cooperation the SEC receives from Ellis will come only at the instruction of the Swiss government. This Recent Development examines the 1977 treaty and 1982 memorandum of understanding, and the detrimental results to the SEC's investigatory powers which will arise should the Swiss continue to deny application of these agreements to brokers such as Ellis.

Insider trading refers to trading in the securities markets while in possession of material information¹⁹ that is not available to the general public.²⁰ Anyone who buys or sells securities based on such non-public information is in violation of section 10b of the Securities Exchange Act and rule 10b-5 of the SEC, promulgated pursuant to the act.²¹ The SEC has the authority to initiate investigations as it deems necessary to determine whether any person has violated or is about to violate these provisions.²² The SEC also has authority to obtain temporary or permanent injunctions for disgorgement of any profits made through illegal transactions, and for civil monetary penalties of up to three times the profit gained or loss avoided through illegal transactions.²³ Criminal proceedings

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ Material information has been defined as that to which a reasonable man would attach importance in determining his choice of action in the transaction in question. *T.S.C. Industries, Inc. v. Norway, Inc.*, 426 U.S. 438 (1976); *List v. Fashion Park, Inc.*, 340 F.2d 457, 462 (2d Cir. 1965), *cert. denied*, 382 U.S. 811 (1965).

²⁰ H.R. REP. No. 355, 98th Cong., 1st Sess. 2 (1983) [hereinafter cited as H.R. REP. No. 355]. See also *supra* note 2. Insider trading often occurs in the context of a corporate buyout; once the takeover intention is announced the value of the stock of the company to be acquired may increase dramatically. An "insider" may be broadly defined as one who has "access, directly or indirectly, to information intended to be available for a corporate purpose and not for the personal benefit of anyone." *Cady, Roberts & Co.*, 40 S.E.C. 907 (1961).

²¹ 15 U.S.C. § 78(j) (1982). For a complete list of the SEC's general rules and regulations, see 17 C.F.R. § 240 (1984).

²² 15 U.S.C. § 78u(a) (1982).

²³ Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 (1984). This act is an amendment to the Securities Exchange Act of 1934, *supra* note 1. The 1934 act, through § 21(e), provided only for injunctions, but once the equity jurisdiction of a court was established on a showing of a securities violation, the court obtained the power to fashion an appropriate remedy. Disgorgement of the illegal profits was often the equitable relief the SEC requested. H.R. REP. No. 355, *supra* note 20, at 7. The penalties contained in the 1984 act are in addition to those existing under the 1934 act, giving the SEC more flexibility

for violations of SEC rules and regulations are also possible, but the SEC must transmit any evidence it has collected concerning alleged violations to the Attorney General, who must initiate any such proceedings.²⁴

On May 25, 1973, the United States and Switzerland signed the Treaty on Mutual Assistance in Criminal Matters.²⁵ President Ford presented the treaty to the Senate for ratification on February 18, 1976.²⁶ In his message to the Senate, President Ford noted that assistance from Switzerland in obtaining evidence and information needed for criminal investigations was uniquely important because of Switzerland's position as an international financial center.²⁷ President Ford also stated that despite previous general cooperation from the Swiss, procedures for obtaining the needed information had been "generally ponderous and inadequate." Federal officials also frequently encountered severe difficulties in obtaining information from Swiss banks due to banking secrecy laws.²⁸ The treaty, effective January 23, 1977, calls for compulsory assistance in the investigation of crimes that are punishable under the laws of the requesting and the requested states and are among the thirty-five crimes listed in the treaty.²⁹ Included in this list of crimes is "[f]raud, including obtaining money or securities by . . . any fraudulent means."³⁰ Insider trading per se, however, is not a

in terms of available remedies. *Id.* at 8. The 1984 act defines "profit gained or loss avoided" to mean the difference between the purchase or sale price of the security and the trading price of that security a reasonable period after public dissemination of the nonpublic information. Insider Trading Sanctions Act of 1984, § 2 (to be codified at 15 U.S.C. § 784). The First Circuit followed this definition in *SEC v. MacDonald*, 699 F.2d 47 (1st Cir. 1983), where disgorgement of the illegal profits was ordered in an action brought under the 1934 act and rule 10b-5.

²⁴ Securities Exchange Act of 1934, § 21(e) (codified as amended at 15 U.S.C. § 78u(d) (1982)). The maximum penalty for any individual is a \$100,000 fine, Insider Trading Sanctions Act of 1984, § 3 (to be codified at 15 U.S.C. 78ff), and/or a five-year prison term. 15 U.S.C. § 78ff(a) (1982).

²⁵ Treaty, *supra* note 4. The President ratified the treaty on July 10, 1976; Swiss ratification was on July 7, 1976. The treaty entered into force on January 23, 1977.

²⁶ President's Message to the Senate Transmitting the Treaty for Advice and Consent to Ratification, 12 WEEKLY COMP. PRES. DOC. 234 (Feb. 18, 1976) [hereinafter cited as President's Message].

²⁷ *Id.* Switzerland is the third largest financial center in the world behind New York and London.

²⁸ President's Message, *supra* note 26. President Ford also stated that the treaty was the first major international agreement by the United States aimed at obtaining information and evidence needed for criminal investigations and prosecutions. *Id.*

²⁹ Treaty, *supra* note 4, art. 4, schedule, 27 U.S.T. at 2028-29, 2064-67.

³⁰ *Id.* schedule, 27 U.S.T. at 2065.

criminal offense punishable under the laws of Switzerland.³¹ In addition, the language of the treaty, while not explicitly excluding other types of institutions, refers to a "bank" and does not mention brokers.³²

On November 16, 1981, the United States District Court for the Southern District of New York issued an order compelling Banca Della Svizzera Italiana (BSI)³³ to divulge the names of its undisclosed principals involved in an SEC insider trading investigation.³⁴ Shortly thereafter, in March and August 1982, the United States and Switzerland met again to discuss mutually acceptable means of improving international law enforcement cooperation in the field of insider trading.³⁵ Swiss authorities, prompted by the fear of future United States court action similar to the BSI case,³⁶ agreed to a memorandum of understanding regarding the 1977 treaty at these meetings.³⁷ In the memorandum, the Swiss agreed that insider trading could be an offense under Articles 148 (fraud), 159 (unfaithful management), or 162 (violations of business secrets) of the Swiss Penal Code.³⁸ The Swiss further agreed that when an insider trading investigation also includes an allegation

³¹ Insider trading, though not illegal per se in Switzerland, is considered unethical. The Swiss consider the practice an "administrative" problem rather than a crime. *Memorandum, supra* note 5, at 1738.

³² Treaty, *supra* note 4, art. 10, § 2.

³³ BSI is a Swiss bank which transacts business on United States securities markets. *SEC v. Banca Della Svizzera Italiana*, 92 F.R.D. 111, 112 (S.D.N.Y. 1981).

³⁴ *Banca Italiana*, 92 F.R.D. at 111. This case was an SEC action against a Swiss bank and unnamed others for an injunction and an accounting for violating insider trading provisions. The SEC also sought to compel discovery of the names of the other parties. While making no mention of the treaty or the memorandum, the court followed a line of case law regarding compelling discovery where foreign law prohibits the requested disclosure. The court applied a balancing test, considering such factors as the good faith of the party resisting discovery, the illegality of disclosing such information under the foreign law, and what view, if any, the foreign government had expressed in the case. *Id.* at 114-15. The court also seemed to come very near a nexus approach as well, stating in its conclusion: "It would be a travesty of justice to permit a foreign company to invade American markets, violate American laws if they were indeed violated, withdraw profits and resist accountability for itself and its principals for the illegality by claiming their anonymity under foreign law." *Id.* at 119.

³⁵ *Memorandum, supra* note 5, at 1737. SEC representatives in the United States delegation included among others, John M. Fedders, Director of the Division of Enforcement, and Edward F. Greene, General Counsel. *Id.*

³⁶ The memorandum specifically mentioned that the United States and Swiss representatives entered into discussions "of concerns in both countries with respect to recent cases involving persons who used Swiss banks as intermediaries to effect securities transactions in the United States" based on inside information. *Id.* at 1738.

³⁷ *Id.*

³⁸ *Id.*

that the Swiss Penal Code has been violated, compulsory measures can be had under the treaty to assist the SEC in obtaining information.³⁹ This part of the memorandum also refers to obtaining information from "banks" that act on behalf of their clients in securities transactions in the United States.⁴⁰ The memorandum further provides that the Swiss Federal Council will submit to the Parliament a bill making insider trading per se illegal under Swiss law.⁴¹ The parties discussed the feasibility of using a private agreement of the Swiss Banker's Association⁴² as a means of handling requests for information by the SEC in the interim pending the passage of the bill.⁴³ The private agreement language is similarly flawed, however, in that it refers only to "banks" with no reference to brokers.⁴⁴

The record of cooperation under the agreements is disappointing in that the only instance in which the SEC successfully relied on the treaty and memorandum to persuade the Swiss government to order disclosure of principals involved in insider trading has been the *Santa Fe* case,⁴⁵ which did involve banks. In *Santa Fe*, the SEC, acting through the United States Department of Justice,⁴⁶ requested information from the Swiss Federal Office of Police on

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.* at 1738-39. On November 16, 1983, the Swiss government officially announced it would submit to its Parliament legislation that would make insider trading a criminal offense under the Swiss Penal Code. A spokesman for the Swiss Ministry of Justice and Police stated that it had begun the usual procedure of consulting the cantonal governments, political parties, and other groups, specifically the banking industry, before any major bill is submitted to Parliament. This process was expected to last until early 1984, with the bill going to Parliament late that year, and if passed, enacted in 1985. N.Y. Times, Nov. 17, 1983, at D6, col. 3.

⁴² Agreement XVI of the Swiss Banker's Association with Regard to the Handling of Requests for Information from the Securities and Exchange Commission of the United States on the Subject of Misuse of Inside Information, 22 I.L.M. 7 (1983), 14 SEC. REG. & L. REP. (BNA) 1740 (Oct. 8, 1982) [hereinafter cited as Private Agreement].

⁴³ The private agreement calls for the appointment of a Commission of Inquiry for the Board of Directors of the Swiss Banker's Association to handle SEC inquiries on the misuse of inside information pursuant to certain conditions set out in the private agreement. The Commission may furnish the requested information to the SEC; however, the conditions and limitations contained in the private agreement have raised questions regarding what practical benefit it will actually be to the SEC in insider trading investigations. For a discussion of the limits of the private agreement, see *Insider Trading Laws and Swiss Banks: Recent Hope for Reconciliation*, 22 COLUM. J. TRANSNAT'L L. 303, 315 (1984).

⁴⁴ Private Agreement, *supra* note 42.

⁴⁵ *Santa Fe* Case, *supra* note 8.

⁴⁶ The treaty provides that requests for assistance must be handled by the Attorney General or his designee. Treaty, *supra* note 4, art. 28, 27 U.S.T. at 2050.

March 22, 1982.⁴⁷ The Federal Office of Police determined that the request met the requirements set out in the treaty and issued an order for the banks involved to disclose the identities of the principals behind the accounts under investigation.⁴⁸ The banks initially appealed this order back to the Federal Office of Police, which affirmed its earlier decision.⁴⁹ A subsequent appeal to the Swiss Supreme Court followed, which originally resulted in a reversal in the banks' favor.⁵⁰ This ruling was short-lived, however, because the court subsequently issued an order directing the banks to release the information to the SEC.⁵¹ This ruling marked the first time the SEC had received such assistance from the Swiss courts.⁵²

The issue presented by the Ellis investigation — whether the Swiss will recognize bank-affiliated brokers as being subject to the terms of the treaty and memorandum — will be a barometer of Swiss attitudes concerning the whole secrecy issue.⁵³ Given that secrecy plays a vital role in Switzerland's attractiveness to investors,⁵⁴ and that secrecy has been the norm since World War II,⁵⁵ it should be no surprise that the Swiss favor a restrictive interpreta-

⁴⁷ Switzerland: Swiss Supreme Court Opinion Concerning Judicial Assistance in the Santa Fe Case, 22 I.L.M. 785 (1983) [reproduced from an English summary prepared by Charles Ponce of Lavine & Budin, Geneva].

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ Wall St. J., July 16, 1984, at 42, col. 4.

⁵² *Id.*

⁵³ The SEC has found the Swiss government often unwilling to cooperate with its investigations. In a case similar to the Ellis investigation involving Marc Rich and Pincus Green, the two principal officers of a Swiss commodity trading concern, the Swiss government not only refused to extradite the two to the United States for prosecution, but also seized certain documents of the company to keep such documents out of the United States courts. Wall St. J., Oct. 22, 1984, at 30, col. 1. The Swiss banking industry is also hostile to any unilateral attempts by the SEC to solve the secrecy problem. Wall St. J., Dec. 6, 1984, at 35, col. 1. Indications are, however, that Swiss attitudes may be moving closer to those of the SEC, as evidenced by the Santa Fe Case, *supra* note 8, and the possibility that the Parliament may pass a bill making insider trading a crime in Switzerland. *Memorandum, supra* note 5, at 1738.

⁵⁴ Switzerland's history of political stability also enhances its attractiveness over other countries with similar secrecy laws. As of November 1, 1982, 26 countries had banking secrecy laws, and 22 countries maintained "blocking laws," which impede judicial or administrative proceedings by restricting testimony or production of documents for use in such proceedings. Outline by John M. Fedders, Director of the Division of Enforcement, Securities and Exchange Commission, in preparation for an address before the Tenth Annual Securities Regulation Institute, University of California, San Diego, January 1983, at 23 (material dated Nov. 1, 1982).

⁵⁵ For a discussion of the history of Swiss banking secrecy, see Meyer, *Swiss Banking Secrecy and Its Legal Implications in the United States*, 14 NEW ENG. L. REV. 18 (1978).

tion of these agreements. The exclusion of institutions such as Ellis from the scope of the treaty and memorandum would mark a major setback for the SEC in its attempts to crack down on what it sees as an increasing problem of insider trading.⁵⁶ If the Swiss decline to furnish assistance on investigations of securities transactions conducted through institutions such as Ellis, any party that intended to trade based on inside information would certainly work the transaction through such a "non-bank" institution to avoid SEC prosecution. Furthermore, the possibility of further United States court decisions similar to *Banca Italiana*⁵⁷ should indicate to the Swiss that United States courts may no longer be willing to tolerate foreign secrecy laws that shield parties which violate United States securities laws in transactions on United States exchanges.

By acknowledging that Swiss brokers should be subject to the treaty and memorandum, the Swiss government could promote goodwill with the United States while at the same time enhancing the integrity of its own financial network. In granting SEC requests for information in cases such as Ellis, Switzerland could send a message to the financial world that it is serious about cooperation with the SEC on insider investigations and will no longer be a haven for securities law violators.

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⁵⁶ *Insider Trading Sanctions and SEC Enforcement Legislation, Hearings on H.R. 559 Before the Subcomm. on Telecommunications, Consumer Protection, and Finance of the House Comm. on Energy and Commerce, 98th Cong., 1st Sess. 19 (1983)* (written statement of John S.R. Shad, Chairman, Securities and Exchange Commission).

⁵⁷ *Banca Italiana*, 92 F.R.D. at 111.