

# Northwestern Journal of International Law & Business

---

Volume 5  
Issue 3 *Fall*

---

Fall 1983

## Recent Development in Insider Trading Through Swiss Bank Accounts: An End to the "Double Standard"

Jonathan Levin

Follow this and additional works at: <http://scholarlycommons.law.northwestern.edu/njilb>



Part of the [International Law Commons](#)

---

### Recommended Citation

Jonathan Levin, Recent Development in Insider Trading Through Swiss Bank Accounts: An End to the "Double Standard", 5 Nw. J. Int'l L. & Bus. 658 (1983-1984)

This Comment is brought to you for free and open access by Northwestern University School of Law Scholarly Commons. It has been accepted for inclusion in Northwestern Journal of International Law & Business by an authorized administrator of Northwestern University School of Law Scholarly Commons.

## Recent Developments in Insider Trading Through Swiss Bank Accounts: An End to the "Double Standard"

In recent years, the Securities and Exchange Commission (SEC) has increased its efforts to combat insider trading<sup>1</sup> in publicly-traded securities in order to ensure fairness, honesty, and confidence in the United States securities markets.<sup>2</sup> Nevertheless, insiders<sup>3</sup> continue to employ Swiss banks as a conduit for their trading activity with little fear of detection.

While Swiss banks trade securities for their account holders on American exchanges,<sup>4</sup> Swiss bank secrecy laws prohibit the identity of account holders from being disclosed except under limited circumstances.<sup>5</sup> The combination of Swiss bank participation on American securities exchanges and strict bank secrecy laws has created a "double standard" for the prosecution of inside traders in the United States.<sup>6</sup> Insiders are subject to securities regulations in the United States, yet those who trade through Swiss bank accounts are able to evade these regulations. According to the SEC, this double standard must be eliminated to maintain the effectiveness of federal securities laws and to en-

---

<sup>1</sup> "Insider trading" is commonly used to describe 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); In the Matter of Cady, Roberts & Co., 40 S.E.C. 907 (1961). Those who engage in insider trading may be referred to as "insider traders" or "insiders."

<sup>2</sup> *Memorandum of the Securities and Exchange Commission in Support of the Insider Trading Sanctions Act of 1982*, 14 SEC. REG. & L. REP. (BNA) 1705 (Oct. 1, 1982) [hereinafter cited as *SEC Memorandum*].

<sup>3</sup> The term "insider" may be broadly defined to include anyone who has "access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone." In the Matter of Cady, Roberts & Co., 40 S.E.C. 907, 912 (1961).

<sup>4</sup> Unlike the banking system in the United States, Swiss banks are permitted to engage in retail stock brokerage activities, as well as conventional commercial banking operations. Meyer, *Swiss Banking Secrecy and Its Legal Implications in the United States*, 14 NEW ENG. L. REV. 18, 45 (1978).

<sup>5</sup> See *infra* notes 32-35 and accompanying text.

<sup>6</sup> 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).

sure the integrity of United States capital markets.<sup>7</sup>

In the fall of 1981, the Federal District Court for the Southern District of New York handed down two decisions which penetrated the veil of bank secrecy in Switzerland.<sup>8</sup> Such action paved the way for the 1982 Memorandum of Understanding between the United States and Switzerland regarding cooperation in the enforcement of United States insider trading regulations.<sup>9</sup> In this Memorandum, the Swiss have agreed to establish a procedure which will permit American authorities to investigate alleged insider trading violations.

This Comment will examine the background and developments leading to the Memorandum of Understanding and the potential impact of the Memorandum on insider trading activities in the United States. It will argue that the breakdown of the Swiss bank secrecy barrier will help eliminate the de facto double standard for insider trading, yet will not reduce legitimate foreign trading activity on American securities exchanges.

## I. THE PROBLEM

Securities trading by Swiss banks in the United States is substantial. In 1981, total foreign trading on American stock markets equalled \$75 billion. Roughly \$14.8 billion (almost twenty percent) of this total came from Swiss banks.<sup>10</sup> Although the exact number of Americans who hold Swiss bank accounts is unknown,<sup>11</sup> the popularity of the accounts has remained high for decades because of Switzerland's reputation for security; social, political and economic stability; and bank secrecy.<sup>12</sup>

In its attempt to combat insider trading, the SEC relies heavily on

---

<sup>7</sup> *Id.*

<sup>8</sup> Securities and Exchange Comm'n v. Banca Della Svizzera Italiana, 92 F.R.D. 111 (S.D.N.Y. 1981); Securities and Exchange Comm'n v. Certain Unknown Purchasers of the Common Stock, and Call Options for the Common Stock of Santa Fe Int'l Corporation, et al., [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,323 (S.D.N.Y. Oct. 26, 1981) [hereinafter cited as Securities and Exchange Comm'n v. Santa Fe Int'l Corp.]. See *infra* notes 98-126 and accompanying text.

<sup>9</sup> U.S.-Swiss Memorandum on Insider Trading, 14 SEC. REG. L. REP. (BNA) 1737 (Oct. 8, 1982). This Memorandum was signed Aug. 31, 1982. See *infra* notes 130-53 and accompanying text.

<sup>10</sup> N.Y. Times, Sept. 1, 1982, at 34, col. 6. Although Swiss banks maintain a small volume of domestic stocks, they trade extensively for U.S. clients on foreign exchanges. Dagon, *Securities Regulation in Switzerland*, 6 VAND. J. OF TRANSNAT'L L. 524 (1973).

<sup>11</sup> It was estimated in 1970 that between 20,000 and 30,000 Americans own Swiss bank accounts with an aggregate value of \$100-200 million. Comment, *Swiss Banks and Their American Clients: A Fading Romance*, 3 CAL. W. INT'L L.J. 37 n.2 (1972).

<sup>12</sup> N.Y. Times, *supra* note 10.

assistance from the major stock exchanges and the National Association of Securities Dealers which supervises the over-the-counter markets.<sup>13</sup> Computers and information-retrieval devices monitor the securities markets throughout the trading day and signal significant price movements or unusual trading volume.<sup>14</sup> When the SEC believes that trading violations have occurred, it evaluates buy and sell orders to determine the source of the trading activity.<sup>15</sup>

Swiss banks, however, maintain "omnibus accounts" with American brokerage houses which permit them to trade for their customers in the bank's name.<sup>16</sup> Under these circumstances, inspection of the broker's records by the SEC only indicates the trades conducted for the bank's account, and thus prohibits the SEC from determining the real party in interest.<sup>17</sup>

## II. BANK SECRECY UNDER SWISS LAW

The Swiss attitude toward bank secrecy developed principally from the high priority placed on privacy in civil law countries.<sup>18</sup> The right to financial privacy, for example, is considered a well-entrenched guarantee which dates back to the Swiss Banking Law of 1934.<sup>19</sup> This law was enacted, in part, to prevent Nazi agents from tracking the assets of fleeing German Jews who kept money in Swiss banks.<sup>20</sup>

Differences with regard to privacy protection have an important

---

<sup>13</sup> Louis, *The Unwinnable War on Insider Trading*, FORTUNE, July 13, 1981, at 76.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> Kelly, *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).

<sup>17</sup> *Id.* For examples of the ways in which omnibus accounts violate U.S. law, see *United States v. Kelly*, 349 F.2d 720 (2d Cir. 1965), *cert. denied*, 384 U.S. 947 (1966) (trusts holding Swiss bank accounts were used by American promoters to sell unregistered over-the-counter stock to the American public at manipulated price levels); *United States v. Hayutin*, 398 F.2d 944 (2d Cir. 1968), *cert. denied* 392 U.S. 961 (1968) (German banks were used by insiders to sell unregistered stock at artificially high prices, while a foreign branch of an American bank was used to eliminate any connection between the proceeds of the sales and the compensation to brokers for selling the stock). According to the SEC, omnibus accounts are also used by underwriters of "hot issues" who secretly purchase shares of new issues for their own accounts through Swiss banks without disclosing this critical fact to the public. In addition, omnibus accounts have been used extensively by both Americans and foreigners to violate the Federal Reserve Board's margin requirements. This practice has been curtailed due to the enactment of Regulation T in 1969. *Foreign Bank Secrecy: Hearings on S. 3678 and H.R. 15073 Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking and Currency*, 91st Cong., 2d Sess. 263-65 (1970).

<sup>18</sup> Comment, *Secret Foreign Bank Accounts*, 6 TEX. INT'L L.J. 105, 115 (1970).

<sup>19</sup> Mueller, *The Swiss Banking Secret*, 18 INT'L & COMP. L.Q. 360, 361-62 (1969).

<sup>20</sup> Wall St. J., Sept. 2, 1982, at 4, col. 1. For a more thorough background of the origins of Swiss bank secrecy, see N. FAITH, *SAFETY IN NUMBERS* (1982).

bearing upon the different positions taken by Switzerland and the United States on bank secrecy.<sup>21</sup> In common law countries such as the United States, the right to financial privacy is generally less developed and not as pervasively recognized.<sup>22</sup> A bank's obligation to keep account records secret is implied and discretionary, and is regulated by state law.<sup>23</sup> American banks consequently have a duty to disclose customer account information only if compelled by a court, grand jury, or the government.<sup>24</sup>

In general, Swiss banks are obliged to maintain strict secrecy. Any unjustifiable disclosure of confidential information, including the identity of the customer,<sup>25</sup> may result in criminal prosecution under three Swiss statutes.<sup>26</sup> First, the Swiss Banking Act establishes criminal penalties for any employee or agent of a bank who discloses the confidential information of a bank customer.<sup>27</sup> Second, Article 273 of the Swiss Penal Code makes it a crime for any person to communicate secret information, including banking information, to a foreign official or a private enterprise.<sup>28</sup> Third, Article 162 of the Swiss Penal Code outlaws the disclosure of a manufacturing or business secret by any person who has a statutory or contractual duty to guard such a secret.<sup>29</sup> In

---

<sup>21</sup> Meyer, *supra* note 4, at 22.

<sup>22</sup> *Id.* at 20-21.

<sup>23</sup> *Id.* at 23.

<sup>24</sup> *Id.*

<sup>25</sup> The holder of a Swiss bank account may choose to identify his or her account by name or by number. With numbered accounts, only a few top bank officers are able to identify the account with the name of the owner. Numbered accounts, therefore, are not anonymous, but solely an internal device to protect customers from the indiscretion of staff members. Swiss banks will not accept anonymous funds. Comment, *supra* note 18, at 122.

<sup>26</sup> In contrast, in common law countries such as the United States, it is often only an ethical violation to divulge confidential information acquired in a privileged position. See, e.g., MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 4 (1979).

<sup>27</sup> Article 47 of the Swiss Banking Act states:

Whoever divulges a secret entrusted to him in his capacity as an officer, employee, mandatory, liquidator, or commissioner of a bank, as a representative of the Banking Commission, officer or employee of a recognized auditing company, or who has become aware of such a secret in this capacity, and whoever tries to induce others to violate professional secrecy, shall be punished by a fine not exceeding 50,000 francs.

Loi fédérale sur les banques et les caisses d'épargne du 8 novembre 1934 art. 47, 51 Recueil officiel des lois et ordonnances de la Confédération suisse [ROLF] 121 (1935). An unofficial English translation may be found in UNION BANK OF SWITZERLAND, SWISS FEDERAL BANKING LAW (1972).

<sup>28</sup> Swiss Penal Code Article 273, states in part: "any person who makes available a manufacturing or business secret to a foreign official or private enterprise or to the agents thereof shall be punished by imprisonment or in serious cases to 'reclusion.'" SCHWEIZERISCHES STRAFGESTZBUCH art. 273, Code PÉNALE SUISSE art. 273, CODICE PENALE SVIZZERO art. 273.

<sup>29</sup> Article 162 states: "Any person who reveals a manufacturing or business secret which he was bound to keep by virtue of a statutory or contractual obligation, and any person who profits

addition to these statutory criminal sanctions, disclosure of customer information by a Swiss bank may subject the bank and its officials to civil liability in tort and contract<sup>30</sup> and to disciplinary sanctions by the Swiss Banking Commission. These sanctions may include the revocation of the bank's authority to do business.<sup>31</sup>

The enforcement of Swiss bank secrecy is not absolute, however, but applies only to unauthorized third parties who seek to obtain banking information without a court order.<sup>32</sup> Bank customers may always require the bank to produce any information relating to their accounts.<sup>33</sup> Furthermore, because Swiss federal and cantonal procedural laws supersede the privacy rights of the account holder, bank secrecy generally cannot be asserted in criminal or civil proceedings brought pursuant to Swiss federal or cantonal jurisdiction.<sup>34</sup>

Swiss banks will release confidential customer information to foreign governments for use in criminal prosecutions when the crime is recognized by the Swiss Penal Code.<sup>35</sup> The Swiss government, however, historically has not recognized insider trading as a criminal violation,<sup>36</sup> and therefore banks have refused to extend cooperation to the

---

thereby shall, upon complaint being filed, be punished by imprisonment or a fine." STGB art. 162, C.P. art. 162, COD. PEN. art. 162.

<sup>30</sup> Memorandum of Defendant Banca Della Svizzera Italiana in Opposition to Plaintiff's Application for an Order Compelling Answers and Imposing Sanctions, at 12, *Securities and Exchange Comm'n v. Banca Della Svizzera Italiana*, 92 F.R.D. 111 (1981) [hereinafter cited as BSI Defendant's Memorandum].

<sup>31</sup> *Id.*

<sup>32</sup> Note, *Swiss Banks and the Avoidance of American Tax and Securities Laws: An Assessment Based on Proposed Legislation*, 3 N.Y.U. J. INT'L L. & POL. 94, 97 (1970).

<sup>33</sup> Meyer, *supra* note 4, at 29. The Swiss public interest also provides exceptions in cases involving heirs, family law, debt collections and bankruptcy, international money transfers, and criminal conduct. Comment, *supra* note 18, at 119. Swiss law, however, contains no provision allowing foreign authorities to compel disclosure of information protected by bank secrecy laws. BSI Defendant's Memorandum, *supra* note 30, at 13.

<sup>34</sup> This obligation of Swiss banks to disclose customer information is an exception to the rule. In general, however, Swiss banks are obligated to maintain secrecy; any unjustifiable violation of bank secrecy may result in a claim for damages as well as penal sanctions. Mueller, *supra* note 19, at 377.

<sup>35</sup> Comment, *supra* note 18, at 119.

<sup>36</sup> Louis, *supra* note 13, at 82. In Switzerland, securities violations are not considered crimes, but rather "administrative" problems. In contrast to the highly regulated Swiss banking system, the Swiss system of securities regulation, to the extent it exists at all, is primarily a system of self-regulation. Dagon, *supra* note 10, at 511. Although mutual funds are under the strict supervision of the Swiss Banking Commission, Switzerland does not have a counterpart to the SEC. *Id.* at 511-12. As a consequence, certain segments of the financial industry, such as the commodities industry, are notorious for underhanded activity. See, e.g., In the Matter of Banque Populaire, CFTC Docket No. 80-8 (Oct. 9, 1981), where an administrative law judge at the Commodities Futures Trading Commission barred Banque Populaire Suisse from trading on United States contracts markets for 90 days because it failed to provide information concerning the bank's silver

SEC during insider trading investigations. This refusal has created the loophole which inside traders have used to escape "the regulatory net carefully woven by Congress."<sup>37</sup>

The frustration of securities laws in the United States because of Swiss bank accounts is particularly detrimental to the positive image of Swiss banks.<sup>38</sup> Thus, most Swiss banks are quick to eliminate customers who engage in suspicious transactions.<sup>39</sup> As a result, the flow of American dollars to Swiss banks is generally deposited and withdrawn for legitimate ends.<sup>40</sup>

Furthermore, in Switzerland, support for the ban on insider trading and the lifting of bank secrecy laws has been mounting.<sup>41</sup> The Social Democrats claim bank secrecy has made Switzerland a haven for underworld criminals and tax evaders,<sup>42</sup> and has encouraged internal corruption within the Swiss banking system.<sup>43</sup> Swiss bankers respond that because much of their foreign business<sup>44</sup> is derived from their reputation for confidentiality, the lifting of bank secrecy laws will weaken the country's position as an international financial capital.<sup>45</sup>

Nevertheless, the Swiss government has reacted in favor of public

---

bullion futures positions and the identity of customers trading these futures in the bank's name. The judge rejected the bank's argument that Swiss privacy laws prohibited disclosure of this information and thus superseded U.S. law. *ALJ Holds Swiss Bank Under Jurisdiction of CFTC*, *LEGAL TIMES OF WASHINGTON*, Oct. 26, 1981, at 11. In relation to this case and the problems on the Swiss commodities exchanges such as "boiler room" sales tactics and outright fraud, see *CFTC Tests Bank Secrecy in Switzerland as Swiss Commodity Firms Battle Fraud*, *Wall St. J.*, Mar. 24, 1980, at 32, col. 1.

<sup>37</sup> *Federal Response to OPEC's Country Investments in the United States (Part 2): Hearings Before a Subcomm. of the House Comm. on Government Operations*, 97th Cong., 1st Sess. 61 (1981) (Statement of James Gallagher, President, Pacific Stock Exchange) [hereinafter cited as *Federal Response Hearings*].

<sup>38</sup> Only recently have the Swiss come to recognize this harmful effect. See *ECONOMIST*, Jan. 21, 1978, at 111, which discusses the Swiss banks' adamant opposition to SEC intervention.

<sup>39</sup> Meyer, *supra* note 4, at 51. Swiss banks which engage in illegal transactions in the United States are generally small, private, regional institutions with lesser reputations to uphold. *Id.* at 52. In the *Santa Fe Int'l* case, however, five major Swiss banks were charged with involvement in insider trading. See *infra* notes 98-111 and accompanying text.

<sup>40</sup> Kelly, *supra* note 16, at 241.

<sup>41</sup> In 1979, 60% of those polled by the Swiss Bankers' Association said they would support the bank revision measure. *Wall St. J.*, June 23, 1980, at 27, col. 2.

<sup>42</sup> *Id.*

<sup>43</sup> The Social Democrats have supported a bank revision initiative since 1977 when the managers of the Chiasso branch of the Swiss Credit Bank (the country's third largest) were caught running an off-the-records bank and funneling deposits into a mysterious conglomerate which they owned. *Id.*

<sup>44</sup> Foreign deposits in Swiss banks totalled \$115.06 billion at the end of 1978. *Id.*

<sup>45</sup> In addition to bank secrecy, Swiss bank popularity also stems from a well-established reputation of banking experience, multilingual ability, and Switzerland's political and economic stability. *Id.*

sentiment by drafting legislation which relaxes the Swiss bank secrecy laws. If passed, the law will permit Swiss bank authorities to inform similar agencies in other countries of suspected illegal bank activity, and thus make it easier for the SEC to investigate securities violations.<sup>46</sup>

### III. INSIDER TRADING REGULATIONS IN THE UNITED STATES

Some economists claim that insider trading harms neither individuals nor the economy.<sup>47</sup> They argue that by permitting insiders to trade based on material, non-public information,<sup>48</sup> the financial markets are brought closer to full efficiency because all relevant information is reflected in the marketplace.<sup>49</sup> They also argue that the investor who trades with the insider on an impersonal exchange would conduct the trade with someone else even if the insider was not involved.<sup>50</sup>

These arguments do not consider the problems faced by exchange specialists and marketmakers who are sometimes obligated to trade securities at prices which do not reflect the value of the inside information and thus often incur great losses when trading with insiders.<sup>51</sup> Furthermore, insider trading undermines the confidence of millions of small investors in the fairness and integrity of American securities markets. This confidence plays an important role in keeping the securities markets functioning smoothly.<sup>52</sup> Finally, many investors believe insider

---

<sup>46</sup> N.Y. Times, Dec. 23, 1982, at 24, col. 2. The legislation does not permit Swiss authorities to pass on information relating to criminal offenses such as tax evasion. Passage of the legislation is expected to take about two years. *Id.* Although this proposal will not affect the Swiss-American Memorandum of Understanding, *see infra* notes 130-53 and accompanying text, dealing with insider trading, it demonstrates the trend in Swiss legislation toward weakening bank secrecy laws.

<sup>47</sup> One proponent of this theory is Henry C. Manne, Professor of Law and Economics at Emory University. *See* Seligman, *An Economic Defense of Insider Trading*, FORTUNE, Sept. 5, 1983, at 48.

<sup>48</sup> "Material" information is any information to which a reasonable man would attach importance in determining his choice of action in the transaction in question. *TSC Industries, Inc. v. Northway, 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).

<sup>49</sup> Louis, *supra* note 13, at 82. An efficient market is one in which prices immediately adjust to changes in underlying realities and thus always reflect everything known about the company's prospects. *Id.*

<sup>50</sup> *Id.*; *see* H. MANNE, *INSIDER TRADING AND THE STOCK MARKET* (1966).

<sup>51</sup> SEC Memorandum, *supra* note 2, at 1706. Exchange specialists and market makers are required to provide market liquidity by standing ready to buy or sell at stated prices. This liquidity helps ensure an orderly market advantageous to all investors. *Id.*

<sup>52</sup> *See* Wall St. J., Sept. 25, 1981, at 39, col. 2. This sentiment is reflected in the statement that "no player should have a priority position." *The SEC Swats at Insider Trading*, BUS. WK., Apr. 19, 1982, at 96 (quoting John M. Fedders, SEC Director of Enforcement). According to SEC Chairman John Shad, "fair and honest markets are an essential predicate for the maintenance of investor confidence." Wall St. J., Sept. 28, 1982, at 1, col. 6.



trading should be barred because it is simply unfair. The unfair advantage for insiders is not that they possess more information than the investing public, but that the investing public is unable to acquire access to this information.<sup>53</sup>

Rule 10b-5 under the Securities Exchange Act prohibits the use of untrue statements, omissions which make other statements misleading, and other fraudulent or deceitful acts and practices in connection with the purchase and sale of a security.<sup>54</sup> Trading securities based upon material, non-public information generally violates Rule 10b-5 unless such information is first released to the investing public. Thus, according to the Supreme Court in *Securities and Exchange Commission v. Texas Gulf Sulphur Co.*,<sup>55</sup> anyone in possession of material information must disclose this information or abstain from trading.<sup>56</sup> This requirement eliminates inherent inequalities in the marketplace by ensuring that investors have relatively equal access to material information with which to make informed judgments.<sup>57</sup>

The Supreme Court has restricted Rule 10b-5 liability to those investors who have an affirmative duty to disclose material information. In *Chiarella v. United States*,<sup>58</sup> the Court held that an employee of a financial printer who obtained confidential information concerning a planned tender offer had no fiduciary duty to the shareholders of the target company and thus could not be convicted under Rule 10b-5.<sup>59</sup> According to the Court, a duty to disclose arises from the relationship between parties and not merely from one's ability to acquire information because of his or her position in the market.<sup>60</sup>

---

<sup>53</sup> Brudney, *Insiders, Outsiders and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322, 346 (1979).

<sup>54</sup> Rule 10b-5(c) states in part: "[i]t shall be unlawful for any person . . . to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5 (1980).

<sup>55</sup> 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1979). In *Texas Gulf Sulphur*, officers, directors, and employees of the company made substantial stock purchases in the company before publicly announcing the discovery of a major copper and zinc mine.

<sup>56</sup> *Id.* at 848.

<sup>57</sup> *Id.*

<sup>58</sup> 445 U.S. 222 (1980).

<sup>59</sup> *Chiarella*, an employee for the financial printer, obtained confidential information regarding several tender offers in the course of printing up the tender offer proposals. He later traded the securities based on this information. The Court held that there exists no general duty to disclose before trading on material, non-public information. Rather, such a duty arises from the existence of a fiduciary relationship. *Id.* at 227-35. According to the Court, there can be no duty to disclose where the person who has traded on inside information was not a corporation's agent, was not a fiduciary, or was not a person in whom the sellers of the securities had placed their trust and confidence. *Id.* at 232.

<sup>60</sup> *Id.* at 232-33, n.14.

In *Chiarella*, the Supreme Court did not decide whether the employee's breach of his duty of silence to his employer and his employer's corporate client (the acquiring company) violated Rule 10b-5.<sup>61</sup> Shortly after *Chiarella*, however, the Second Circuit held that the duty of a securities trader to his employer and the employer's clients prohibits him from trading on confidential, non-public information obtained in the course of his work.<sup>62</sup> In reaching its conclusion, the court cited the Supreme Court decision in *United States v. Naftalin*,<sup>63</sup> which stated that the securities laws were enacted not only to protect investors,<sup>64</sup> but also "to achieve a high standard of business ethics . . . in every facet of the securities industry."<sup>65</sup>

In an effort to recoup any ground lost in *Chiarella*, the SEC issued Rule 14e-3.<sup>66</sup> Rule 14e-3 avoids the fiduciary duty question by banning any trading on advance knowledge of tender offers by any person who knows or should know that the information comes from the target company, the acquiring company, or the agents of either company, unless the information and its source are first publicly disclosed.<sup>67</sup> Since such disclosure would undoubtedly remove the profit incentive to trade, the regulation may be considered an outright prohibition against trading on material, non-public information regarding tender offers.<sup>68</sup>

Rule 10b-5 is not only applicable to traditional insiders,<sup>69</sup> but to anyone having a relationship to a company which gives them access to material, non-public information.<sup>70</sup> This includes "tippees" who receive material, non-public information from an insider or other person

---

<sup>61</sup> *Id.* at 235-37 (Stevens, J., concurring).

<sup>62</sup> *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981).

<sup>63</sup> 441 U.S. 768 (1979).

<sup>64</sup> *Id.* at 775.

<sup>65</sup> *Id.* (quoting Securities and Exchange Comm'n v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186-87 (1963)).

<sup>66</sup> 17 C.F.R. § 240.14e-3(a) (1980).

<sup>67</sup> *Id.*

<sup>68</sup> *Louis*, *supra* note 13, at 75. A case involving Rule 14e-3 has yet to come before the Supreme Court.

<sup>69</sup> Traditional insiders are generally regarded as corporate officers, directors, and controlling shareholders.

<sup>70</sup> Thus, traditional insiders and other corporate employees with access to material, non-public information have a duty to disclose due to their relationship to the corporation. *Chiarella*, 445 U.S. at 227. Rule 10b-5 has been applied to: employees, *Securities and Exchange Commission v. Texas Gulf Sulphur Co.*, 401 F.2d 883 (2d Cir. 1968); broker-dealers, *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228 (2d Cir. 1974); *Securities and Exchange Commission v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963); *Kidder, Peabody & Co.*, 43 S.E.C. 911 (1968); investment bankers, *United States v. Newman*, 644 F.2d 12 (2d Cir. 1981); and financial columnists, *Zweig v. The Hearst Corp.*, 521 F.2d 1129 (9th Cir. 1975).

related to the company.<sup>71</sup> In *Dirks v. Securities and Exchange Commission*,<sup>72</sup> however, the Supreme Court restricted tippee liability by stating that a tippee has a duty to refrain from insider trading only if the insider who passed on the material, non-public information did so for personal benefit. Without some "personal gain" to the insider, the tippee owes no fiduciary duty to the shareholders of a company.<sup>73</sup>

Current penalties for insider trading impose little downside risk on offenders, and thus are a very weak deterrent. Although the SEC can refer cases to the Justice Department for criminal prosecution,<sup>74</sup> conviction requires proof that the insider transaction was a culpable act and that criminal motives existed. As a result, indictments are rare.<sup>75</sup> Rather than risk acquittal in criminal prosecutions, the SEC generally obtains injunctions against inside traders in civil actions where liability is limited to the disgorgement of any profits made on the transaction. These cases are usually settled by consent decree, whereby the accused admits no guilt, disgorges all profits, and promises not to commit the offense in the future.<sup>76</sup> Because such penalties are lenient and successful criminal prosecution occurs in only a fraction of the violations, the risk/reward ratio for the inside trader is very favorable.<sup>77</sup>

Recognizing that current penalties do not provide sufficient deterrence, the SEC is lobbying Congress to pass the Insider Trading Sanc-

---

<sup>71</sup> Tippees have a duty to disclose because they know their source was not supposed to disclose the material, non-public information. *Chiarella*, 443 U.S. at 230, n.12. For a discussion of tippee liability, see *Shapiro*, 495 F.2d at 228; *Ross v. Licht*, 263 F. Supp. 395, 409-10 (S.D.N.Y. 1967).

<sup>72</sup> 1983 FED. SEC. L. REP. (CCH) ¶ 99,255 (U.S. S. Ct. July 1, 1983). In *Dirks*, petitioner, while working as a securities analyst, was informed by a former official of an insurance holding company of massive fraud at the company. Based on this information, he advised several clients to sell their shares in the company. Neither petitioner nor his firm owned or traded any stock in the company. In addition, the facts revealed that the insider who tipped petitioner was motivated by a desire to expose the fraud rather than by personal or monetary gain. Nevertheless, the SEC charged petitioner with insider trading, claiming that as a matter of law, anyone receiving material, non-public information from a corporate insider "inherits" the insider's legal obligation to "disclose or abstain from trading." *Id.*

<sup>73</sup> According to the Court, "the test is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach." *Id.* Thus, there must be a breach of the insider's fiduciary duty before the tippee inherits the duty to disclose or abstain from trading. *Id.*

<sup>74</sup> The maximum penalty is a five-year prison term. 15 U.S.C. § 78ff (1976).

<sup>75</sup> *Burne, Dealing with Insider Trading*, INT'L MGMT., Feb. 1979, 48, 50. There have been only six convictions. *Wall St. J.*, Sept. 28, 1982, at 1, col. 6.

<sup>76</sup> *Louis, supra* note 13, at 72.

<sup>77</sup> Judges have refused to sign consent decrees which they consider to have no deterrent effect on insider trading and to lack in overall fairness to the investing public. *New SEC Proposal to Settle Insider Case is Rejected*, *Wall St. J.*, Apr. 19, 1983, at 23, col. 1.

tions Act.<sup>78</sup> This legislation would allow the government to recover in civil suits up to three times the amount of profits gained or losses avoided in the illegal trading. It would also increase the maximum fine for most criminal violations under the Securities Exchange Act from \$10,000 to \$100,000.<sup>79</sup> These changes are designed to have a prophylactic effect by raising the level of risk for insider trading.<sup>80</sup>

The need for such strict measures becomes continually more apparent in the 1980s. With increasingly volatile options markets<sup>81</sup> and the increased number of corporate takeovers, it is very easy for someone with inside information to use a Swiss bank account "to run roughshod through the financial markets, with little likelihood of being caught."<sup>82</sup>

#### IV. THE CONFLICT BETWEEN THE UNITED STATES AND SWISS LAW

Banking secrecy has been a troublesome issue in American-Swiss relations since World War II. In 1945, the United States controlled the bargaining power. To force Switzerland to disclose information regarding German funds held in Swiss banks,<sup>83</sup> it froze Swiss funds in the United States, blacklisted Swiss firms, and refused to trade goods necessary for Swiss survival.<sup>84</sup> During the bull market of the 1960s, however, this balance of power rapidly shifted to the Swiss as American citizens began using Swiss bank accounts to violate and evade American security laws.<sup>85</sup>

The famous "Interhandel" controversy<sup>86</sup> of the 1950s resulted in

---

<sup>78</sup> SEC Memorandum, *supra* note 2.

<sup>79</sup> The current limit is contained in the Securities Exchange Act, § 32(a), 15 U.S.C. § 78ff (1976).

<sup>80</sup> Wall St. J., Sept. 28, 1982, at 1, col. 6.

<sup>81</sup> Even those with relatively little to invest are able to exploit inside information by purchasing call options to acquire a target company's stock at close to the current market price. Such options are cheap and can rapidly multiply in value if an acquisition proposal is subsequently announced. Block & Prussin, "Outsider" Duties in Insider Trading, NAT'L L.J., Dec. 28, 1981, at 19. Information concerning impending tender offers or merger proposals is particularly difficult to keep secret due to the elaborate filing and disclosure requirements imposed by the SEC for such transactions. Corporations planning an offer must make preparations requiring the assistance of such non-insiders as lawyers, paralegals, investment bankers, secretaries, printing companies, accountants, etc. *Id.* at 20.

<sup>82</sup> Louis, *supra* note 13, at 78.

<sup>83</sup> Meyer, *supra* note 4, at 40.

<sup>84</sup> Kelly, *supra* note 16, at 236.

<sup>85</sup> *Id.* American investors used Swiss bank accounts to violate margin requirements, manipulate market prices, and retain short-swing insider trading profits. *Id.* at 237-38.

<sup>86</sup> Interhandel, or Societe Internationale as it was later called, was a holding company organized to retain controlling interests in foreign enterprises of I.G. Farben, the Nazi multinational corporation. During World War II, the United States seized the assets of an American subsidiary

the case of *Societe Internationale v. Rogers*,<sup>87</sup> which concerned the relationship between United States discovery and foreign non-disclosure rules. In *Societe Internationale*, the Supreme Court held that a foreign government's prohibition against document disclosure was not an absolute bar in determining whether a foreign company should be relieved from compliance with a discovery order.<sup>88</sup> Rather, the company's "good faith" effort in attempting to secure government permission to disclose documents subject to foreign secrecy laws was a vital factor to consider.<sup>89</sup> This good faith test has been incorporated into a revised draft of the Second Restatement of Foreign Relations Law.<sup>90</sup>

The Second Restatement of Foreign Relations Law<sup>91</sup> requires a balancing of interests when two states have jurisdiction to prescribe and enforce rules of law which require inconsistent conduct on the part of the individual.<sup>92</sup> The revised draft of the Second Restatement also

---

of Interhandel as enemy-owned property. *Societe Internationale* sued the U.S. government after the war to recover these assets. Meyer, *supra* note 4, at 41.

<sup>87</sup> 357 U.S. 197 (1958).

<sup>88</sup> This controversy arose during the trial when the U.S. government asked for the release of bank documents. Interhandel's Swiss bank refused to release the documents asserting that such disclosure would violate the Swiss Penal Code, Business Secrets Law, and Banking Law. *Id.* at 200. See *supra* notes 27-29 and accompanying text.

<sup>89</sup> According to the Supreme Court, inability of a foreign company to comply with a production order "fostered neither by its own conduct nor by circumstances within its control . . . constitutes a weighty excuse for non-production." 357 U.S. at 211.

<sup>90</sup> RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW, § 420 reporter's note 5 (Tent. Draft, Mar. 1982).

<sup>91</sup> RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW § 40 (1965).

<sup>92</sup> The interests to be balanced include: a) the vital national interests of each of the states; b) the extent and nature of the hardship that inconsistent enforcement actions would impose upon the person; c) the extent to which the required conduct is to take place in the territory of the other state; d) the nationality of the person; and e) the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule prescribed by that state. *Id.* Decisions of U.S. courts which have expressly engaged in a balancing of interests include: *United States v. First Nat'l City Bank*, 396 F.2d 897 (2d Cir. 1968) (the importance of U.S. antitrust enforcement outweighed potential exposure to civil liability and economic loss resulting from German laws prohibiting bank records disclosure); *United States v. Vetco, Inc.*, 644 F.2d 1324 (9th Cir. 1981), *cert. denied*, 454 U.S. 1098 (1981) (the need to collect taxes and prosecute tax fraud outweighed Switzerland's privacy laws preventing a U.S. corporation from disclosing records of its Swiss subsidiaries); *Ings v. Ferguson*, 282 F.2d 149 (2d Cir. 1960) (Canadian laws which may prohibit the removal of bank documents outweighed shareholders' request for subpoena duces tecum of bank records located in Canada); *Trade Dev. Bank v. Continental Ins. Co.*, 469 F.2d 35 (2d Cir. 1972) (Swiss bank secrecy laws prohibiting disclosure of clients' identity outweighed a request for identity information unnecessary to defendant's case); *In re Grand Jury Proceedings*, 532 F.2d 404 (5th Cir. 1976) (necessity of appearance before a grand jury outweighed nonresident alien's exposure to criminal prosecution in his own country for violating bank secrecy laws); *Securities and Exchange Comm'n v. Banca Della Svizzera Italiana*, 92 F.R.D. 111 (S.D.N.Y. 1981) (the importance of information in apprehending and prosecuting inside traders outweighed the potential exposure of Swiss banks to criminal liability if such information was disclosed).

requires a balancing test. Where the original Second Restatement applies to rules of law which require inconsistent conduct, the revised draft focuses directly on the production of documents or other information important to an action or jurisdiction.<sup>93</sup> In addition to weighing various factors to determine whether such documents should be produced, the revised draft adopts a "good faith" test similar to that used by the Supreme Court in *Societe Internationale v. Rogers*.<sup>94</sup>

The foreign response to United States discovery requests has generally been that such pre-trial or investigative procedures may be applied to persons or documents located in another country only with that country's permission.<sup>95</sup> The United States, however, takes the position that persons who do business in the United States, or who bring themselves within United States jurisdiction to prescribe and adjudicate, must be subject to the burdens, as well as the benefits, of United States law.<sup>96</sup> The revised draft supports the United States position, subject to the requirement of reasonableness.<sup>97</sup>

#### V. THE *SANTA FE* CASE

The destructive impact of insider trading on investor confidence is apparent in the events surrounding the 1981 takeover of the Santa Fe International Corporation by the Kuwait Petroleum Corporation. On

---

<sup>93</sup> Section 420(1)(c) of the revised draft includes the following factors: "the importance to the investigation or litigation of the documents or other information requested; the degree of specificity of the request; in which of the states involved the documents or information originated; the extent to which compliance with the request would undermine important interests of the state where the information is located; and the possibility of alternative means of securing the information." RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW § 420(1)(c) (Tent. Draft, Mar. 1982).

<sup>94</sup> Section 420(2) states that if disclosure of information located outside the United States is prohibited by the law of the state where the information is located, the court may not impose criminal sanctions of contempt, dismissal, or default on a party which failed to comply with the production order if the party made a good faith effort to secure permission from foreign authorities to make the information available. Thus, before criminal sanction can be imposed, "deliberate concealment or removal of information or a failure to make a good faith effort" must be shown. RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW § 420(2) (Tent. Draft, Mar. 1982). The "good faith" test has been applied with the balancing of interests test in: *United States v. First Nat'l City Bank*, 396 F.2d 897 (2d Cir. 1968) (Citibank had not shown good faith in its attempts to comply with the subpoena duces tecum); *United States v. Vetco, Inc.*, 644 F.2d 1324 (9th Cir. 1981) (defendant had not shown good faith in failing to comply with an IRS summons); *Ohio v. Arthur Andersen Co.*, 570 F.2d 1370 (10th Cir. 1978), cert. denied 439 U.S. 833 (1978); *In re Westinghouse Electric Corp.*, 563 F.2d 992 (10th Cir. 1977); *Securities and Exchange Comm'n v. Banca Della Svizzera Italiana*, 92 F.R.D. 111 (S.D.N.Y. 1981).

<sup>95</sup> *Id.*

<sup>96</sup> *Id.*

<sup>97</sup> RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW § 420 reporter's note 1 (Tent. Draft, Mar. 1982).

October 5, 1981, Santa Fe announced a definitive merger agreement in which it would become a United States subsidiary of the Kuwait Petroleum Corporation. The tender offer included a cash purchase of all outstanding stock for \$51 per share.<sup>98</sup> The next day, after forty-three minutes of trading on the New York Stock Exchange, the price of Santa Fe stock had increased from \$24.75 per share to \$43.75 per share, and trading was halted due to an influx of orders creating an imbalance on the buy side of the market.<sup>99</sup>

Although this increase of \$19 per share represents a seventy-seven percent increase in the value of the stock, the percentage increase in call option contracts<sup>100</sup> was far more dramatic. When the Santa Fe stock resumed trading on the New York Stock Exchange, the market for call option contracts for Santa Fe stock had risen 1,325%.<sup>101</sup> Traders who sold options on or before October 1 without owning the underlying stock<sup>102</sup> lost millions of dollars when they were forced to buy the stock when the options were exercised at significantly higher prices.<sup>103</sup> Although this risk is an inherent part of the securities business, it should not be caused by investors trading on inside information regarding potential takeovers.

Immediately following the halt in trading, the Pacific Stock Exchange and the New York Stock Exchange began an investigation to determine which customers purchased call options and/or common stock before the takeover announcement was made. The results indicated that during the two-week period before trading in the stock and options was halted, there were "significant and unusual purchases of call options" which originated not only in the United States, but also from Swiss banks.<sup>104</sup>

---

<sup>98</sup> See *Federal Response Hearings*, *supra* note 37, at 47.

<sup>99</sup> *Id.* at 65. An imbalance on the buy side of the market means orders to buy stock in a company exceed orders to sell stock in the company to such an extent that there is an inability to trade the stock.

<sup>100</sup> A call option contract generally gives the owner the right to buy 100 shares of underlying common stock at a specified "striking" or exercise price at anytime during the lifetime of the contract.

<sup>101</sup> Before the announcements, the options sold for \$1.00 per contract. When trading resumed, the price had risen to \$14.25 per contract. *Federal Response Hearings*, *supra* note 37, at 34.

<sup>102</sup> This practice is referred to as writing "naked" options. *Federal Response Hearings*, *supra* note 37, at 51.

<sup>103</sup> Wall St. J., Oct. 21, 1981, at 7, col. 1.

<sup>104</sup> *Federal Response Hearings*, *supra* note 37, at 41. One Swiss banker entered orders on the Pacific Stock Exchange to buy 2,000 option contracts representing 200,000 shares of common stock. *Id.*

Under pressure from Congress,<sup>105</sup> the SEC moved into federal district court within three weeks of the takeover announcement and won a temporary restraining order which froze \$5.2 million (the amount allegedly obtained through insider trading) being held in United States brokerage and bank accounts.<sup>106</sup> In an unusual and surprising move, the SEC framed its complaint against "certain unknown purchasers."<sup>107</sup> It argued that even though it had not completed the investigation, a temporary restraining order was necessary in order to keep any assets derived from insider trading from flowing outside the country.<sup>108</sup>

With the funds safely frozen in New York, the SEC proceeded to extract the names of the "certain unknown purchasers" who traded the Santa Fe stock and options on the basis of inside information.<sup>109</sup> In September of 1982, a director of Santa Fe International settled SEC charges against him by agreeing to repay \$278,750. This money represented the profit which the director made by buying 10,000 shares of Santa Fe common stock through a Swiss bank account thirteen days before the takeover was announced.<sup>110</sup> This case, coming at a time of heavy merger activity and widespread buying in advance of public disclosure, signaled the start of an enforcement drive by the SEC to curb insider trading.<sup>111</sup>

---

<sup>105</sup> See *Federal Response Hearings*, *supra* note 37, at 67-71 (testimony by John Evans, Commissioner, Securities and Exchange Commission).

<sup>106</sup> *Securities and Exchange Comm'n v. Santa Fe Int'l Corp.*, *supra* note 8. The SEC's principal weapon against insider trading has been the freezing of profits arising from suspected transactions in American banks.

<sup>107</sup> *Securities and Exchange Comm'n v. Santa Fe Int'l Corp.*, *supra* note 8.

<sup>108</sup> *LEGAL TIMES OF WASHINGTON*, Nov. 30, 1981, at 2.

<sup>109</sup> *NAT'L L.J.*, Nov. 30, 1981, at 26. These people were initially thought to be Kuwaitis trading through Swiss banks and charges are still pending against one Kuwaiti businessman. *Wall St. J.*, Jan. 26, 1983, at 7, col. 1. See *Wall St. J.*, Oct. 27, 1981, at 2, col. 3. Along with the unknown purchasers, five Swiss banks (including Credit Suisse and Swiss Banking Corp.) were named as nominal defendants. *Id.* See also *Wall St. J.*, Oct. 28, 1981, at 2, col. 3. This signified a departure from the 1960s and 1970s when the banks which acted as conduits for inside traders were small regional banks without important reputations to uphold.

<sup>110</sup> *Wall St. J.*, Sept. 30, 1982, at 8, col. 3. Other insider trading cases are still pending in New York and Seattle to recover the remainder of the illegal profits. The balance of the \$5.2 million is still frozen in U.S. bank accounts pending the outcome of these cases. *Id.* See *Wall St. J.*, Jan. 26, 1983, at 7, col. 2 (accountant arrested for violating the court freeze by secretly transferring to Mexico at least \$250,000 in Santa Fe insider trading profits).

<sup>111</sup> According to SEC Chairman John Shad, "We're going to come down with hobnail boots to give some shocking examples to inhibit activity." *N.Y. Times*, Oct. 27, 1981, at D1, col. 3. In what has become the agency's most productive insider trading investigation, the SEC has filed suits around the country alleging that at least \$8.5 million in illegal profit was reaped by people privy to Santa Fe's plans. *Wall St. J.*, Apr. 19, 1983, at 23, col. 1.



## VI. THE *ST. JOE MINERALS* CASE

Along with the *Santa Fe* case, the most important event to weaken the foundation of Swiss bank secrecy began in March 1981 when the Canadian company, Joseph E. Seagrams & Sons, announced a tender offer for the common stock of St. Joe Minerals Corporation. Eight months later, with judicial assistance, the SEC pierced the veil of Swiss bank secrecy and gained important information needed to prosecute inside traders.<sup>112</sup>

Banca Della Svizzera Italiana (BSI), a Swiss bank, purchased stock options and common shares of St. Joe one day before Seagrams announced its tender offer. Immediately after the announcement, the price of St. Joe common stock rose from \$29.875 per share to \$45.25 per share<sup>113</sup> and BSI liquidated most of the investment. These activities resulted in a "virtually overnight" profit of approximately \$1.4 million.<sup>114</sup>

Within three weeks, the SEC obtained a temporary restraining order freezing \$2 million, the maximum amount of alleged profits thought to be derived from the insider trading, in BSI's United States bank account. In addition, the order directed immediate discovery proceedings including the disclosure of BSI's principals.<sup>115</sup> After BSI refused to produce the requested information on the basis that such disclosure would subject the bank to criminal liabilities under Swiss law,<sup>116</sup> the SEC brought a civil action against BSI, its United States bank, and "certain purchasers of call options," to enjoin further insider

---

<sup>112</sup> Securities and Exchange Comm'n v. Banca Della Svizzera Italiana, 92 F.R.D. 111 (S.D.N.Y. 1981).

<sup>113</sup> 92 F.R.D. at 112. The SEC was able to ascertain that the options had been purchased by BSI with the Geneva branch of A.G. Becker, Inc. acting as broker. Consistent with the confidentiality surrounding Swiss bank dealings, A.G. Becker was not informed as to who ultimately initiated the orders as the brokerage account lists only the name of the bank. N.Y. Times, Mar. 28, 1981, at 29, col. 4. The underlying stock prices of the options purchased were between \$25 and \$35 per share. Thus, when the bank liquidated the options, the price of the options had increased approximately \$15 per share with a realized profit in excess of \$1 million. *Id.*

<sup>114</sup> Memorandum in Support of Plaintiff's Application for an Order Compelling Answers and Imposing Sanctions, at 2, Securities and Exchange Comm'n v. Banca Della Svizzera Italiana, 92 F.R.D. 111 (1981) [hereinafter cited as BSI Plaintiff's Memorandum]. To demonstrate the extent of the profits involved, A.G. Becker purchased 455 call options in St. Joe Minerals common stock on Mar. 10 for a total of \$97,825. That investment increased in value to \$801,937.50 by Mar. 13.

<sup>115</sup> 92 F.R.D. at 111.

<sup>116</sup> BSI Plaintiff's Memorandum, *supra* note 114, at 3. BSI argued that through the use of "letters rogatory" the SEC could obtain the requested information without subjecting the bank to criminal liability. *Id.* at 4. "Letters rogatory" is defined in BLACK'S LAW DICTIONARY (5th ed. 1979) as "the medium whereby one country, speaking through one of its courts, requests another country, acting through its own courts and by methods of court procedure peculiar thereto and entirely within the latter's control, to assist the administration of justice in the former country."

trading and require the disgorgement of all profits resulting from the illegal trading.<sup>117</sup> Following a hearing, Judge Milton Pollack<sup>118</sup> ordered "prompt and fair disclosure" and threatened the bank with substantial penalties<sup>119</sup> if it did not comply with the court's decision. Before the order was released, however, BSI obtained waivers of confidentiality from its clients which enabled it to release customer information without violating Swiss law.<sup>120</sup>

In its decision, the court applied both the "balancing of interests" test<sup>121</sup> established in the Second Restatement of Foreign Relations Law and the "good faith" test first used by the Supreme Court in *Societe Internationale* and later adopted in the revised draft of the Second Restatement. In balancing the interests at stake, the court stated that a foreign law's prohibition against disclosure is not decisive, but only one of many factors to consider.<sup>122</sup> It decided that the Swiss secrecy law was outweighed by the vital national interest of the United States in "maintaining the integrity of the securities markets against violations committed and/or aided and assisted by the parties located abroad."<sup>123</sup> With regard to the good faith test, the court ruled that BSI acted in bad faith by deliberately using the Swiss nondisclosure law to evade rules 10b-5 and 14e-3 of the 1934 Securities Exchange Act.<sup>124</sup> Although the court considered the hardship which the enforcement measures would impose on the bank, it concluded that the Swiss Penal Code's flexibility in the form of a "state of necessity" exception, as well as the bank's

---

The SEC does not feel this generally cumbersome procedure is of practical value. BSI Plaintiff's Memorandum, *supra* note 114, at 4-5.

<sup>117</sup> *Federal Response Hearings*, *supra* note 37, at 77.

<sup>118</sup> Judge Pollack is a federal district judge for the Southern District of New York known for his opinions on federal securities law.

<sup>119</sup> These penalties included daily fines and the barring of access to U.S. securities markets. Lowenfeld, *Bank Secrecy and Insider Trading: The Banca Della Svizzera Italiana Case*, 15 REV. OF SEC. REG. 942 (1982).

<sup>120</sup> It is not clear what prompted BSI's clients to sign these waivers. In addition, the bank answered some interrogatories. Judge Pollack gave the bank a one-week extension to produce answers to the remaining interrogatories. 92 F.R.D. at 113.

<sup>121</sup> The court cited two recent Second Circuit opinions which adopted a balancing test approach: *United States v. First Nat'l City Bank*, 396 F.2d 897 (2d Cir. 1968) and *Trade Dev. Bank v. Continental Ins. Co.*, 469 F.2d 35 (2d Cir. 1972). See *supra* note 92. The court distinguished three earlier Second Circuit decisions which viewed foreign law prohibitions as an absolute bar to discovery on the basis that all three cases dealt with non-party witnesses. 92 F.R.D. at 115.

<sup>122</sup> 92 F.R.D. at 114.

<sup>123</sup> *Id.* at 112.

<sup>124</sup> *Id.* at 117. BSI argued that it had acted in good faith in its attempt to secure a waiver of confidentiality from its customers, and thus complied with the SEC discovery request. The court, however, relied on the fact that neither the State Department nor the Swiss government had expressed opposition to the discovery proceedings. It also found significant the fact that the secrecy privilege belongs to the customer, not the bank.

ability to obtain waivers from its clients, were sufficient protection against criminal prosecution.<sup>125</sup>

The *BSI* decision supports the principle that foreign institutions must abide by United States statutes, including disclosure requirements, when they enter United States markets. In stressing the necessity for uniform compliance, Judge Pollack concluded his opinion by stating that "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."<sup>126</sup>

Wall Street officials fear the *BSI* decision will force large Swiss banks to take their investment business elsewhere in order to retain their secrecy standards.<sup>127</sup> Wall Street, however, should not place a high value on the business of foreign banking institutions which facilitate violations of United States securities laws.<sup>128</sup> Furthermore, this fear is unjustified because in January 1983, Swiss banks inaugurated insider trading rules which force their clients who trade on American exchanges to sign waivers which will permit the banks to disclose identity and trading information to the SEC.<sup>129</sup> This new development is a direct consequence of the Memorandum of Understanding on Insider Trading signed by the United States and Switzerland in 1982.

## VII. THE MEMORANDUM OF UNDERSTANDING

The 1977 Treaty on Mutual Assistance in Criminal Matters<sup>130</sup> provides a mechanism which permits the United States and Switzerland to furnish each other with assistance in the investigation and prosecution of criminal matters.<sup>131</sup> In particular, the Treaty calls for compulsory mutual assistance with respect to the investigation and prosecution of

---

<sup>125</sup> *Id.* at 118.

<sup>126</sup> *Id.* at 119. The *BSI* case added a great deal of weight to the SEC's prosecution in the *Santa Fe* case. Throughout the proceedings in *Santa Fe*, the SEC constantly threatened to use the *BSI* holding as a precedent.

<sup>127</sup> Swiss banks can still circumvent U.S. securities laws by buying U.S. securities on the London Stock Exchange through British stockbrokers or London branches of U.S. banks.

<sup>128</sup> Wall St. J., Nov. 11, 1981, at 8, col. 3.

<sup>129</sup> N.Y. Times, Jan. 3, 1983, at D1, col. 3. See *infra* note 149 and accompanying text.

<sup>130</sup> Mutual Assistance in Criminal Matters, May 25, 1973, United States-Switzerland, 27 U.S.T. 2019, T.I.A.S. No. 8302 (effective Jan. 23, 1977).

<sup>131</sup> See Note, *The Recent Swiss-American Treaty to Render Mutual Assistance in Criminal Law Enforcement (An Application of the Bank Secrecy Act): Panacea or Placebo?*, 7 INT'L L. & POL. 103 (1974).

thirty-five enumerated crimes.<sup>132</sup> Although banking is not specifically addressed, both governments intended that banking secrets would be disclosed in criminal investigations.<sup>133</sup>

Under the Treaty, however, the Swiss agree to provide legal assistance in criminal matters only where such actions are *mutually punishable* under the penal laws of both the United States and Switzerland. Thus, although the schedule of criminal matters under the Treaty includes "fraud, including . . . obtaining . . . securities by . . . any fraudulent means,"<sup>134</sup> the SEC has not been able to use the treaty to obtain Swiss bank information relating to insider trading violations because insider trading is not a criminal offense in Switzerland.<sup>135</sup> Until 1982, this wide gap permitted insiders with material, non-public information to trade on American exchanges through Swiss banks with little risk.

After the filing of the *Santa Fe* case, representatives of the United States and Swiss governments met to discuss the growing conflict in securities law enforcement matters.<sup>136</sup> After extended discussions, an interim agreement pertaining to insider trading cases not covered under the 1977 Mutual Assistance Treaty was signed by both countries on August 31, 1982.<sup>137</sup> This interim agreement, embodied in a "Memorandum of Understanding," is to remain in effect until insider trading is made a criminal offense under Swiss law.<sup>138</sup>

The interim agreement established a complicated procedure permitting the SEC to formally request information from Swiss authorities. Under this procedure, the SEC, after conducting an investigation which indicates evidence of insider trading in a security, would make a written request for information through the United States Department of Justice. The Justice Department would then send this request to the Swiss Federal Office for Police Matters which, in turn, would forward it to a three-member commission of enquiry appointed by the Swiss

---

<sup>132</sup> The emphasis of the Treaty centers on issues concerning organized crime and access to Swiss bank information by American prosecutors and tax officials. Meyer, *supra* note 4, at 65.

<sup>133</sup> *Id.*

<sup>134</sup> Mutual Assistance in Criminal Matters, *supra* note 130, item 19, 27 U.S.T. at 2065.

<sup>135</sup> See *supra* note 36 and accompanying text.

<sup>136</sup> Greene, *U.S., Switzerland Agree to Prosecute Inside Traders*, LEGAL TIMES OF WASHINGTON, Oct. 4, 1982, at 15. The U.S. delegation was composed of officials from the SEC, the Justice Department, and the State Department.

<sup>137</sup> This interim agreement consists of a proposal submitted by the Swiss Bankers' Association. *U.S.-Swiss Memorandum on Insider Trading*, *supra* note 9, at 1740.

<sup>138</sup> On Nov. 16, 1983, the Swiss government announced that it would submit legislation to Parliament making insider trading a crime under the Swiss Penal Code. The bill is expected to be enacted some time in 1985. N.Y. Times, Nov. 17, 1983, at 29, col. 6.

Bankers' Association.<sup>139</sup>

The written request must identify the suspected transactions and be accompanied by relevant documentation.<sup>140</sup> It must also satisfy the commission of enquiry that there were significant price or volume movements or other indications of insider trading.<sup>141</sup> In addition, the transactions pertaining to the request must be related either to a business combination or to the acquisition of at least ten percent of a company's shares.<sup>142</sup> This requirement, therefore, will generally exclude insider trading based on information such as a company's poor earnings prospects.

Upon accepting the request, the commission of enquiry will require the bank in question to submit a detailed report regarding the alleged insider transaction. The bank's report will include the customer's identity and all details of the customer's securities transactions relating to the acquired company for forty trading days prior to the tender offer announcement.<sup>143</sup> If the commission determines from the report that the bank customer engaged in insider trading, it will send the report to the Federal Office for Police Matters to be forwarded to the SEC.<sup>144</sup> The SEC may not disclose the information contained in the report unless the information pertains to an SEC investigation or enforcement action for insider trading.<sup>145</sup> The commission of enquiry will also notify the bank to freeze all assets in the customer's account up to the amount of profit gained or loss avoided.<sup>146</sup> It will have the authority to forward this amount to the SEC if judgment is entered against the customer in a United States court or if the customer consents.<sup>147</sup> If the commission of enquiry or the SEC question the bank's report, either agency can ask the Swiss Federal Banking Commission to examine whether the report conforms to the facts and to the

---

<sup>139</sup> *U.S.-Swiss Memorandum on Insider Trading*, art. 1, *supra* note 9, at 1740.

<sup>140</sup> *Id.*, art. 3(2),(3), at 1740-41.

<sup>141</sup> *Id.*, art. 3(4), at 1740-41. The interim agreement provides that: "The Commission shall be satisfied in all cases in which the daily trading volume of such securities increased 50% or more at any time during the 25 trading days prior to . . . [the announcement of an acquisition or business combination]." *Id.*

<sup>142</sup> *Id.*, art. 1, at 1740. The transactions must have been made within 25 trading days of the announcement of the acquisition or business combination. *Id.*, arts. 1, 3(3), at 1740.

<sup>143</sup> *Id.*, art. 4(3), at 1741.

<sup>144</sup> *Id.*, art. 5. If the Commission finds that the bank customer is not an inside trader, or did not place the transactions identified by the SEC, it will state this in a separate report to the SEC. *Id.*, art. 7.

<sup>145</sup> *Id.*, art. 3(5).

<sup>146</sup> *Id.*, art. 9(1).

<sup>147</sup> *Id.*, art. 9(2).

Agreement.<sup>148</sup>

In addition to the interim agreement, the Memorandum of Understanding also proposed a private agreement which led to the insider trading rules recently adopted by Swiss banks.<sup>149</sup> These rules require bank customers who trade on American securities exchanges to sign waivers of confidentiality. Such waivers permit Swiss banks to legally disclose customer identities and other information when the Mutual Assistance Treaty is not applicable or when it is not possible to gather evidence by employing compulsory process.

Many bankers feel the effectiveness of the new United States-Swiss accord is limited because insiders still have the option of trading through banks in other countries which also maintain strict bank secrecy laws.<sup>150</sup> In the past, secrecy laws in countries like Panama, the Bahamas, and the Cayman Islands have been used by narcotics dealers, organized crime figures, con artists, and tax evaders to hide their transactions and assets from United States authorities.<sup>151</sup> Bilateral agreements with these countries are expected to be very difficult to obtain.<sup>152</sup> Nevertheless, the Justice Department is currently trying to persuade

---

<sup>148</sup> *Id.*, art. 8.

<sup>149</sup> The Swiss Bank Corp. and Credit Suisse have asked their clients to sign a statement accepting or refusing the new conditions set for trading on American markets. Union Bank of Switzerland has asked only those clients who refuse the conditions to sign a declaration to this effect. Nevertheless, the consequences are the same. The banks' clients have been officially notified that as of Jan. 1, 1983, an order for execution on American exchanges will be accepted only on the express understanding that the clients agree to possible exposure to the SEC if they are suspected of trading on inside information. *N.Y. Times*, Jan. 3, 1983, at D1, col. 3.

<sup>150</sup> *N.Y. Times*, Sept. 1, 1982, at D13, col. 6. Currently there are 26 countries which maintain bank secrecy laws, and 22 countries which maintain "blocking" laws. Outline by John M. Fedders, *supra* note 6, at 11-19. "Blocking" laws impede judicial or administrative proceedings by restricting testimony or production of documents for use in such proceedings. The statutes prohibit the disclosure, copying, inspection or removal of documents located in the territory of the enacting state in compliance with orders of foreign authorities. *Id.* at 11.

<sup>151</sup> *Wall St. J.*, Sept. 2, 1982, at 4, col. 1. Nevertheless, inside traders are reluctant to place assets in these countries which lack the political stability of Switzerland.

<sup>152</sup> Panama, for instance, intentionally tightened its bank secrecy laws in the 1970s to lure foreign deposits, and is reluctant to weaken them for fear of losing its newly acquired business. *N.Y. Times*, Sept. 1, 1982, at D13, col. 6. One of the many alternatives to bilateral agreements which Congress might consider in an attempt to enforce insider trading laws is "waiver by conduct" legislation. See Written Statement of John M. Fedders, Director, Division of Enforcement, Securities and Exchange Commission, Before the Permanent Subcommittee on Investigations of the Senate Committee on Governmental Affairs, May 24, 1983, at 12. This legislation would declare, as a matter of U.S. law, that the act of trading securities in the United States shall constitute a waiver of any otherwise applicable secrecy or blocking laws that a person or an agent may waive. In addition, the legislation could require that brokers or dealers effecting transactions on behalf of persons or institutions located abroad provide notice that the act of trading will be deemed to constitute such a waiver. *Id.* Such legislation would be similar to the private agreement recently adopted by Swiss banks. See *supra* note 149 and accompanying text.

several Caribbean nations with strict secrecy laws to cooperate with United States prosecutors.<sup>153</sup>

### VIII. CONCLUSION

The United States economy directly benefits from the heavy investment of capital in its securities markets. At the same time, Switzerland and its financial community have a strong interest in maintaining the integrity of the American securities markets. These markets are international in appeal and numerous Swiss citizens, banks, and businesses are active participants. Thus, although the direct effects of insider trading fall upon the United States, Switzerland shares an interest in assuring the effective policing of American securities markets.

This shared interest is reflected by the signing of a Memorandum of Understanding with the United States and the great progress which has since taken place. Such developments as the voluntary implementation of insider trading rules by Swiss banks and Swiss legislation outlawing insider trading will greatly assist the SEC in closing the loopholes which have plagued the American securities exchanges.

In the United States, the *Santa Fe* and *Banca Della Svizzera Italiana* decisions have given the SEC unprecedented leverage against inside traders who use foreign banks to reap millions of dollars in profits on United States securities markets. To completely eliminate the use of foreign bank accounts for insider trading purposes, additional bilateral treaties with all countries that maintain strict bank secrecy laws are necessary. The action already taken, however, has created a strong foundation for the principle that when foreign institutions trade securities on United States exchanges, they must abide by United States law. This foundation is essential for preserving the health and integrity of American securities markets.

*Jonathan Levin*

---

<sup>153</sup> For example, the Cayman Islands, unhappy with its status as a tax haven for controversial depositors, has offered assistance to U.S. prosecutors. *Wall St. J.*, Oct. 14, 1982, at 33, col. 4.