Why America is the New Switzerland – and How Panama is About to Change This

by Susan Emmenegger

When in 1848 the Swiss cantons agreed to form a federal state modeled after the U.S. Constitution of 1787, they called Switzerland the New America. More recently, the roles have been reversed: America is called the New Switzerland. The claim is not that America is making better chocolate than the Swiss. It is that America has become the world's leading bank secrecy jurisdiction. Yet America's "Swissness" is about to be scaled down. Following the Panama Papers scandal, the Treasury has activated long-standing proposals to improve U.S. financial transparency. Among other things, new rules on Customer Due Diligence were published on May 11, 2016. In Europe, the general view is that the changes – even if approved by Congress – are not sufficient. Nevertheless, they are an important step forward.

When America enacted the Foreign Account Tax Compliance Act of 2010, it sparked an international movement to exchange financial account information and to end tax secrecy. Currently, 101 jurisdictions have committed to exchanging account information based on the OECD Common Reporting Standard. Yet the U.S. as initiator of this financial transparency is not part of the new worldwide system: A footnote of the committed jurisdictions list explains that the U.S. continues with FATCA and the FATCA related intergovernmental agreements (IGAs).

The problem with the IGAs is that while the partner jurisdictions provide information to the U.S. according to the global standard, the U.S. does not reciprocate. The image capturing the *malaise* is that of an informational pipeline flowing into the United States and an informational straw flowing out of it. Some IGAs, for instance the ones signed with Bulgaria or Argentina (Model 1B-IGAs), offer no reciprocity at all. But even in the best of all cases, informational black holes remain. If one takes the EU as an example, important account information which is received by the U.S. but not provided to the EU partner jurisdictions include: Cash accounts held by EU-resident individuals if they earn less than $10 U.S. interest, cash accounts held by EU-resident entities, custodial (i.e. equity) accounts held by EU-resident entities or individuals as long as these accounts do not earn U.S. interest. Even if an account is reported, the U.S. only provides information about the U.S.-source interest earned, not about the account balance. And then there is the issue of beneficial ownership. The EU-resident beneficial owners of entities which have mostly passive income (income from interest, dividends, etc.) are not reported by the U.S., whereas the EU partner jurisdictions have to look through these entities and report U.S. beneficial ownership.

The U.S. does not share this information because the IRS does not collect this type of data. This creates a competitive advantage for the U.S. The fact that European based financial institutions are opening subsidiaries in Nevada or South Dakota proves the point. Yet Europe and notably Switzerland should not deplore the fact that they no longer serve as havens for undeclared accounts. The issue really goes beyond market shares. U.S. bank secrecy raises serious concerns that its financial system is being misused for money laundering and the financing of terrorism. As international alternatives dwindle, the risk for the U.S. increases.

The lack of any meaningful beneficial ownership legislation and the weak customer due diligence regulation (CDD) has been long recognized. There hasn't been a peer review or an evaluation report where the U.S. has been deemed compliant with international standards (e.g. FATF 2006, IMF 2015). The White House has made several budget proposals. The Treasury proposed a CDD Rule in 2014. Yet only some sector-specific measures in the area of real estate were enacted. And then came the Panama Papers: Millions of documents stolen from a law firm in Panama highlighting the use of legal entities to conduct illicit financial activities. Following the release of the papers, the Treasury announced key regulations and legislation to counter money laundering and corruption and to combat tax evasion on May 5, 2016.

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The Treasury chose the moment well – you never want a serious crisis go to waste. The initiative includes the CDD Final Rule. It requires that financial institutions collect and verify the beneficial owners of companies when these companies open accounts. Other CDD requirements have been made explicit, including the duty to develop customer risk profiles and to conduct ongoing monitoring to identify and report suspicious transactions as well as to maintain and updated customer information. Also, the Treasury sent beneficial ownership legislation to Congress, which requires corporations to file beneficial ownership information with the Treasury. Lastly, it announced proposed regulation to tackle the reciprocity issue in connection with the automatic exchange of account information.

Needless to say, the measures create new and substantial compliance obligations on the part of U.S. financial institutions. As for the U.S. partner jurisdictions and especially the EU, critical voices point out that these new initiatives are not sufficient to achieve full reciprocity or full compliance with international standards. There are proposals in the EU parliament to black list the U.S. and/or to impose a 30% withholding tax on EU-sourced payments to U.S. financial institutions. Although the critical voices have a point, it is important to recognize that the U.S. proposals are substantial in nature. Thanks to Panama, the U.S. is becoming less of a New Switzerland. This regards bank secrecy only. When it comes to chocolate, the U.S. never stood a chance.

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