May bank refuse to execute client's transfer instructions for tax compliance reasons?

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Banking, Switzerland

The Appellate Court of the Canton of Geneva recently rendered three decisions ordering a bank (apparently the same bank in all cases) to execute the clients' transfer and payment instructions. A first decision was rendered in summary proceedings on October 21 2016, while the other two, which are very similar, were rendered in proceedings on the merits on December 2 2016. This update discusses one of the latter decisions published on December 16 2016.

Facts

A Dutch citizen opened a bank account with a bank in Geneva in 1997. At that time he was living in France and has not changed domicile since.

In June 2013 the bank informed the client that it was obliged to draw his attention to the necessity to declare his assets to the relevant tax authorities. A declaration of tax conformity was enclosed with the letter. The bank issued the client with a deadline by which to complete and return the declaration, which the client never did.

The client later instructed the bank to transfer his assets to a bank in Dubai and close his account. As a result of failing to return the completed declaration of tax conformity, the bank refused to execute the instructions.

The client seized the first-instance tribunal in January 2015 and requested that it order the bank to execute his instructions. The tribunal admitted the client's claim and ordered the bank to execute the transfer. The bank challenged the tribunal's decision before the appellate court.

Nature of legal relationship

The relationship between the client and the bank is one of mandate and bailment.an exception to the principle

The agent in a mandate agreement is obliged to comply with the principal's instructions and is liable to the principal for the diligent and faithful performance of his, hers or its duties, whereas the bailor may reclaim the bailed chattel at any time, even where a fixed term has been agreed for the bailment. In this respect, the appellate court referred to two summary decisions in so-called 'clear cases' in 2015, in which the Federal Tribunal had held that the client of a bank in Switzerland was entitled, as per the applicable civil law rules, to retrieve his assets in cash without having to justify his tax compliance.

Arguments to oppose client's instructions

General conditions

The bank's general conditions provided that the bank was notably entitled, at any time and without motivating its decision, to:

- refuse operations;
- restrict such operations; and
- impose particular conditions on such operations.

The bank relied on this clause to argue that it was entitled to refuse to wire the client's assets elsewhere than to an account in the client's name with a bank in France or on presentation of documents evidencing that the said assets had been declared to the French tax authorities.

The court rejected this argument because the general conditions did not explicitly address the restitution of assets which could not objectively be encompassed within the term 'operations'. Assuming that the restitution of the client's assets was explicitly addressed, the validity of such a clause would be doubtful in light of the mandatory rule governing the restitution of assets with regard to the bailment agreement.

Subsequent impossibility to perform

The bank further argued that it could not execute the client's instructions, as such execution would make it an accomplice of criminal misdemeanours as per French law, as a result of which it would be in breach of its duty to act irreproachably as per Swiss legal and regulatory provisions.

The court examined the content of provisions enshrined in anti-money laundering legislation, as well as regulatory provisions (ordinances and circulars) issued by the Swiss Financial Market Supervisory Authority (FINMA) by virtue of the delegation clause contained in the Financial Market Supervision Act.

The court first noted that FINMA ordinances were part of Swiss law insofar as they were published in the classified compilation of Swiss laws.

It went on to examine an October 22 2010 press release entitled "FINMA position paper on risks in cross-border financial services" and a draft amended circular (2008/21, March 1 2016) entitled "*Risques opérationnels – banques*".

According to the former:

> "*the Swiss Financial Market Supervision Act does not contain any provision that supervised institutions must observe foreign law. However, breaches of foreign regulations may still be of relevance under the various acts of supervisory legislation. For instance, violating foreign rules may breach the requirement that business be conducted in a proper manner. In addition, supervisory rules regarding organisational structure require institutions to identify, mitigate and monitor all risks in an appropriate manner, including legal and reputational risks, and establish an effective system of internal control. Naturally, this also applies to cross-border business.*"

Pursuant to the latter, which was due to come into force on August 1 2016 (but has yet to do so), when banks or their subsidiaries provide cross-border services or distribute financial products within the frame of cross-border operations, the risks deriving from foreign laws (eg, tax, criminal and anti-money laundering) ought to be "taken into account, limited and controlled" appropriately. Further, FINMA "expects banks to abide by foreign supervisory laws". The court pointed out that the consultation report relating to this draft circular had not been published on FINMA's website and that the version of the circular actually published was a previous one. It also raised the absence of indications of FINMA as to how banks are to control the risk of taking part in a criminal offence.

The court expressed the view that both the press release and the draft circular were to be placed in the context of awareness that Swiss banks are not immune from criminal proceedings abroad as a result of banking relationships that they opened or maintained if the assets deposited in the frame of such relationships were not known by the relevant tax authorities. The court opined that this did not amount to a change in Swiss legislation.

It also referred to scholars who opine that the principle of the irreproachable activity cannot justify the bank's refusal to execute the client's instructions to close an account by way of withdrawal of the funds in cash or transfer to another bank in another jurisdiction for which tax compliance is not a concern.

The court then examined the applicable French legislation regarding tax fraud and pointed out that the relevant provision already existed at the time when the client had opened the bank account in 1997, even though the penalties were then less severe. The appellate court denied the alleged subsequent impossibility due to the fact that French law

and its implementation had become more stringent. No important amendment had occurred either in Swiss law (there is no particular provision prohibiting Swiss banks from transferring assets, the tax conformity of which would not be ascertained) or French criminal law since 1997. It also referred to a French anti-money laundering provision which has been effective since 1996 (the penalties had nonetheless been amended in 2002).

According to the court, the bank could already be held criminally liable for accepting the client's funds at the time of opening the account and for managing them, such that the subsequent impossibility argument could not be admitted.

Illegal instructions

The court further rejected the alleged illegality of the client's transfer instructions. With reference to scholars, the court held that the fact that the instructions suggested that the client was unwilling to regularise his tax situation did not make such instructions illegal.

Taking account of foreign law

The Swiss International Private Law Act provides that when legitimate and manifestly prevailing interests with regard to the conception of Swiss law so require, a mandatory provision of a law other than that designated by the act may be taken into account, provided that there is a close connection with that law.

While the bank relied on this provision to argue that French laws prohibiting tax fraud ought to be considered, the court found that it had not been ascertained that French laws aimed at fighting tax fraud were so fundamental in the French legal system that they ought to be considered as public order rules. It further expressed the view that should such laws be considered as rules of the French public order, it remained that taking foreign laws into account while applying Swiss law was exceptional, thereby referring to the very restrictive federal jurisprudence. It referred to scholars according to whom it was doubtful that the act was allowed to take into account foreign legal provisions which only pursue economic or tax purposes. It also pointed out that three proposals made by Federal Council with a view to increasing the due diligence obligations of financial intermediaries had encountered strong opposition and that until recently tax fraud was not enough to lift banking secrecy. As a result, the court refused to consider French law provisions while applying Swiss law.

Breach of good faith

Clausula rebus sic stantibus

Clausula rebus sic stantibus is an exception to the principle of *pacta sunt servanda* – it allows the adaptation of a long-term contract when the circumstances have changed to such a degree that the respective obligations of each party have become so unbalanced that a party demanding performance from the other manifestly abuses his, hers or its right.

The bank claimed that the nature, extent and consequences of the legislative evolution (which itself could be anticipated) could not be anticipated and that it could not be expected to execute instructions that would considerably increase its risk of being punished.

The court denied the applicability of the *clausula rebus sic stantibus* exception and stressed again that both Swiss and French legislations had not been fundamentally amended since the beginning of the banking relationship. The court also stressed that since then the bank had never invoked the effects of French laws as against its client.

Abuse of right

The court denied the alleged abuse of right by the client who instructed the bank to transfer his funds. An abuse of right ought to be admitted with utmost restraint. In this case, the client's interest to retrieve his funds was legitimate and could therefore not be regarded as abusive.

Comment

The bank did not challenge the decision before the Federal Tribunal, so the decision is now final.

In an environment where banks show extreme caution to preserve their own interests in an ongoing difficult economic context and where fighting tax fraud is fashionable, the basic principles of the agency and bailment contracts, and thus the clients' interests, should remain in sight at all times.

Banks' general conditions may not protect the bank against all risks, but if they do, their validity may be challenged in the light of compulsory rules of law. Any change in the regulatory framework in Switzerland (particularly FINMA ordinances) should be looked at closely, as should its interaction with civil law provisions.

This decision leaves the door open for banks to argue that the legislation of the state where taxes ought to be paid on assets held for a foreign client's account have changed and that, as a result, they now incur the risk of criminal charges which would prevail over their obligation to execute their clients' payment or transfer instructions.

In any event, this decision is not likely to end the need for clients seeking execution of their payment or transfer instructions to sue their bank, as the latter will be desirous to show foreign authorities that they acted on the basis of judgments and accordingly had no choice but to pay their clients' funds.

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