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The long arm of justice: U.S. structural power and international banking

Abstract: How much authority can sovereign states exercise over international banking in times of financial globalization? While most literature on international finance is rather pessimistic, this article argues that in case of US law enforcement, this pessimistic view is increasingly erroneous. The reason is that US authorities can take advantage of international banks' structural dependence on access to the dollar-based financial system to force banks into punitive agreements or to plead guilty in case of criminal offenses. Using the conflict between the USA and Swiss banks over tax evasion by US persons, this article demonstrates that banks in the liberal economic system can no longer survive without access to the US-controlled, dollar-based financial system, thus giving the USA structural power over banks. In addition, it is shown that US structural power can be used strategically during negotiation processes to apply pressure on banks. Finally, while the use of this structural power was originally restricted to smaller banks, whose collapse would not endanger the world economy, US authorities have recently learnt to manage market expectations in a way that allows them to also target banks that were previously considered "too big to jail."

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1 Introduction

How much authority can sovereign states exercise over international banking in times of financial globalization? The literature on international finance is typically pessimistic, for two reasons: First, the activities of national regulatory bodies and law enforcement authorities are often constrained by the legal sovereignty of other states, thus making the regulation and criminal prosecution of international banking dependent on bilateral or multilateral cooperation. Absent

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such cooperation, international bank activities, although impacting states in important ways, may be beyond the reach of national regulation and law enforcement.[1] Second, the most important international banks are typically considered to be "too big to fail" – i.e., their collapse could endanger the viability of the global financial system. Such banks are therefore often off-limits for criminal prosecution ("too big to jail") because criminal prosecutions are expected to lead to the bank's collapse.[2]

I argue that in the case of US law enforcement, this pessimistic view is increasingly erroneous. Consider the cases of the two unequal Swiss banks, Banque Cantonale du Valais (BCVS) and Credit Suisse (CS). BCVS has no representation outside the smallish Swiss region of Valais, whose regional government owns a large majority of its shares. Its main business is retail banking and providing credit to local companies. However, in December 2013, the bank announced its participation in an amnesty program for Swiss banks that the US Department of Justice (DoJ) had created. The program allows banks to obtain non-prosecution agreements in return for detailed information on business practices and the payment of a penalty up to 50% of the maximum aggregate dollar value of US-related undeclared accounts that existed on August 1, 2008 or thereafter. CS is a very different company. As one of the world's largest banks, it is firmly in the "too big to fail" category. Nevertheless, in May 2014, CS agreed to plead guilty and pay a penalty of USD 2.6 billion for facilitating tax evasion by some of its US clients. In both cases, the outcomes are striking because, as I show below, doubts remain whether the two banks did in fact break the law. However, neither the DoJ nor the banks displayed any interest in a proper trial.

At first sight, both banks appear to be out of reach for the DoJ, albeit for different reasons. Nevertheless, the DoJ managed to make them enter into agreements. For both banks and prosecutors alike, such agreements are flexible and convenient alternatives to criminal trials, on the one hand, and prosecutorial declination, on the other. They allow for the punishment of banks for improper conduct while mitigating the collateral consequences that criminal trials can inflict on companies and the economy. There is, however, also a more problematic side to these agreements. While they are the result of bargaining, US prosecutors are typically in a better bargaining position because they always have the option to indict banks. Banks have good reasons to fear criminal prosecutions because they often lead to the exclusion from the dollar-based financial system and therefore the banks' collapse. Hence, they are willing to go at great lengths to avoid them,

1 Palan (2002).
2 Garrett (2014).

possibly resulting in very lopsided agreements with prosecutors. As *The Economist* notes, in these agreements, US authorities are "in effect judge and jury as well as plaintiff."[3]

What allows US authorities to force banks into punitive agreements? I argue that US authorities can take advantage of banks' structural dependence on access to the dollar-based financial system. Given that US regulatory bodies control access and can therefore exclude banks from the dollar-based financial system, they can exercise structural power over banks. Admittedly, this structural power is not new. Already several decades ago, the US used its ability to restrict access to the dollar-based financial system to inflict harm on enemy countries. However, as the global financial system has grown more integrated, US structural power has increased to the extent that it can be used to exercise power over banks that have never set foot on US soil (like BCVS). In addition, the US has grown more sophisticated in using its structural power, in particular by learning how to manage market expectations, so that they can use structural power in the case of large banks (like CS) without harming their own economy.

Using the conflict between the US and Swiss banks over tax evasion, this article makes three contributions to the literature on structural power and state-business relations. First, I argue that banks in the liberal economic system can no longer survive without access to the US-controlled, dollar-based financial system, thus giving the US structural power over banks. Second, I demonstrate that US authorities use structural power strategically during bargaining processes to apply pressure on banks. Third, while the use of structural power was originally restricted to smaller banks, whose collapse would not endanger the world economy, US authorities have learnt to manage market expectations in a way that allows them to target banks that were previously considered "too big to jail."

2 Structural power in state-business relations

When discussing the role of structural power in state-business relations, the existing literature typically emphasizes the structural dependence of the state on business. Business has structural power because it performs core functions in liberal capitalist societies.[4] The state cannot organize production, mandate

3 *The Economist*, "The Criminalisation of American Business," 30 Aug 2014.

4 Hacker and Pierson (2002); Hindmoor and McGeechan (2013); Culpepper and Reinke (2014). The structural power of business needs to be distinguished from its instrumental power, which concerns the various means that business can deploy to lobby governments for favorable policies, most notably campaign donations, media campaigns, and expert advice.

investment, or command consumption because these are prerogatives reserved to owners of private property.[5] Of course, it could be argued that the state is – to some extent – dependent on numerous societal groups, but business is in a uniquely privileged position because governments cannot force firms to invest or produce.[6] At the same time, however, governments are held responsible for the economic performance, leaving governments no choice but to provide a policy environment that is conducive to investment and production. Put simply, the state is structurally dependent on business because business – unlike the state – has an outside option: it can choose to not invest or even relocate its business activities to another country. Economic globalization has further increased this structural power of business over governments.[7]

This standard conceptualization of structural power has two important implications. First, it implies that structural power is exercised "automatically and apolitically."[8] If governments know what business wants, they will anticipate the possible consequences of adverse policy decisions and adapt their policies accordingly in order to avoid punishment. As Lindblom observes, "punishment is not dependent on conspiracy or intention to punish." Rather, "if, anticipating new regulations, a businessman decides not to go through with a planned output expansion, he has in effect punished us without the intention of doing so."[9] A second implication of this conceptualization of structural power is that if business has no outside option, it cannot exercise structural power over the government. Put differently, if the costs of an investment stop or a relocation of activities to another country are prohibitive, business loses its privileged position and the state can no longer be said to be structurally dependent on it.

There are, however, three important qualifications that need to be made. First, just because the state is structurally dependent on business does not mean that business gets whatever it wants. The structural power of business is subject to changing dynamics over time.[10] For instance, research has repeatedly shown that market-restricting reforms against the preferences of business are possible during the rare moments of formative political intervention when the power resources of business are temporarily diminished.[11] In addition, business faces other powerful interest groups, while the business community might be internally divided.[12]

5 Przeworski and Wallerstein (1988).
6 Lindblom (1977: pp. 170–188).
7 Strange (1996).
8 Hacker and Pierson (2002: p. 281).
9 Lindblom (1982: p. 326).
10 Block (1977); Hacker and Pierson (2002).
11 Emmenegger (2014).
12 Vogel (1987); Smith (2000).

Hence, while business may be a uniquely privileged group, as noted by Lindblom, it is not the only group, and neither does it always speak with one voice.[13]

Second, structural power is often but not always exercised automatically and apolitically.[14] The conventional account of the structural power of business assumes that the government is fully informed about the preferences of business. However, this is not necessarily the case, particularly in times of great economic uncertainty.[15] Given the complexity of reality, business might first have to credibly signal what it wants and what kind of consequences it would consider if it does not get what it wants. In this scenario, the exercise of structural power is intentional in the sense that business has to do something to get what it wants. However, instead of reverting to the use of instrumental power such as lobbying or campaign donations, business can simply communicate its policy preferences and its willingness to take advantage of its privileged structural position.

Third, government policymakers can take these signals at face value or question their validity. For instance, business representatives might warn of adverse consequences of a given regulatory reform. However, these warnings do not necessarily imply that the negative consequences will materialize, because in the short term, business representatives have an interest in exaggerating the consequences of undesired regulatory reforms. Hence, ideas and perceptions of government policymakers matter in mediating and shaping the impact of the structural power of business.[16] If government policymakers do not believe that their reforms will affect business' investments decisions, they will not consider the warnings to be credible information. As in the case of the intentional exercise of structural power, the need to interpret behavior and declarations has important implications for the automaticity of business power.

3 The structural dependence of international banks on access to the US-controlled, dollar-based financial system

In the literature on state-business relations, the focus is typically on situations in which the state is structurally dependent on business. However, in the following, I argue that in international banking and as a result of financial globalization,

13 Dahl (1961).
14 Winters (1996); Fairfield (2015).
15 Culpepper and Reinke (2014).
16 Bell (2012); Hindmoor and McGeechan (2013).

the US is in a uniquely privileged position to exercise structural power over international banks. Of course, I am not the first to argue that the US enjoys a unique position of power in economic and financial matters.[17] Instead, it is my ambition to analyze US structural power in a relationship that has so far been neglected in the literature.[18]

Helleiner argues that the US derives its structural power in finance "from the size of its economy, the relative attractiveness of its financial markets, and the prominence of its financial institutions and the dollar within this order."[19] Similarly, McGill describes the US securities market as "the biggest sand pit" in the world, adding that "while we may not like it, and many don't, we don't make the rules of the sand pit, but we have to abide by them if we want to continue to play in it."[20]

But why do banks *need* to play in this sand pit and why are they so worried about being excluded from it (if there are also other sand pits)? Put differently, what turns an issue of size into a problem of structural dependence? Following the classic account by Hirschman and its recent extension by Newman and Posner,[21] I argue that in the case of banking, US power is best understood as being structural. International banks are not primarily concerned with the size of the US financial market but rather with its centrality in the global system of financial relationships. Centrality here means that there is virtually no possibility for a bank to be internationally active without repeatedly trading in US dollars, with US-based institutions, or with other banks that trade in US dollars or with US-based institutions. However, by doing so, international banks are, from the point of view of US regulatory agencies, subject to US jurisdiction. This combination of international banks' economic dependence on access to the dollar-based financial system and US regulatory bodies' ability to control access to it makes international finance structurally dependent on the US.

Consider the case of dollar clearing, upon which foreign banks often depend to complete international payments. In international transactions, the trading parties typically rely on so-called vehicle currencies because it is easier to complete transactions in these currencies than in the more peripheral currencies that the two traders normally use. Hence, if a Japanese firm sells goods to a Swedish importer, the two parties will typically complete their transaction in US

17 Krasner (1976); Drezner (2007).

18 To some extent, the following considerations also apply to the European Union. However, the European Union's political structure can impede its ability to act decisively (Hakelberg 2015).

19 Helleiner (1994: p. 201).

20 McGill (2013: p. 24).

21 Hirschman (1969); Newman and Posner (2011). See also Emmenegger and Eggenberger (2015) and Winecoff (2015).

dollars. Otherwise, the Japanese exporter would be stuck with a certain amount of Swedish krona that would be difficult to convert into Japanese yen. In contrast, Swedish krona and Japanese yen are both easily convertible into US dollar. Importantly, the US dollar is by far the most popular vehicle currency, appearing on one side of approximately 86% of all market transactions.[22] Hence, "vehicle currencies clearly enjoy a position of centrality in the global currency network."[23]

Traders often prefer to use US dollars in these transactions because of the size and liquidity of the US financial market, which allows them to easily convert any currency into dollars.[24] However, by doing so, they contribute to a process of self-sustaining increasing returns. The size and liquidity of the US financial market make traders use US dollars in international transactions, which in turn increases the size and liquidity of the US financial market. The circular nature of this process implies that the centrality of the US dollar is not set in stone. Rather, it is to some extent a matter of convention, although it of course also reflects economic fundamentals. Most importantly, by acknowledging the role of the US dollar as the world's leading currency, other countries also accept the central role of the regulatory bodies that control the access to the US dollar. By directing transactions between two peripheral currencies through the center of the dollar-based financial system, the two trading countries ultimately accept that the transaction is subject to *three* jurisdictions, the exporting country, the importing country, and the country that controls the vehicle currency.

For instance, in the legal matter against BNP Paribas, US authorities argued that the French bank had systematically violated US sanctions against a third state although the transaction, at first sight, did not involve any US actors. However, by using the US dollar as the vehicle currency and therefore dollar clearing, the transaction was considered subject to US jurisdiction. In June 2014, BNP Paribas was the second bank after Credit Suisse (whose case I discuss in more detail below) to plead guilty and pay USD 8.9 billion as penalty for illegally processing financial transactions for countries subject to US economic sanctions. Importantly, dollar clearing plays a double role in this context. While it extends US jurisdiction, it also gives US authorities an instrument to exercise pressure on international banks by allowing them to exclude banks from it.

The control over dollar clearing is not the only but possibly the most obvious way through which the US can exercise structural power. In practice, the more a bank is economically dependent on cooperating with actors at the center of

22 The percentages add up to 200% because every transaction involves two currencies (Cohen 2013: p. 166).

23 Cohen (2013: p. 166).

24 Norrlof (2014: p. 1061).

the dollar-based financial system, the more exposed it is to US structural power because the Federal Reserve controls the clearing of transactions in US dollars, the IRS taxes all income from a source inside the country, and several agencies regulate banking activities within and occasionally even outside the US. This structural dependence of banks on access to the dollar-based financial system allows the US to impose certain conditions. In addition, it allows US authorities to use exclusion from the dollar-based financial system as a threat to enforce concessions in bargaining situations.

Relational dynamics, however, complicate the exercise of US structural power in law enforcement because they often turn criminal indictments into a "corporate death penalty."[25] This has two important implications. On the one hand, the drastic consequences of criminal indictments strengthen the bargaining position of prosecutors in agreements with most banks. On the other hand, they imply that the most important international banks are typically considered to be off-limits for criminal prosecution ("too big to jail") because their collapse could endanger the viability of the global financial system ("too big to fail").

The structural dependence of banks on access to the dollar-based financial system is so strong that even the mere possibility of exclusion might lead to the banks' collapse. Hence, banks try to avoid criminal indictments – written accusations that the bank *may* have committed an act that is punishable by law – at any cost. And while an indictment only indicates that a competent body has concluded there is sufficient probability a bank has committed a crime, nevertheless, banks more than likely accept punitive settlements with US authorities in order avoid criminal indictments even if they believe themselves to be innocent. As *The Economist* observes, "bank executives contend that they have little choice but to accept punitive settlements because the alternative, facing a criminal indictment and going to court, could destroy their businesses, even if they are subsequently found not guilty."[26]

The mechanism through which indictments lead to bankruptcy is a combination of reputational damage, collective behavior, and the so-called International Swaps and Derivatives Association (ISDA) Master Agreement, which sets out the standard terms that apply to all over-the-counter transactions between banks.[27]

25 Garrett (2014: p. 14).

26 *The Economist*, "A Culture of Fear," 2 Nov 2013.

27 A criminal conviction following a trial can lead to the revocation of the bank's license and charter and thus its collapse. However, banks already try to avoid criminal indictments at all costs, for instance by entering an agreement with prosecutors (Garrett 2014). If banks cannot avoid an indictment, they typically collapse already before the trial (see the case of the private bank WEGELIN discussed below).

The ISDA Master Agreement contains a series of termination events that allow banks to sever financial ties with indicted banks, such as "any action taken by a taxing authority, or brought in a court of competent jurisdiction, after a transaction is entered into."[28] There are several other clauses in the Master Agreement such as the exclusion from financial markets or the revocation of licenses that allow banks to unilaterally end the business relationship. Generally, a criminal indictment by US authorities is considered sufficient grounds for other banks to sever ties with the indicted bank, thereby depriving the bank of any liquidity within a relatively short period, which would ultimately result in bankruptcy.[29]

If banks collectively believe that an indictment could endanger a bank's economic survival and if they worry that the reputational damage caused by the indictment might cause a run on the bank, they have strong incentives to end transactions with the indicted bank or, in the case of the bank facing the indictment, to avoid the indictment at any cost. The threat to indict is thus more than just a reporting of ongoing criminal investigations. Rather, it triggers an immediate response by the concerned parties, even if the threatened criminal indictment is on questionable legal grounds. Therefore, the drastic consequences of criminal indictments strengthen the bargaining position of prosecutors in agreements with most banks. US authorities must credibly convey that they are considering a criminal indictment and can then use this threat to force banks to assent to more punitive agreements.

This mechanism through which criminal indictments lead to bank collapses also shows how US authorities can overcome the "too big to jail" problem. As mentioned above, banks do not collapse because of the agreement with prosecutors but rather because of how markets react to them. The key for US authorities is therefore to manage market expectations. Banks immediately sever ties with the incriminated one because they expect other banks to do the same. If they are, however, reasonably sure that US investigations will not lead to the bank's collapse (for instance, because other important banks signal that they are not going to sever ties), they have no reason to stop conducting transactions. Hence, what US regulators need to do is to keep the other banks informed about the process to prevent panic reactions.

As I show in the case study below, US authorities have first used the ability to restrict access to the US-controlled, dollar-based financial system to extract concessions from international banks. Subsequently, they have mastered the use of criminal indictment threats to reach more punitive agreements with banks, even if these banks have no representation on US soil. Finally, US authorities have

28 ISDA (2002: p. 9).

29 Landmann (2013: p. 152).

learnt to perform the balancing act of using threats to extract concessions, while managing market expectations to avoid panic reactions. Using this strategy, US authorities have managed to get banks to plead guilty that were previously deemed off-limits for criminal prosecution.[30]

4 The struggle over Swiss banking secrecy

In this section, I discuss five instances of the exercise of US structural power in the dispute over Swiss banking secrecy: the creation of the Qualified Intermediary Program (QIP), the deferred prosecution agreement (DPA) of UBS, the criminal indictment of WEGELIN, the amnesty program for Swiss banks, and the plea bargain of CS.[31]

4.1 Qualified Intermediaries: Information sharing in return for market access

In the late 1990s, the US Internal Revenue Service (IRS) created the Qualified Intermediary Program (QIP) to increase tax compliance. The QIP had two main goals. First, it strived to identify US persons that held beneficial interests in US securities. Second, it attempted to ensure the appropriate withholding of US tax from payments of US source income to non-US persons. However, foreign banks could eliminate some of these reporting requirements by applying for the status of qualified intermediaries. As such, foreign banks themselves would be responsible for information collection by determining which of its customers were US persons subject to information sharing and which were non-US persons entitled to reduced rates of withholding tax under a treaty or statute.[32]

Foreign banks had a strong interest in participating in the QIP. If banks did not participate, their payments were subject to withholding at a rate of approximately 30%. However, in the case of Swiss banks, there were two major issues that complicated participation. On the one hand, the QIP conflicted with Swiss banking secrecy if banks were engaged in offshore wealth management for US

30 These considerations raise the interesting question of whether the authorities' ability to shape market expectations blunts the threat potential of criminal indictments in case of smaller banks. I suspect that the answer to this question is a function of the authorities' ability to not only shape but also control market expectations.
31 For a more detailed account see Emmenegger and Eggenberger (2015).
32 Hanrehan and Shapiro (1998).

clients. As originally conceived, the QIP had left Swiss banks with two possibilities: Stay out of the QIP and pay the punitive withholding tax, or participate in the QIP and lift the veil of secrecy in the case of US clients. On the other hand, the US had a strong interest in maximizing foreign direct investment. With Swiss banks managing approximately 25% of total offshore wealth,[33] if the Swiss Government barred its banks from participating in the QIP, the program might have resulted in negative economic consequences for the US. In other words, the large withholding tax would have made the US financial market simply unattractive.

The solution to this dilemma was quickly found. First, the QIP allowed foreign banks to keep the names of foreign clients confidential. Instead, the implementation of the QIP by foreign banks was subject to two external audits within a six-year period (Sec. 10.03 QIP). In practice, this meant that in presence of bilateral double taxation agreements, the US financial market remained a very lucrative destination for *foreign* investors with undeclared assets. Second, the QIP did not require foreign banks to share information with the IRS if they refrained from investing in US securities on behalf of their US clients (Sec 6.04 QIP). This exemption from reporting requirements was the reason why the Swiss Government did not consider the QIP to be in violation of banking secrecy regulations because the QIP left US clients of Swiss banks the choice between giving up banking secrecy and forgoing the right to invest in US securities.[34]

Hence, the QIP kept the US securities market attractive for foreign holders of undeclared assets, while ensuring that the IRS received the appropriate tax on US source income. The US could force the QIP upon foreign banks because the unique attractiveness and centrality of its financial market created strong incentives to accept all conditions for market access. There were, however, limits to US structural power. If all major financial centers outside the US had refused to participate in the QIP, the program would not have been viable. Hence, the US had to compromise with the likes of Switzerland by granting an important exception: Qualified intermediaries did not have to share information about their US clients if they did not invest these clients' assets in US securities.

4.2 The UBS case: Agreeing to a DPA to avoid a criminal indictment

The QIP, however, contained a major loophole. Consistent with US law, the QIP defined the beneficial owner of an account to include (foreign) corporations. This

33 BCG (2013: p. 12).
34 Swiss Government (2012).

grey zone allowed banks to continue to service US clients that were interested in trading US securities while respecting both the QIP as well as confidentiality requirements of Swiss banking secrecy. In this scenario, US clients of foreign banks appeared as foreign legal entities and were thus not subject to information reporting.[35] This possibility to circumvent the information sharing requirements was widely noticed. For instance, the law firm Baker & McKenzie observed that "the fact that a non-US company is "passive" and wholly or partially owned by a US person should *not* prevent the non-US company from being treated as a non-US person for US withholding tax and information reporting purposes."[36] Using such foreign corporations was therefore perfectly legal. However, as the Government Accountability Office noted, "establishing a foreign corporation provides a legal mechanism for shielding the identity of the owner of income."[37] Hence, like banking secrecy, using foreign corporations in this way could be used to evade taxation.

In summer 2008, US authorities informed that the large Swiss bank UBS had used this loophole to continue servicing US clients that were interested in trading US securities but refused to have their identities communicated to the IRS.[38] The authorities argued that if the sole purpose of these intermediary structures was tax evasion, they were abusive and thus illegal, and by using structures in this way, UBS was conspiring to defraud the US. The information the US authorities had obtained from a whistleblower in 2007 allowed them to arrest the head of UBS wealth management in the US at a Miami airport in April 2008. In a Senate hearing in July 2008, the bank's representatives admitted compliance failures on the bank's part and informed that UBS was in the process of shutting down its offshore business with US clients.

From this point onwards, UBS was facing the possibility of a criminal indictment, which could have led to the bank's collapse. In addition, in July 2008, a district court allowed the IRS to serve a John Doe summons on UBS, requesting 19,000 client files.[39] John Doe summons are issued to third parties to provide information on unknown taxpayers with potential tax liabilities. However, lacking documentation of tax fraud by clearly identified individuals, Swiss banking secrecy regulations did not allow UBS to comply with the order. Hence, in parallel, the IRS also requested international administrative assistance to get access to data on US clients of UBS, but this process, due to the time-consuming procedure, is very

35 Morse (2012: p. 533).
36 Baker and McKenzie (2000: p. 3, emphasis in the original).
37 Government Accountability Office (2007: p. 14).
38 Levin and Coleman (2008).
39 Bondi (2010).

slow.[40] Unable to provide the IRS with the requested client files, UBS found itself is a tough situation.

In February 2009, the US authorities lost patience. In a letter to UBS dated February 17, the US. Department of Justice (DoJ) offered a Deferred Prosecution Agreement (DPA) to UBS but in return it openly threatened that "if UBS fails to enter into this deferred prosecution agreement with the Department of Justice by February 18, 2009, the trial team will immediately seek authorization to obtain a criminal indictment against the bank."[41] UBS immediately requested emergency permission from the Swiss Financial Market Supervisory Authority (FINMA) to enter into the DPA, which was granted within 24 h. FINMA had good reasons to accept this request, not least because Switzerland is structurally dependent on the bank's survival. As the Swiss Federal Court later noted, "an indictment would have led to the bankruptcy of the bank which in turn would have caused serious and virtually uncontrollable economic repercussions for Switzerland."[42] Hence, facing the possibility of a criminal indictment, UBS was willing to do whatever it took to get out of the line of fire.[43]

4.3 The WEGELIN case: Making an example

After UBS was off the hook, attention turned to other Swiss banks. One of them was the small private bank, WEGELIN, which had no representation outside Switzerland. After UBS had come under pressure in the US, some of its clients were looking for ways to get their assets out of reach. While some decided to transfer their assets to other offshore financial centers, others went to small banks with no representation outside Switzerland. WEGELIN still welcomed US clients because it believed that by keeping a low profile and reducing investments in US securities, WEGELIN would not draw any attention from US authorities. According to the indictment issued by the US Court of the Southern District of New York

40 Schaub (2011).
41 GPK (2010: p. 3361).
42 Swiss Federal Court (2011).
43 As part of the DPA, UBS had to admit to helping US clients avoid paying taxes, pay a fine of USD 780 million, and disclose the names of approximately 250 account holders to the IRS (Bondi 2010: p. 9; Schaub 2011: pp. 212–213). Interestingly, US authorities repeated their strategy to enforce further concessions. The day after UBS had entered into the DPA, the IRS requested the US district court to enforce the John Doe summons, thereby once again endangering the survival of UBS. In August 2009, the US and Switzerland finally signed an agreement in which Switzerland agreed to give the US access to 4,450 additional client files and give expedited review to information requests in return for closing the proceedings.

against WEGELIN, its client managers "told US taxpayer-clients, in substance, that their undeclared accounts at WEGELIN would not be disclosed to the US authorities because WEGELIN had a long tradition of banking secrecy and, unlike UBS, did not have offices outside Switzerland, thereby making WEGELIN less vulnerable to US law enforcement pressure."[44] A year later the bank had ceased to exist. What happened?

Data obtained from UBS and several voluntary offshore disclosure programs allowed the US authorities to expand their investigations to other banks. In October 2010, US authorities arrested a senior WEGELIN client manager who had worked with a US-based lawyer. The lawyer had been arrested by US authorities in autumn 2009 and subsequently cooperated with them, thereby providing sufficient material to indict WEGELIN. In January 2012, the Court of the Southern District of New York indicted three WEGELIN employees and ultimately, in February 2012, the bank itself.[45] The bank immediately withdrew from business and subsequently agreed to plead guilty and a substantial penalty.[46]

Following the indictment, *The Economist* wrote that WEGELIN was "a mere pawn in a much bigger game played between Switzerland and America over banking secrecy and tax fraud."[47] In 2012, this game had ceased to be about violations of the QIP. As the criminal indictment shows, WEGELIN had very few US clients and was hardly present in the US securities market.[48] However, WEGELIN could be indicted without endangering global financial markets due to its small presence. In addition, the indictment was of high symbolic importance because of the bank's old age and its well-known co-owner, a prominent advocate of banking secrecy.

Hence, WEGELIN was the perfect bank to make an example out of and to convey two important messages. First, the indictment showed that banks were now held accountable for managing *any* undeclared assets of US persons, an important change in policy because until then clients, rather than banks, were responsible for the declaration of the assets. The QIP had already made banks responsible for the tax status of their US clients but only if these clients invested in US securities. The indictment showed that this condition no longer applied.

44 Court of the Southern District of New York (2012: pp. 7–8).

45 Court of the Southern District of New York (2012).

46 Court of the Southern District of New York (2013). It is not known why WEGELIN entered a plea bargain instead of fighting the accusations in court, although it is clear that going to court would not have saved the bank. In agreements, the defendant is typically prohibited from speaking about the criminal case and the reasons for entering the agreement (the so-called non-disparagement clause).

47 *The Economist*, "Pawn Sacrifice," 3 Feb 2012.

48 Court of the Southern District of New York (2012).

Politically, this change of policy found its expression in the Foreign Account Tax Compliance Act (FATCA), which extends this obligation to all banks in return for market access. Second, the criminal indictment (and the calculated collapse of WEGELIN) demonstrated that US authorities were using this instrument to enforce compliance. While the possibility of an indictment was always in the room, this demonstration showed that the US was willing to use it.

4.4 The amnesty program: Reversing the burden of proof

The escalation of the conflict with the criminal indictment of WEGELIN had the desired effect. Leading representatives of the Swiss financial services industry began to publicly lobby for far-reaching concessions, including the acceptance of the automatic exchange of information on tax matters. The Swiss Government reacted too, for instance, by allowing group requests in cases of international administrative assistance and agreeing to implement FATCA. However, these concessions did not satisfy US authorities, which insisted on access to client files outside the regular procedures (and thus in violation of banking secrecy).

After lengthy negotiations and new threats of criminal indictments, Switzerland and the US agreed on a unilateral amnesty program for Swiss banks, in which banks can obtain non-prosecution agreements or non-target letters if they are not already under investigation.[49] Banks requesting non-target letters must prove that all of their US clients have paid their taxes. If they fail to do so, they are excluded from the program and may be subject to criminal investigations. However, many banks do not know their clients' tax status and, given the vague definition of US persons, often do not even know whether their clients are in fact US persons. These banks can request a non-prosecution agreement, for which they must provide detailed information that would allow US authorities to get access to client files through the system of international administrative assistance. In addition, these banks must agree to pay an amount equal to between 20 and 50% of the maximum aggregate dollar value of undeclared US-related accounts as a penalty.[50]

Three things are striking about this amnesty program. First, the penalties for the same offence are rapidly increasing. While in the cases of UBS and WEGELIN, penalties amounted to approximately 5% of the maximum aggregate dollar value of US related accounts, the new penalties are considerably higher. In general, it

49 U.S. Department of Justice and Swiss Federal Department of Finance (2013).
50 U.S. Department of Justice and Swiss Federal Department of Finance (2013: pp. 7–8).

is unclear on what basis these penalties are determined.[51] Second, the program criminalizes banks for activities that were not necessarily illegal at the time they were committed because the banks were not responsible for the tax status of their US clients unless they had participated in the QIP *and* their US clients had invested in US securities. The fact that it is not clear what laws these banks have broken is also reflected in the amnesty program, in which penalties do not reflect regulatory changes but increase with time and in parallel to the developments in the UBS case. Banks pay as a penalty 20% of the maximum aggregate dollar value of undeclared US-related accounts they held at the time of the UBS Senate hearing, 30% at the time of the UBS DPA, and 50% thereafter. Third, the amnesty program shifts the burden of proof onto the banks. Even if banks have never been subject to US investigations, they are expected to demonstrate to the IRS that they did not violate US laws (if they want to obtain a non-target letter) or provide extensive documentation (if they want to obtain a non-prosecution agreement).

In sum, in a stunning display of structural power, the US managed to get numerous banks to sign up to a program that makes them pay penalties for activities that were not necessarily illegal at the time they were committed. Although participation is officially voluntary, it is voluntary in words only. In reality, banks signed up because they were afraid of facing a criminal indictment.

4.5 The CS case: Solving the "too big to jail" problem

The amnesty program does not cover banks that were already under investigation, which includes some of the biggest Swiss banks – such as Credit Suisse (CS) – that are typically considered "too big to fail." Due to their size, big banks have long been considered off-limits for criminal prosecution, a position also long shared by the serving US Attorney General, Eric Holder.[52] What can the DoJ do to get a major bank to plead guilty without collapsing and thereby endangering the global economy? The answer, the DoJ has learnt, is to manage market expectations.

Public pressure had been mounting over the years as both the public and influential politicians expressed dissatisfaction with investigations and the (what they considered) lenient treatment of big banks. In February 2014, CS representatives as well as the Attorney General were asked to participate in a hearing with US Senate's Permanent Subcommittee on Investigations. While the Senators used the hearing to make their case against CS, they also took advantage of the

51 Garrett (2014: p. 149).

52 Garrett (2014: pp. 55–56, p. 252).

opportunity to push Holder to be tougher on big banks and to consider criminal indictments.

After the hearing, Holder adopted a more determined language.[53] In particular, the DoJ now began to inform that it was considering criminal indictments. Gradually, these public statements became more concrete. For instance, on 31 March 2014, the Court of the Southern District of New York (which is the relevant court for most of these investigations) tweeted that "you can expect that before long a significant financial institution will be charged with a felony or be made to plead guilty to a felony."[54] A few weeks later, Holder explicitly remarked in a publicly broadcasted statement that no bank was (any longer) considered to be "too big to jail."[55] Although, at this point, it was not yet known which bank might face this fate, as there were plenty of large candidates around, what was clearly visible is that the DoJ was preparing the markets for a change in strategy. In addition, the DoJ publicly informed that it had received assurances from regulatory bodies that, if convicted, the banks' corporate charters and licenses would not be revoked.[56] Hence, the DoJ unambiguously signaled that it wanted the banks to survive the forthcoming criminal conviction.

This communication strategy allowed investors and other banks to prepare for the criminal conviction and coordinate their activities. As mentioned above, the main reason why criminal convictions ruin banks is the uncertainty about how other actors will respond to them. Although all actors would be collectively better off if the indicted bank survived, they face strong incentives to immediately sever ties with the bank to avoid being the last one to do so. The DoJ's communication strategy allowed actors to overcome this cooperation dilemma by giving them time to communicate their behavior. This process cannot be observed but it found its public expression in statements such as the one by Goldman Sachs CEO Lloyd C. Blankfein who argued (referring to CS) that "for us, it's not just a question of what's in our economic interest; we have a role in the system, and for us to not deal with someone would be a further risk to the system" and added that "it becomes a very weighty decision for us to cut someone off, and we wouldn't do it lightly."[57]

Statements like this as well as public assurances that CS would not see its corporate charter revoked clearly signaled to other market participants that

53 Garrett (2014: p. 253).
54 Source: URL: https://twitter.com/SDNYnews/status/450680278894522370 (accessed 8 Sep, 2014). I thank Olivia Kühni for drawing my attention to this tweet.
55 Source: URL: https://www.youtube.com/watch?v=JLsOXB4ht94 (accessed 8 Sep, 2014).
56 Garrett (2014: p. 258).
57 *Bloomberg*, 16 May 2014, "Blankfein Sees Concern in Guilty Plea by Any Global Bank."

influential banks like Goldman Sachs would not abandon CS in case of a guilty plea. This management of expectations increased the likelihood of the bank surviving a criminal conviction and cleared the way for a deal between the DoJ and CS. On 19 May 2014, CS pleaded guilty to criminal charges and agreed to a penalty of USD 2.6 billion. Since markets hardly reacted to the guilty plea, the DoJ has continued to rely on the same strategy to enforce further guilty pleas from other banks. Banks that are still "too big to fail" are thus no longer "too big to jail." Put differently, the US extended its structural power to banks that were previously considered off-limits for criminal prosecution.

5 Conclusions

Banks in the liberal economic system cannot survive without access to the US-controlled, dollar-based financial system, thus giving the US structural power over banks. This structural power allows US authorities to define conditions for market access that would otherwise undermine the competitive position of the American economy. In addition, this structural power can be used in criminal proceedings. The banks' structural dependence on market access forces them to enter into agreements whose terms are dictated by US authorities. In this context, the exercise of structural power is clearly strategic and thus intentional. Hence, this article suggests that the literature on structural power needs to focus more on state agency and the power of states with large markets.[58]

Arguably, US structural power has increased over time, as the global financial system has become more integrated. In addition, US authorities first had to learn how to use their structural power. For a long period, big banks were considered off-limits for criminal prosecution, as their collapse might have endangered the world economy. Recently, however, US authorities have changed their position on this matter, a development best exemplified by the outgoing Attorney General, Eric Holder. The solution to the "too big to jail" problem is to manage market expectations as banks collapse because of how markets react to criminal investigations, not because of the investigations themselves.

This structural power has found frequent use in recent years. Between 2008 and 2013, the ten largest Western banks have paid around USD 160 billion in fines. According to some estimates, this number has increased to USD 300 billion by the end of 2014. Bank of America alone has paid almost USD 80 billion since 2008.[59]

58 Drezner (2007); Newman and Posner (2011); Bell (2012); Culpepper and Reinke (2014).

59 *Financial Times*, "Regulatory Revenge Risks Scaring Investors Away," 28 Aug 2014.

The comparison to the fines paid before the financial crisis is staggering.[60] Interestingly, US authorities do not only investigate misdeeds committed in the US or involving US residents, as the case of BNP Paribas demonstrates. However, what all affected banks share is their need to participate in the dollar-based financial system and therefore the structural dependence on US authorities to give them access to it.

There are also limits to the extent to which the US can exercise structural power. As costs associated with US dominance in finance increase, other financial centers have incentives to challenge the US' central position, which could ultimately undermine its structural power. Tellingly, news coverage in the financial press has grown increasingly critical of the US practice of imposing large fines. Hence, US authorities have a strong interest in conveying that the fines are legitimate given the banks' past transgressions. However, the lack of transparency in case of agreements between the DoJ and banks as well as the fact that the size of the fines are to a large extent the result of the exercise of structural power, make it difficult to evaluate their reasonableness.[61] Not surprisingly, foreign governments increasingly intervene on behalf of their banks in the hope of changing the terms of the agreements. Of course, these interventions are also the result of structural dependencies. Just as foreign banks are dependent on access to the US market, so are countries dependent on their banks' survival.

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60 *The Economist*, "A Mammoth Guilt Trip," 30 Aug 2014.

61 There are also important voices that consider these fines to be still too low (cf. Garrett 2014).

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