

French cross-border matter

An update ahead of UBS's 2020 Annual General Meeting, in response to questions asked by UBS shareholders, clients and employees

Introduction

In February 2019, the Paris Court of First Instance imposed fines of EUR 3.7 billion on UBS, and awarded the French state civil damages of EUR 800 million. This judgment was issued in connection with a litigation matter related to cross-border business activities with French residents between 2004 and 2011/2012. UBS has appealed the decision of the Court of First Instance, and it will still take time for this matter to be finally concluded.

The court's decision, together with the unprecedented scale of the penalties and almost decade-long proceedings, drew considerable attention, and UBS has received numerous questions from shareholders, clients and employees and other stakeholders. The judgment also contributed to shareholders not granting the discharge to UBS's executive management and Board of Directors at the 2019 Annual General Meeting.

The appeal process is pending and a *de novo* trial has now been scheduled for 8-24 March 2021. UBS has compiled this report ahead of its 2020 Annual General Meeting to address some of the most common questions that UBS shareholders, clients and employees have asked.

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Background

Banking secrecy has existed in most developed countries, albeit implemented in different ways. In Europe, countries such as Austria, Belgium, Luxembourg and Switzerland have had long-standing banking secrecy traditions, for example. Banking secrecy does not conceal the identity of the client from the bank. Nor does it preclude the disclosure of information by the bank at the request of foreign authorities under applicable international treaties.

The move towards tax transparency and the adoption of the new standard of an automatic exchange of information has evolved over several decades. In the European Union (EU) this was initially opposed by EU Member States with banking secrecy traditions, such as Austria, Belgium and Luxembourg. After many years of negotiations, a compromise was reached in 2000. As a step in the direction towards full tax transparency, the EU agreed to allow Member States the option of not disclosing client details but to collect a “withholding tax” from them instead, which would be remitted to the client’s home state. However, the Member States with banking secrecy only agreed to implement this compromise if Switzerland (and certain other countries) signed up to the same arrangement, which they eventually did.

The EU measure was named the European Savings Tax Directive and the deal between the EU and Switzerland was the EU–Switzerland Agreement on Savings Tax, known as the EU–Swiss Agreement. The concept of having some states apply automatic exchange of information while others maintained banking secrecy accompanied by a withholding tax was called the “co-existence model.”

The EU–Swiss Agreement came into effect on 1 July 2005 and reflects the compromise reached within the EU. For the EU, it was a step towards the full automatic cross-border exchange of information between banks and tax authorities. It allowed the EU to implement the European Savings Tax Directive, thereby securing information exchange amongst Member States (other than Austria, Belgium and Luxembourg, which were allowed to maintain banking secrecy); and it meant that significant withholding tax would be recovered. For Switzerland, EU Member States agreed that Swiss and foreign banks operating in Switzerland (a) would not disclose a client’s details to their home tax authorities without the client’s consent, and (b) where such consent was not given, the banks would charge and remit to the Swiss authorities a withholding tax that would then be passed on to the client’s home state.

Since the EU–Swiss Agreement came into effect in 2005 and until it was replaced in 2017, consistent with French, Swiss and EU law, UBS applied the withholding tax to

the accounts of individuals domiciled in the EU who did not consent to their information being shared outside of Switzerland. While the withholding tax was not applicable for companies or trusts under the European Savings Tax Directive or the EU–Swiss Agreement, the majority of accounts and assets of French-domiciled clients at UBS were held by individuals to whom the withholding tax requirements were applicable. UBS collected substantial tax revenues that were delivered to the EU Member States.

When France began its first tax regularization program in 2009, UBS informed its clients of this procedure and offered support to clients who wished to participate. Subsequently, UBS actively encouraged clients to participate in tax regularization programs and asked its clients to provide proof of tax declaration of their assets held with UBS in Switzerland. Accounts were systematically closed and new accounts could not be opened without such proof.

In 2015, the EU and Switzerland agreed to amend and update the EU–Swiss Agreement, which had been in place since 2005. Since 1 January 2017, Swiss and foreign Swiss-domiciled banks have been required to share client information with a number of foreign authorities (including those in France). This agreement to introduce automatic information exchange can be seen as the culmination of a process that started with the European Savings Tax Directive and the EU–Swiss Agreement.

UBS’s local presence in France

In 1999, UBS created a local wealth management business in France, a French-regulated legal entity called UBS (France) SA (“UBS France”), as part of a strategy of expanding its local presence in the largest European countries including Germany, the United Kingdom, Italy, Spain and France.

This initiative coincided with the introduction of the euro, which many at the time saw as a catalyst for future growth and prosperity in Europe. It was expected that growing numbers of people would want the convenience of their assets being in their home country. A local presence would also allow UBS to be competitive in attracting a greater number of clients who wished to bring their assets back to their home country.

UBS France has been largely managed as a separate entity from UBS in Switzerland. Over the last two decades, UBS France has grown successfully and created about 350 jobs in Paris, Lyon, Strasbourg, Bordeaux and Nantes.

The investigation

When and why was the investigation initiated?

In March 2011, French authorities started an investigation into the cross-border business activities in France of some Swiss-based UBS employees.

In response to whistleblowing allegations by four employees or former employees of UBS France, the investigating judges initially focused on (i) whether French-domiciled clients had been unlawfully solicited in France to open accounts in Switzerland by Swiss-based UBS employees and (ii) whether UBS had laundered the proceeds of such unlawful solicitation.

In June 2013, UBS AG was placed under formal examination (*mise en examen*) with respect to the alleged unlawful solicitation only.

French investigators collected a substantial volume of documents and conducted interviews with current and former employees as well as clients. However, it is UBS's view that these investigations did not establish evidence supporting the whistleblowing allegations.

Did UBS try to resolve the matter early on?

UBS discussed the possibility of reaching a financial agreement with French authorities in the first half of 2014. Under French law at the time, a settlement would have required a guilty plea, which UBS was unwilling to accept given the potentially very serious consequences for UBS's ability to conduct business around the world.

In March 2014, the French authorities broadened their investigation to include all accounts held by UBS in Switzerland for French-domiciled clients who had allegedly been committing tax fraud.

On 23 July 2014, UBS AG was placed under formal examination (*mise en examen*) with respect to potential charges of aggravated (which means carried out in the course of a professional activity) laundering of proceeds of tax fraud by French-domiciled clients from 2004 through 2012. The investigating judges then ordered UBS AG to post a bail (*caution*) amount of EUR 1.1 billion. UBS appealed the bail (unsuccessfully) in national courts and all the way up to the European Court of Human Rights on grounds including that UBS believed it was excessive and amounted to a conviction without due process. The posting of this bail did not affect UBS's profit and loss, as the bail amount did not represent a fine for which an expense would have to be recorded.

The French tax authorities compiled lists of what they called "regularized taxpayers" containing the names of French tax residents who had entered the French tax regularization programs and the volume of their assets purportedly kept at UBS. These lists were used against UBS in the criminal investigation in support of the laundering charge.

What charges were recommended by the prosecutor?

In July 2016, UBS AG and UBS France received the prosecutor's trial recommendation (*réquisitoire définitif*), which stated that UBS AG should be tried for unlawful solicitation of French-domiciled clients on French territory and for aggravated laundering of the proceeds of tax fraud by French-domiciled clients. The prosecutor also recommended that UBS France be tried for aiding and abetting unlawful solicitation, and for aiding and abetting the laundering of the proceeds of tax fraud.

Did UBS try to reach a settlement after the introduction of the “Sapin II” law?

In the autumn of 2016, a new law (*loi Sapin II*) was introduced in France, which allows companies to settle certain criminal prosecutions without a guilty plea.

As part of its duty to consider all options to mitigate risk to shareholders, UBS explored whether an agreement with French authorities under the framework of this new law (referred to as *convention judiciaire d'intérêt public* or CJIP) could be reached. However, a mutually agreeable solution could not be reached. UBS in particular denies media reports that a settlement at the amount of the bail of EUR 1.1 billion was possible.

In March 2017, the investigating judges issued a trial order (*ordonnance de renvoi*) that charged UBS AG with unlawful solicitation of French-domiciled clients on French territory and with aggravated laundering of the proceeds of tax fraud by French-domiciled clients, and UBS France with aiding and abetting these offenses. Under French law, a settlement during court proceedings is not possible.

What are the key elements of the decision issued by the Court of First Instance?

The trial on these charges in the Court of First Instance took place from 8 October 2018 to 15 November 2018.

On 20 February 2019, the court issued its judgment, finding UBS AG guilty of unlawful solicitation of French-domiciled clients on French territory and aggravated laundering of the proceeds of tax fraud by French-domiciled clients. It also found UBS France guilty of aiding and abetting unlawful solicitation, and of aiding and abetting the laundering of the proceeds of tax fraud. One of the four UBS AG defendants, Raoul Weil, who was previously responsible for UBS's wealth management business, was acquitted. The other three were found guilty.

The court imposed fines in an aggregate amount of EUR 3.7 billion on UBS AG. The amount of the fines was based on data that had been provided by the French tax authorities during the criminal investigation concerning French taxpayers and clients of UBS AG who regularized their tax situation under French tax regularization programs. UBS France was ordered to pay a fine of EUR 15 million. UBS AG, UBS France and the three UBS AG defendants who were found guilty were jointly ordered to pay civil damages of EUR 800 million.

UBS appealed the judgment to the Court of Appeal (*Cour d'appel*) on 20 February 2019. UBS acknowledges that appealing any judgment always entails risk, but believes that in this specific case its legal position supports a decision to pursue the appeal. The other defendants have also appealed the judgment, except for Raoul Weil. The prosecution and the French state have also appealed (including the acquittal of Raoul Weil).

UBS's position on the charges

What are the charges brought against UBS?

The Court of Appeal will hear the case *de novo*, so both the facts in the case and matters of law will be considered by the Court of Appeal.

The trial order issued in March 2017 sets out the charges against UBS which will be the basis for the trial in the Court of Appeal. UBS AG is charged with unlawful solicitation of French-domiciled clients on French territory from 2004 to 2011 and with aggravated laundering of the proceeds of tax fraud by French-domiciled clients from 2004 to 2012. UBS France is charged with aiding and abetting unlawful solicitation by UBS AG from 2004 to 2009 and aiding and abetting aggravated laundering of the proceeds of tax fraud by UBS AG from 2004 to 2008.

What is UBS's position?

UBS denies any criminal wrongdoing.

The case against UBS is centered around an allegation that the firm had established a global, sophisticated "system" with the specific purpose of unlawfully soliciting on French territory and laundering the proceeds of tax fraud by French clients. It is UBS's position that it did not at any time operate such a "system" to solicit prospective or current clients unlawfully, or to help clients commit tax fraud or to launder the proceeds thereof. Moreover UBS believes that a criminal prosecution for solicitation or laundering in France cannot rely on such "systemic approach" as French criminal law requires specific evidence of misconduct and intent with respect to identified and determined facts in order for a prosecution to be brought.

Alleged unlawful solicitation

UBS does not dispute that some of its Swiss-based client advisors met with their clients in France. Banks regularly organize social events in order to promote their brand and entertain clients, and some UBS clients met with their Swiss-based advisors in France at some of these events. UBS's position is that these activities did not constitute unlawful solicitation or qualified as exceptions to unlawful solicitation that are explicitly allowed under French law.

Both the trial order and the first instance judgment acknowledged that none of the UBS clients who were interviewed during the investigations were found to have been unlawfully solicited in France.

Alleged laundering of the proceeds of tax fraud

The purpose of both the European Savings Tax Directive and the EU–Swiss Agreement was to move towards the adequate taxation of undeclared assets. The compromise that was negotiated was the co-existence model, under which some countries opted to exchange information, while other countries opted to maintain banking secrecy and to require banks operating in their jurisdiction to deduct the withholding tax unless the account holder elected for disclosure.

In compliance with this Agreement, UBS continued to provide services to clients, including those who were subject to the withholding tax. UBS also supported those clients who wished to participate in France's tax regularization program. In doing so, UBS complied with its obligation to adhere to Swiss banking secrecy laws, as well as applicable French and EU laws.

Size of penalties

What are the potential penalties under French criminal law?

Under French law, the maximum fine that may be imposed for unlawful solicitation is EUR 375,000 for individuals. For legal entities, the maximum fine for unlawful solicitation is five times the amount applicable to individuals, or EUR 1,875,000.

As far as laundering is concerned, French law allows a maximum fine of EUR 750,000 for individuals, and for legal entities, the maximum fine is EUR 3,750,000.

In addition, in cases of laundering, the law allows a judge to raise the maximum fine to “up to half of the value of the property or funds in respect of which the money laundering operations were carried out.” This is referred to as the “proportional” fine. The amount of any fine, up to the permitted maximum, is left to the judge’s discretion and it should be proportionate to the seriousness of the crime as well as the financial position of the defendant.

As noted above, under French criminal law the maximum fine applicable to an individual should be multiplied by five when dealing with legal entities. UBS believes that there is no indication in French law that this “multiplier” was intended to apply to proportional fines, as opposed to the nominal maximum fine of EUR 750,000 for individuals.

What penalties were imposed by the Court of First Instance?

In its judgment of 20 February 2019, the Court of First Instance imposed “proportional” fines in an aggregate amount of EUR 3.7 billion on UBS, and awarded the French state additional damages of EUR 800 million.

The Court did not make the assessment based on the avoided taxes, but considered the “value of the property” that was purportedly laundered to be the total assets of UBS clients who had participated in France’s tax regularization programs up to 30 October 2015, which it found to be EUR 3.773 billion. This amount was then rounded down to EUR 3.7 billion, divided in half (as required under French law for arriving at the proportional fine amount), and then multiplied by a factor of five, to derive a maximum fine of EUR 9.25 billion. The Court of First Instance then, at its discretion, set the penalty at EUR 3.7 billion.

Which data is the Court of First Instance referring to with respect to tax regularization?

The trial order and the judgment of the Court of First Instance refer to data that was provided by the French tax authorities concerning approximately 3,900 French taxpayers and clients of UBS AG who had regularized their tax situation under French tax regularization programs, as of 30 October 2015. The French tax authorities reported that the amount of back taxes paid by these clients totaled EUR 620 million, and that they had paid a further EUR 342 million in fines and penalties.

UBS has argued that the lists in question do not in themselves establish facts relevant for the laundering charge against UBS (for example, the given client may not have been subject to tax during the prosecuted period, may have been subject to taxes that do not fall within the scope of the charges against UBS, or may have evaded taxes in relation to assets held at banks other than UBS).

During the first instance trial, the French tax authorities produced an “update note” in which they estimated that the total back taxes of all regularized taxpayers with an account at UBS only as of 31 December 2017 was EUR 820 million, plus an additional EUR 514 million for taxpayers with accounts at UBS and other banks. The French tax authorities did not provide evidence to support these figures, which are estimates based on extrapolated percentages and a sample of regularization files. The Court of First Instance disregarded these updated figures.

How were the civil damages calculated?

In addition to any fines, civil damages can be awarded to the French state where it can prove specific costs in relation to the launch and pursuit of proceedings to collect unpaid taxes from French taxpayers who were clients of UBS. To UBS’s knowledge, the French state did not provide the Court of First Instance with any documentation supporting these costs. Nor does the judgment of the Court of First Instance contain, in UBS’s view, any substantiated justification of the amount of damages awarded by the Court. An official report published in October 2017 by the *Cour des Comptes* (the French supreme body for auditing the use of public funds in France) valued the costs incurred by the French tax authorities in connection with regularization across all banks (i.e., not just UBS) to the end of 2016 at EUR 40 million, or about 5% of the EUR 800 million in civil damages awarded to the French state by the Court of First Instance.

Provisions made by UBS

How does UBS establish accounting provisions?

UBS prepares and publishes its financial statements in accordance with International Financial Reporting Standards (IFRS).

Under the IFRS accounting standard IAS 37, Provisions, Contingent Liabilities and Contingent Assets, an entity is required to recognize a provision if (i) an obligation exists, (ii) an outflow is probable and (iii) a reliable estimate of such an outflow can be made. Under this standard, uncertainties surrounding the amount to be recognized as a provision are dealt with by various means according to the circumstances. Where a single obligation is being measured, the single most likely outcome may be the best estimate of the liability. However, where other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate may be adjusted to a higher or lower amount.

Litigation cases can raise difficult judgments in applying this accounting standard, especially if (as in this case) the charges, and therefore the existence of an obligation, are disputed. When the existence of an obligation is not clear, the assessment should focus on whether an outflow is more likely than not to arise and how much that outflow could be.

Which provisions were made prior to February 2019?

From the early stages of the investigation and prior to the judgment of the Court of First Instance in February 2019, UBS conducted such assessments on a regular basis. Prior to February 2019, provisions were primarily informed by what UBS saw in the ongoing investigation, as well as a limited number of observation points in the form of settlements reached by UBS and other banks on similar matters in various jurisdictions. These included a settlement with French authorities by a foreign bank in 2017.

How did UBS determine the amount of its provision following the judgment of the Court of First Instance?

Immediately following the issuance of the judgment of the Court of First Instance in February 2019, UBS undertook a comprehensive assessment of the facts and legal arguments in arriving at its provision, with support from external legal counsel, including specialist French Supreme Court counsel, and subject to audit by EY in the context of its external audit of UBS's 2018 financial statements.

Although UBS believes that it should not be convicted by the Court of Appeal, it must comply with IFRS and make an accounting provision reflecting the risk associated with the case.

UBS believes that, if ultimately found guilty under applicable laws for the crimes it was charged with, the fine should be based on the amount of unpaid taxes. The best estimate of an outflow was therefore measured using the unpaid taxes as a starting point. In a recent case not involving UBS, and published in September 2019, the French Supreme Court ruled that the maximum proportional fine applicable in cases of laundering of the proceeds of tax fraud can only be based on the taxes that have been avoided. This decision is consistent with and supports UBS's assumption with regards to the basis of measurement of a potential outflow. It is also consistent with what UBS pleaded in its defense before the Court of First Instance.

All relevant facts that may impact any final outflow were individually assessed. These included the scope of unpaid taxes that should be taken into consideration, as well as the potential use of multipliers that could be applied to derive fines for legal entities.

These considerations led to a range of potential outcomes. An assessment was therefore made based on the probability of these outcomes, leading to provisions totaling EUR 450 million, or USD 516 million. This conclusion was confirmed by UBS's Audit Committee on 11 March 2019, approved by the firm's Board of Directors on 12 March 2019 and subjected to audit by EY in the context of its external audit of UBS's 2018 financial statements. The provision amount was then reflected on UBS's balance sheet as of 31 December 2018, and in UBS's Annual Report 2018, which was published in March 2019.

UBS will monitor developments and will adjust the provisioned amounts in the event material new facts arise that affect its estimate.

Next steps

What will happen next?

UBS has appealed the judgement of the Court of First Instance. The case has been transferred to the Court of Appeal where it will be heard by a panel of three judges in one of the sections specializing in financial matters. The prosecution will be conducted by the appellate prosecutor's office (*Parquet général*) – a different body from the national financial prosecutor's office (*Parquet national financier*) that prosecuted the case at the Court of First Instance.

The trial was originally scheduled for 2-29 June 2020, and subsequently re-scheduled to 8-24 March 2021 following the Covid-19 outbreak.

The Court of Appeal will hear the case *de novo*, meaning the case will be heard anew on the facts and the law. However, the scope of the charges cannot be extended and the trial order issued in March 2017 will still be the framework within which the trial is conducted.

French criminal procedural law requires the Court of Appeal to "respond to the pleadings duly filed", which means that the Court of Appeal is required by law to address the arguments raised by the defendants.

Could UBS appeal the decision of the Court of Appeal?

A ruling by the Court of Appeal may be further appealed to the French Supreme Court (*Cour de cassation*).

Unlike the Court of Appeal, the French Supreme Court does not assess cases *de novo*. It focuses solely on questions of law, i.e., on whether the law has been correctly applied by the Court of Appeal. The French Supreme Court could disagree with the decision of the Court of Appeal in whole or in part, and it could remit the case back to the Court of Appeal for a new trial.

Additional information

In July 2019, the Swiss Supreme Court rendered a ruling in relation to an international administrative request in fiscal matters by the French tax authorities to obtain information about certain bank accounts held by French-domiciled clients of UBS in Switzerland.

This decision is not directly relevant to the French cross-border matter covered by this document. However, UBS shareholders, clients and employees asked a number of questions about the July 2019 Swiss Supreme Court decision, which is why UBS decided to provide the short summary below.

Background information on the July 2019 decision by the Swiss Supreme Court

In January 2016, the French media reported that French tax authorities obtained data in relation to approximately 38,000 bank accounts of French citizens at UBS in Switzerland, including information about their alleged aggregate assets. This data was passed on to French authorities by German authorities outside regular channels for international administrative assistance in fiscal matters.

This data, which is for 2006 and 2008, includes information such as account numbers and account balances. It does not include the names of the beneficial owners of these accounts.

In June 2016, French authorities made a bulk request for international administrative assistance to the Swiss Federal Tax Administration (SFTA) to obtain additional information about these accounts, for the declared purpose of verifying the tax compliance status of the account holders.

In July 2018, the Swiss Federal Administrative Court considered the French bulk request for administrative assistance as illegal, given that there was no evidence of tax evasion related to the assets on these accounts. The SFTA appealed this decision to the Swiss Supreme Court.

In July 2019, the Swiss Supreme Court granted the appeal by the SFTA. This means that the SFTA must provide information relating to these accounts to the French tax authorities. The Swiss Supreme Court decision is final.

Implications of the recent Swiss Supreme Court decision for UBS's French cross-border matter

The Swiss Tax Administrative Assistance Act and its interpretation prohibits the sharing of data in proceedings against anyone other than the targeted taxpayers and states that the information may only be used for the purposes specified in the underlying tax-related request. This is known as the specialty principle.

In its written decision, the Swiss Supreme Court stated the SFTA must ensure to only perform its obligation to share the requested information after receipt of an explicit written confirmation by the French tax authorities agreeing that they will fully comply with the specialty principle and that the information cannot be passed on to the criminal authorities or used against UBS in the ongoing criminal trial before the Court of Appeal. The SFTA has requested a respective confirmation by the *Directeur Général des Finances Publiques*, which is expected to be concluded.

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