BANKING SECRECY AFTER THE DER WEDUWE CASE: AN OBSTACLE TO THE FREE PROVISION OF CROSS-BORDER BANKING SERVICES?

Marc Dassesse[1]

On 10 December 2002 the European Court handed down a long awaited judgement in the so-called *der Weduwe Case*, in which it was apprised of a request for a preliminary ruling from a Belgian investigating judge in connection with criminal proceedings brought in Belgium against two employees of Luxembourg-based banks[2].

Even though the European Court eventually ruled that the request for a preliminary ruling of which it was apprised was inadmissible, the reasoning which led the Court to this conclusion has far reaching implications for the free provision of cross-border banking services when either the bank providing the services, or the customer who is a recipient of said services is resident in a Member State where banking secrecy is put on a par with traditional professional secrecy, and its violation by the bank is subject to a criminal sanction.

The Factual Position

Two employees of Luxembourg-based banks had provided banking services in Belgium for the account of their employers. They visited (prospective) clients resident in Belgium; collected cash for deposits with their employers, and collected dividend and interest coupons for encashment in Luxembourg etc.

---

1 Professor at the Institute of European Studies of the Free University of Brussels (ULB). E-mail: mdassess@ulb.ac.be

2 Case C-153/00.Criminal proceedings against Paul der Weduwe. .The full text of the judgement and of the Opinion of Advocate General Léger is available from the ECJ's website.

In connection with criminal proceedings for tax evasion and money laundering which were brought against some of their clients by the Belgian judicial authorities, they were 'invited' by a Belgian investigating judge to answer a series of questions regarding the way in which they had been exercising their activities in Belgium. [3]

The two Luxembourg-based bank employees refused to answer the questions put to them by the Belgian investigating judge.

They argued, in substance, that by answering those questions, they would make themselves liable to criminal proceedings in Luxembourg for violation of the duty of professional secrecy by which they were bound.

On the other hand, under Belgian law, refusal by a witness to answer the questions put to him by an investigating judge is also subject to criminal sanctions unless the witness can show that by doing so he would be violating the duty of professional secrecy by which he is bound.

However, according to the case law of the Belgian Supreme Court, the provisions of the Belgian Criminal Code dealing with professional secrecy do not apply to bankers. They are only bound by a duty of contractual discretion vis-à-vis their clients.

Article 41 of the Luxembourg law of 5 April 1993 on the financial sector (together with the relevant provisions of the Luxembourg Criminal Code) provides the basis for the obligation of professional secrecy incumbent on bankers. It reads as follows:

"1. Directors, members of the governing and supervisory boards, managers, employees and other persons employed by the credit institutions and other professions of the financial sector … shall be required to maintain secrecy in regard to information entrusted to them in the course of their professional business. Disclosure of such information is an offence punishable under Article 458 of the Criminal Code.

3 One of the two bank employees was actually himself indicted, presumably as an accomplice to the charges brought against his clients. However, he did not invoke his right, as a defendant, to refuse to answer questions on the ground that he might by so doing implicate himself. Instead, he invoked the duty of professional secrecy by which he was bound under Luxembourg law, as did the other bank employee brought before the investigating judge.

2 The duty to maintain secrecy shall cease when disclosure of information is authorised or required by or pursuant to a legislative provision even if it predates the enactment hereof.

…

6 Anyone bound by the obligation to maintain secrecy referred to in paragraph 1 hereof, who lawfully discloses information covered by that obligation, shall not incur criminal or civil liability on the sole ground of that disclosure."

In other words, the two recalcitrant witnesses asserted that they were put in a position of double jeopardy in that:

- Either they accepted to answer the questions put to them by the Belgian investigating judge, in which case they were liable to criminal prosecution in Luxembourg, their country of residence and employment, for breach of their duty of professional secrecy;

- Or they refused to answer the questions put to them by the Belgian investigating judge, in order to avoid criminal prosecution in Luxembourg, but were then faced with criminal prosecution in Belgium.

The Astonishing Question raised by the Belgian Investigating Judge

"In his order for reference [to the European Court], the [Belgian] investigating judge explained that the Luxembourg legislation on banking secrecy constitutes [in his view] a serious impediment to the collection of evidence.

In his view, there is a conflict of law between the provisions of Belgian law establishing an obligation to give evidence and the provisions of Luxembourg law prescribing an obligation of professional secrecy. That situation gravely impedes the proper operation of the Belgian judicial system because, in order to avoid liability for breach of banking secrecy, [in Luxembourg], Luxembourg bankers prefer to refuse to give evidence in Belgium and, accordingly, to incur a fine under Article 80 of the Belgian Code of Criminal Procedure." [4]

Surprisingly, however, the Belgian investigating judge came to the conclusion that this conflict of law raised the question whether "the extraterritorial validity of the Luxembourg banking secrecy laws constitutes an unreasonable impediment

4 See Opinion of Advocate General Léger, at paragraph 13.

to the free provision of financial services [by Luxembourg-based bankers in Belgium][5].

Indeed, it is, to say the least, surprising that a Belgian investigating judge, dealing with suspected cases of tax evasion as a result of the activities of Luxembourg based bankers in Belgium, should express concern that some provisions of Luxembourg law could restrict the freedom of service of Luxembourg-based banks in his own country.

To many Belgian observers, the circumstances of the referral made by the Belgian investigating judge to the European Court had to be seen in the broader context of the contentious relationship between the Belgian judicial and tax authorities , and the Luxembourg banking community ever since the so-called KB LUX case erupted in Belgium. In that case, Luxembourg-based employees who had been fired by Kredietbank Luxembourg (KB LUX) "offered" to the Belgian tax authorities a computer printout from KB LUX customers database with the names and banking details (sometimes, only the numbered accounts) of literally thousands of Belgian residents. This case is presently winding its way through the Belgian courts.

It is submitted that these circumstances may have played a role in the scepticism with which the questions raised by the Belgian investigating judge were approached by the Advocate General in his Opinion, and which led him to advise the European Court to rule that the questions of the Belgian judge were inadmissible.

The Position taken by the Belgian Government before the European Court

The Belgian Government, who had no qualms about setting about to construe the legislation of a fellow Member State before the European Court, explained "that the question of extraterritorial validity of the Luxembourg legislation is highly controversial.

[That legislation] is open to three different interpretations:

- According to the first interpretation, the principle of banking secrecy is considered to have no extraterritorial effect. Accordingly, the Luxembourg authorities may only impose sanctions on bankers established on their territory when the disclosure of information covered by banking secrecy occurs on the territory of the Grand Duchy. By

5 See Opinion of Advocate General Léger at paragraph 16.

contrast, the disclosure of information outside Luxembourg territory is not punishable under Luxembourg law.

- According to the second interpretation, the Luxembourg legislation has an extraterritorial effect with regard to *both the principle of banking secrecy and to exceptions to that principle*. On that interpretation, bankers established in Luxembourg have a duty to respect banking secrecy not only on Luxembourg territory but also on the territory of other Member States. However, where they are called upon to give evidence before the judicial authorities of another Member State, Luxembourg bankers may disclose information covered by the rules on banking secrecy. In other words, [the Luxembourg legal provisions dealing with professional secrecy of bankers] *are interpreted in such a way that the obligation to give evidence prescribed by the legislation of another Member State causes the obligation of banking secrecy to be waived* when giving evidence before the judicial authorities of that State.

- Finally, according to the third interpretation, the Luxembourg legislation has an extraterritorial effect *only in so far as the principle of banking secrecy is concerned*. That would mean that bankers established in Luxembourg have a duty to respect the obligation of banking secrecy outside Luxembourg territory. However, they are not authorised to disregard the rules on banking secrecy when they are called upon to give evidence before the judicial authorities of another Member State. They are permitted to disclose information covered by banking secrecy solely to the Luxembourg judicial authorities." [6]

In its written observations before the European Court, the Belgian Government took the view that the first of the above interpretations was correct: It submitted that the Luxembourg banker may not be prosecuted by the Luxembourg authorities if the disclosure of information covered by Luxembourg banking secrecy takes place outside the territory of the Grand Duchy of Luxembourg.

The Belgian Government further pointed out that, in any event, it is only if the third of the interpretation of the Luxembourg legislation set out above is correct that that legislation presents any difficulties with reference to the questions put to the European Court by the Belgian investigating judge.

---

6 See Opinion of Advocate General Léger at paragraph 38

Viz:

- If the first interpretation is correct, the principle of Luxembourg banking secrecy does not apply in Belgian territory. Accordingly, Mr der Weduwe and his fellow banking employee can testify before the investigating judge in Belgium without fear of being prosecuted in Luxembourg.

- Similarly, if the second interpretation is the correct one, the obligation to give evidence before the Belgian investigating judge is a ground which justifies waiving the obligation of banking secrecy under Luxembourg banking legislation. In that case, Mr der Weduwe and his fellow Luxembourg bank employee can also testify before the Belgian investigating judge without fear of making themselves liable to prosecution in Luxembourg.

- It is only if the third interpretation is the correct one that a problem could arise in terms of the compatibility of the Luxembourg legislation on professional banking secrecy with Article 59 of the Treaty [Freedom of provision of services]. Namely, according to the Belgian Government, in that case, Mr der Weduwe and his fellow Luxembourg bank employee "would be *under an obligation* [under Luxembourg law] not to disclose information covered by [Luxembourg] banking secrecy to the [Belgian] investigating judge ... [The Belgian Government] considers that, in that case, it is for the Court of Justice to state whether such an interpretation of [Luxembourg law] is compatible with Community Law" [7]

It must therefore be assumed that the third possible interpretation of Luxembourg legislation dealing with professional banking secrecy was the interpretation which was deemed to be the correct one by the Belgian investigating magistrate. Otherwise, there would have been no reason for him to make a reference to the European Court regarding the compatibility or otherwise of Luxembourg professional banking secrecy with the Treaty.

The Position of the Luxembourg Government

At the hearing, the Grand Duchy of Luxembourg stated that its national courts have not yet resolved the issue of the extraterritorial effect of banking secrecy. It also observed that the Luxembourg courts will probably never be called upon to

7 See Opinion of Advocate General Léger at paragraph 39-42.

settle that controversy. In its view, factual situations giving rise to that type of dispute are too rare and too atypical ever to come before the Luxembourg courts. Given the lack of (existing or foreseeable) case law on that issue, the Luxembourg Government set out the interpretation which, in its opinion, ought to be accepted.[8].

Its interpretation can be summarised as follows:

- First "the Luxembourg Government submits that the principle of banking secrecy *does have extraterritorial scope*. In its view, the Luxembourg legislation would be totally ineffective if it permitted persons to disclose information covered by banking secrecy of the Grand Duchy. In that case, bankers would only have to leave Luxembourg territory to be able to disclose with impunity information which would otherwise be covered by banking secrecy. It follows that, subject to the exceptions provided for by Luxembourg law, the disclosure of information covered by banking secrecy outside the territory of the Grand Duchy constitutes an offence liable to criminal prosecution by the Luxembourg authorities.

- Second the Luxembourg Government states that the exceptions to banking secrecy also have extraterritorial effect. However, the reasons underlying that interpretation are different from those put forward by the Kingdom of Belgium.

  The Kingdom of Belgium submitted that the obligation to give evidence laid down [by the Belgian Code] was capable of constituting an exception to the obligation of banking secrecy established by the [relevant Luxembourg legislation]. The Luxembourg Government considers that accepting that interpretation would be tantamount to accepting that one State may establish exceptions to the criminal laws of another State. According to the Grand Duchy of Luxembourg, such an interpretation would be in clear conflict with the general principles of international criminal law.

  The Luxembourg Government considers that exceptions to banking secrecy *may only be based on provisions of the Luxembourg Criminal Code* [in this respect], the Grand Duchy observes that [the relevant Luxembourg legislation] provides that persons are permitted to disclose information covered by banking secrecy where they are called upon to give evidence before the 'judicial authorities'. The Luxembourg Government points out that the term 'judicial authorities' covers not only

8 See Opinion of Advocate General Léger at paragraph 44-45.

the Luxembourg judicial authorities, but also the judicial authorities of other Member States". [9]

The Position taken by the European Court

As could be expected, the European Court had little difficulty in coming to the conclusion that the questions referred to it for a preliminary ruling by the Belgian investigating judge were inadmissible:

"As the Advocate General correctly pointed out in ... his Opinion, the interpretation chosen by the national court is hypothetical, since the Luxembourg courts have not ruled on the issue. It is not the only possible interpretation of those provisions. Moreover, the Belgian Government has made it clear in its submissions to the Court that it regards the national court's interpretation as implausible. That interpretation is further challenged by the Luxembourg Government itself, which considers that the banking secrecy prescribed by Luxembourg law cannot be invoked against judicial authorities in other Member States in investigations such as the one being conducted in the main proceedings.

The national court has not in any way explained why it considers the interpretation on which it relies to be the only one possible. The fact that the relevance of the questions raised by the national court rests on a particular interpretation of a national law other than its own made it particularly necessary to state the grounds for the order for reference on that point". [10]

The Implications of the Interpretation put forward by the Belgian Government and by the Luxembourg Government in the Context of the Co-ordinated Banking Directive (CBD)

It must be underlined at the outset that since the coming into force of the (then) Second Banking Directive[11] on 1 January 1993, a bank incorporated in one Member State has a 'single passport' which allows it, among others, to provide services 'in the territory' of another Member State subject only, as a rule, to the supervision of the banking supervisors of its home Member State.

However, that right is subject to a so-called 'notification procedure'.

---

9 See Opinion of Advocate General Léger at paragraph 47-48.

10 See Judgement, at paragraph 37-38.

11 Directive 89-646-EEC of 15 December 1989.

The terms of the Co-ordinated Banking Directive (CBD)[12], which incorporates the provisions of the then Second Banking Directive, provided that when a bank incorporated in say Luxembourg wishes, for the first time, to provide services 'in the territory' of another Member State (say Belgium), that bank must seek the approval of its home country supervisor, in the instant case the Luxembourg banking authorities.

If the banking supervisor of the home Member State is satisfied that 'its' bank has the requisite organisation to embark on such a project, it will then inform the authorities of the 'host' Member State (in this case, Belgium) that it has given permission to the Luxembourg bank (in the instant case) to provide services on the territory of (in the instant case) Belgium.

However, when a Luxembourg bank is thus authorised to provide its services 'on the territory' of Belgium (or of any other Member States for that matter), it is bound to abide by all laws and regulations of the host Member State which are justified by the 'general good'.

It is beyond a doubt, in terms of the case law of the European Court, that the tax legislation of a host Member State destined to ensure the due assessment and collection of taxes is, as a rule, justified by the 'general good'.

If a bank providing services 'on the territory' of a host Member States persistently fails to observe the local legislation justified by the general good of that Member State, the banking authorities of the host Member State may prohibit that 'foreign EC' bank from continuing to provide services on their territory. Before they do so, they are expected to ask the banking authorities of the home

Member State to take the necessary steps to ensure that 'their' bank observe the local legislation of the host Member State justified by the general good.

It follows from the above that, in terms of the CBD, the banking authorities of the home Member State should not give permission to a bank falling within their jurisdiction to provide services 'on the territory' of another Member State if it is apparent, from the outset, that that credit institution will not be able to operate on the territory of the host Member State in full observance of the latter's laws and regulations justified by the general good. This will be the case if, by so doing, that bank puts itself in breach of the laws and regulations justified by the general good of its home Member State.

12 Directive 2000/12/EC of 20 March 2000.

It is important to note in this respect that whereas Luxembourg law makes an exception to professional banking secrecy in respect of enquiries made by judicial authorities, it does not do so in respect of enquiries made by the Luxembourg tax authorities (except for a few limited exceptions left here outside consideration).

On the other hand, the laws of (most) other Member States provide, in substance, that the tax authorities have unlimited powers of enquiry vis-à-vis banks regarding the financial affairs of their clients with a view to the due assessment and collection of all taxes.

This is the case in Belgium: Leaving aside the area of income tax, where a few limited restrictions apply, the Belgian tax authorities may demand from anyone, including bank institutions, all information they deem necessary for the due assessment and collection of, among others, death duties and gift taxes.

Yet, under Luxembourg law as interpreted by the Luxembourg Government in its observations before the European Court, the exceptions to the professional banking secrecy provided for by Luxembourg law apply not only in Luxembourg but also outside of Luxembourg. In other words, the only permitted exceptions to the principle of professional banking secrecy are those exceptions which are provided for by the laws of the host Member State.

Therefore, if Mr der Weduwe and his fellow Luxembourg banking employee had been faced with enquiries not from an investigating judge in Belgium but from the Belgian tax authorities, they would have found themselves in a position of double jeopardy. By answering the questions put to them by the Belgian tax authorities they would laid themselves open to criminal prosecution in Luxembourg; yet by refusing to answer the questions of the Belgian tax authorities, they would have made themselves and their employers open to hefty fines by the Belgian tax authorities.

In addition, the Belgian banking authorities would eventually be justified in forbidding the Luxembourg banks concerned to continue to provide services 'on the territory' of Belgium.

In such a scenario, the only solution for the Luxembourg banks is to have the Belgian customers come to them and not the reverse …

A Boomerang Effect for Banks having their Head Office in Belgium (or other Member States) and Providing Services 'on the Territory' of Luxembourg

The Belgian banks should not however rejoice too soon at the prospect that they could be freed from the growing competition of the Luxembourg banks trying to drum up new business in Belgium.

Namely, in terms of the CBD, the Belgian banking authorities should also refrain from granting permission to Belgian banks to provide services 'on the territory' of Luxembourg (for example, with a view to continuing to serve the growing number of Belgian expatriates who work in that Member State).

Let us take the following example:

Mr X is initially resident in Belgium He has an account with a Belgian bank which also looks after his investment portfolio.

He is posted by his Belgian employer to Luxembourg.

The Belgian bank which looks after his investment does not wish to lose a valued customer. It has applied for permission from the Belgian Banking Commission to provide services 'on the territory' of Luxembourg where it visits Mr X from time to time.

The employees of the Belgian bank who are in charge of the account of Mr X go down for the day to Luxembourg and come back to Belgium thereafter.

Mr X's father has died a few months before his son's move to Luxembourg. Mr X is his sole heir.

The Belgian tax authorities suspect that Mr X has failed to disclose to them the largest part of his father's portfolio in order to avoid paying death duties.

What is the position if the Belgian tax authorities decide to demand information from the Belgian bank looking after the affairs of Mr X in Luxembourg on a cross-border basis?

Here too, the Belgian bank and its employees are put in a situation of double jeopardy:

If they refuse to provide the Belgian tax authorities with the information requested, they make themselves liable to hefty fines.

On the other hand, if they answer the questions put to them by the Belgian tax authorities, they clearly violate the Luxembourg rules on professional banking secrecy. Yet, to the extent that they provide banking services 'on the territory' of Luxembourg, they are bound to abide by Luxembourg laws and regulations justified by the general good. As recently affirmed by the Court of Appeals of Luxembourg in the KB LUX case referred to above, the Luxembourg laws imposing criminal sanctions for breaches of banking secrecy are a matter of public policy[13].

It follows from the above that the Belgian banking authorities should also refrain from granting permission to a Belgian bank to provide services 'on the territory' of Luxembourg:

Indeed, it is clear from the outset that the Belgian bank operating on Luxembourg territory cannot observe Luxembourg professional banking secrecy legislation and, at the same time, Belgian tax legislation requiring full disclosure at the request of the Belgian tax authorities.

General Conclusion

It is surprising to see that the debate regarding the scope of Luxembourg professional banking secrecy before the European Court never took into account the implications of the various interpretations put before the European Court, by the Belgian Government of the one part, and by the Luxembourg Government of the other part, in the context of the principles laid down by the CBD.

Yet, the conflict of criminal law, the existence of which was assumed by the Belgian investigating judge, can only take place because, as a result of the Second Banking Directive and the subsequent CBD, a bank incorporated in Luxembourg is authorised to provide cross-border services 'on the territory' of Belgium and vice versa.

One balks at the consequences of the interpretation of Luxembourg law put forward by the Luxembourg Government before the European Court if that reasoning is pursued to its full logical consequences.

The solution to these difficulties is obvious, but is very regressive: The banker should not provide services 'on the territory' of the client. Instead, it is the client

13 Judgment of the Luxembourg Court of Appeals dated 2 April 2003 in re H W v Kredietbank Luxembourg. Excerpts of the judgement have been published in Journal des Tribunaux, Brussels, 2002, page 315.

who should come and purchase his banking services 'on the territory' of the bank …[14]

14 See, in this connection, among others, M Dassesse, "Localisation of financial services: Regulatory and tax implications", in "Services and free movement in EU Law, Mads Andenas and Wulf Henning Roth Editors, Oxford University Press, June 2001 and M Dassesse "Where is a financial service provided?", Butterworth Journal of International Banking & Financial Law, October 2001.