The 2012 Swiss Federal Supreme Court landmark decision on retrocessions: clients are entitled to get their money back

Until recently, so-called ‘retrocessions’ represented a substantial part of the remuneration of Swiss asset managers, whether banks or independent advisors. The generic term ‘retrocessions’ generally refers to different forms of fee-sharing arrangements (e.g., commissions, finder’s fees, kickbacks or trailer fees) between financial intermediaries such as banks, broker dealers, portfolio managers, fund promoters and distributors of financial products.

In a landmark decision of 30 October 2012, the Swiss Federal Supreme Court (SFSC) clarified the legal framework applicable to retrocessions collected by banks for their asset management services and established that such retrocessions accrue to their clients unless a valid waiver has been signed by the client.¹

The Swiss Federal Supreme Court decision of 30 October 2012

The facts

In the case considered, a Swiss bank and its client entered into an asset management agreement in 1988. Based on this agreement, the bank invested a substantial part of the client’s assets in investment funds and structured products. Most of the investment funds and structured products selected were issued by affiliates of the bank. As a result, the bank received retrocessions, including trailer fees, in return for the distribution of said products to the client, corresponding to a percentage of the management fee charged periodically by the relevant fund management company to the fund. Moreover, the asset management agreement between the bank and the client contained a waiver which, however, did not specify the foreseeable amount of the expected retrocessions.

As is often the case, the bank served two masters: on the one hand, the client when acting as an asset manager and, on the other hand, providers of collective investment schemes and structured products when acting as a distributor. The bank received retrocessions for its distribution activities within the framework of the asset management agreement with the client without passing them on to the client.

Faced with the bank’s silence despite repeated requests to render accounts, the client initiated proceedings against the bank before the Zurich courts to obtain information about the retrocessions received and to recoup them. On appeal from the bank, the SFSC confirmed the Zurich Court of Appeal’s decision which upheld the client’s claims.

The decision

The SFSC’s decision was based on Article 400(1) of the Swiss Code of obligations, according to which the agent is obliged at all times to account for the management of his business activities and return to the principal all the advantages of any kind related to the performance of the mandate, the rationale being the avoidance of any conflict of interests.

Against this background, the SFSC recalled its earlier case law which established that retrocessions collected by independent asset managers accrue to the clients unless they have waived their right and title to their restitution in advance, having been properly informed of the foreseeable amount and the calculation parameters of the expected retrocessions (e.g., communication of ranges of percentages).²

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¹ The decision of 30 October 2012, Swiss Federal Supreme Court, E-2012-00252.
² The decision of 30 October 2012, Swiss Federal Supreme Court, E-2012-00252.
In 2012, the SFSC went one step further and decided that these precedents also apply to banks that manage clients’ assets on the basis of a mandate agreement, an interpretation that most banks had always rejected. Accordingly, retrocessions received from third parties for distributing financial products (e.g., shares of collective investment schemes and structured products) should be returned to the clients. This also applies to the retrocessions a bank receives from entities of the same group, the objective being the avoidance of existing and potential conflict of interests.

This decision clarifies that banks are liable to rebate any commission received in the context of management mandates to their customers or investors, even if such commissions are meant to remunerate a bank’s distribution activities. As a result and in the context of an asset management agreement, third party and intra-group retrocessions may be reclaimed by clients provided the statute of limitation has not lapsed and clients have not validly waived their rights to the retrocessions.

Statute of limitation

The question of the statute of limitation applicable to claims for restitution of retrocessions is a matter of debate.

Under Swiss law, the standard statutory period of limitation for contractual claims is of ten years, unless otherwise provided by law. By contrast, for periodic claims such as payments relating to rent, interest on capital and other periodic services, the statutory period of limitation is of five years only.

While banks and other financial service providers argue that retrocessions qualify as periodical payments to which the shorter limitation period of five years applies, other renowned Swiss legal scholars opined that retrocessions only become time-barred ten years after the mandate agreement has been terminated. It remains to be seen how Swiss courts will resolve this question of considerable practical importance.

Waiver

Further to its earlier case law, the SFSC confirmed the conditions of validity of an advance waiver of a client’s right to retrocession. Such waivers are void unless the client has received detailed information about the scope and amount of the payments to be received.

Accordingly, the client must have been informed of the method of calculation of any retrocessions and their foreseeable amount. The purpose is to enable the client to take an enlightened decision and assess the weight of retrocessions in relation to the financial service provider’s total remuneration. It would, for instance, be insufficient to simply provide the maximum amount of the expected trailer fees.

Questions left open

The 2012 SFSC’s decision, while bringing welcome clarification regarding the banks’ obligations to return retrocessions received in the context of asset management mandate, leaves open a number of issues.

First, the Court did not elaborate on the possible application of this ruling to investment advisory mandates. Under such mandates, the bank suggests investments to the client, who has the final word on the investment decision. By contrast, under an asset management mandate, the client defines the overall strategy to be achieved and authorises the bank to prepare, implement and supervise all investment decisions. Contrary to the investment advisory mandate, the final investment decision rests with the bank. Despite these differences, both contracts are subject to the rules regarding the mandate and in particular the agent’s duty to account for the management of the principal’s business activities which is the cornerstone of the SFSC’s reasoning. As a result, it seems difficult to argue that the 2012 SFSC’s decision does not apply to investment advisory mandates. Notwithstanding this, in the absence of an asset management mandate, most banks continue to turn down clients requesting the repayment of retrocessions received by their bank.

Secondly, the situation is even less clear in the case of execution-only agreements whereby clients instruct their bank to purchase financial products on their own initiative and the bank merely executes the orders received.

Finally, the Court did not examine whether commissions made specifically to investment fund distributors for distribution expenses should also be returned. Equally, for procedural reasons, namely the bank’s failure to provide the necessary evidence, the SFSC did not comment on the possibility banks may have of charging costs incurred as reimbursable expenses.
Given the number of cases which clients are likely to bring against banks, it can be expected that these points will be submitted to courts in the not too distant future.

Related developments

In the aftermath of the 2012 decision, the Swiss Financial Market Supervisory Authority (FINMA) has weighed into the debate and has clarified its expectations regarding the adequate precautionary measures to be taken by banks. By communication of 26 November 2012, FINMA requested banks to:

- promptly take account of the Swiss Federal Supreme Court’s decision for current business activities;
- contact all their clients who are potentially affected and inform them about the court decision to ensure transparency;
- provide these clients with the coordinates of the contact person within the bank with whom they can then get in touch for further information; and
- inform clients upon request about the amount of reimbursements received.

Under its supervisory remit, FINMA will examine and monitor the measures taken and planned by the banks and whether further regulatory action is required, in particular possible amendments to FINMA Circular 2009/1 Guidelines on asset management. In addition, the Swiss government is currently working on a Draft Swiss Financial Services Act, inter alia, with a view of improving client protection, which will include rules on retrocessions.

Conclusion

The 2012 SFSC’s decision sets a precedent which should improve transparency for private banking clients. It falls in line with the current international trend towards the prevention of conflicts of interests.

This decision is also expected to considerably affect the Swiss financial industry. Estimates of potential losses of income for banks globally reach billions. As a result, banks and financial intermediaries will have to reflect on how to adapt for the future, in particular as regards the type of information and documentation they provide to their clients and how they document their services. The challenge resides in finding a solution that allows for a combination between a transparent and competitive remuneration practice.

The consequence of this decision can already be foreseen in light of the questions still outstanding, and both clients and banks are gearing up to confront future battles.

Notes
1 Client A v UBS AG, Swiss Federal Supreme Court decision of 30 October 2012, case 4A_127/2012 and 4A_141/2012.
2 Swiss Federal Supreme Court decisions of 22 March 2006 (ATF 132 III 460) and 29 August 2011 (ATF 157 III 393).
3 Article 127 of the Swiss Code of Obligations.
4 Article 128 of the Swiss Code of Obligations.

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Precautionary taking of evidence – Swiss style pre-trial discovery?

A recent Federal Tribunal decision of 5 November 2012 (BGer 4A_488/2012) has shed more light on the prerequisites for making use of the instrument of ‘precautionary taking of evidence’ as provided in Article 138 of the Swiss Federal Civil Procedure Act (CPA). Practitioners from Anglo-Saxon jurisdictions, who might have encountered frustration in Swiss proceedings with regard to the rules of disclosure, might find some new resolve upon reading what the highest Swiss court has had to say on the pre-trial obtaining of evidence, an issue that was until recently a thorny legal field in Switzerland.
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