

LALIVE & AFBS Roundtable on retrocessions

- Alexander Troller and Nicolas Ollivier
Where do we stand
- Sandrine Giroud
What's next
- Simone Nadlhofer
Future regulations in Switzerland and Europe



LALIVE

LALIVE & AFBS Roundtable

Retrocessions: Where Do We Stand ?

Alexander Troller & Nicolas Ollivier

11 December 2012 – Geneva



LALIVE

Plan

- I. Step 1: Decision of 22 March 2006 (ATF 132 III 460)**
 - A. Facts & lessons**
 - B. Swiss Fund Association's Communication (5 December 2006)**
 - C. FINMA Guidelines on Asset Management (Circular 2009/1)**
 - D. Rules of Professional Organisations**
 - E. Swiss Bankers Association's Portfolio Management Guidelines**
- II. Step 2: Decision of 13 January 2011 (6B_223/2010)**
- III. Step 3: Decision of 29 August 2011 (ATF 137 III 393)**
- IV. Step 4: Decision of 30 October 2012 (4A_127/2012)**
 - A. Facts & lessons**
 - B. FINMA Newsletter 41 (2012) of 26 November 2012**
 - C. Swiss Bankers Association's reaction**
- V. Conclusion**

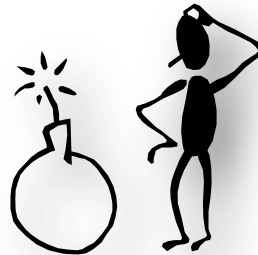
I.A. Step 1: Facts & lessons(1/2)

- **ATF 132 III 460** : Claim against an **independent asset manager** who had received finder's fees and other retrocessions. The asset management contract did not set out any waiver by the client
- **Principle**: restitution to the client of retrocessions **closely connected to the performance** of the relevant discretionary or advisory asset management agreement
- **Possibility of Waiver** if
 - ▶ **Express**
 - ▶ “Client **fully and truly informed**” (“*client informé de manière complète et conforme à la vérité*”)
- **Lessons**
 - ▶ Independent asset managers
 - ▶ Avoidance of **conflicts of interests**

I. A. Step 1: Facts & lessons (2/2)



Bombshell for Swiss asset management industry or not



→ Amendment to asset management agreements

I. B. SFA's Communication (5 December 2006)

- **Distributors** of financial products **not affected** by the Swiss Supreme Court decision
- Distributors are entitled to keep retrocessions if (i) services are provided, and (ii) not paid for otherwise (trailer fee)



Trailer fees are not considered closely connected to the performance of the relevant discretionary or advisory asset management agreement

- Transparency toward clients is deemed to be adequately guaranteed by **disclosure in prospectus** of **percentages of fees** and of the **fact that retrocessions may be paid to distributors**

I. C. FINMA Guidelines on Asset Management (Circular 2009/1)

- Asset management agreement must indicate **who is entitled to the retrocessions** (asset manager or client)
- Disclosure of any **conflict of interest** possibly resulting from retrocessions
- Disclosure of **how to determine retrocessions**
 - ▶ Calculation parameters; **or**
 - ▶ Proportion of amounts involved (differentiation / various product classes)

I. D. Rules of Professional Organisations

- Professional organisations
 - ▶ Swiss Association of Independent Financial Advisors (SAIF)
 - ▶ Swiss Association of Asset Managers (SAAM)
 - ▶ Swiss Self-Regulating Body of the SAAM (SRO of SAAM)
- Implementation of FINMA Circular 2009/1
- Compliance check of asset management agreements with FINMA Circular 2009/1

I. E. SBA's Portfolio Management Guidelines (1/2)

- Guidelines amended in 2010 following FINMA Circular 2009/1
- SBA's guidelines match SFA's position
- Asset management agreement must specify who is entitled to retrocessions
- Retrocessions, **closely connected** to the performance of the relevant asset management agreement, **must be passed on to the client unless otherwise foreseen by (written) agreement**
- Retrocessions received **at the opportunity** of executing the asset management agreement **need not be passed on to client**
→ e.g. retrocessions for services provided – trailer fees

I. E. SBA's Portfolio Management Guidelines (2/2)

- Banks must inform clients of
 - ▶ Conflicts of interest possibly resulting from retrocessions;
 - ▶ Calculation parameters or of the proportion of amounts involved

II. Step 2: Decision of 13 January 2011

- **6B_223/2010** : Criminal case in which employee was sued by its employer (bank) for embezzling retrocessions
→ Employee convicted for criminal mismanagement (Art. 158(1) Swiss Criminal Code)

- **Principle:** Retrocessions received for distribution activity not in close connection to asset management services



Need not be returned to client

- **Lessons:** Confirmation of SFA and SBA's positions
→ independent asset managers and banks are entitled to keep trailer fees

III. Step 3: Decision of 29 August 2011 (1/2)

- **ATF 137 III 393** : retrocessions paid by custodian bank to independent asset manager. Waiver read as follows: the asset management company is entitled to keep any possible retrocessions received. The decision did not address the issue of retrocessions paid for distribution services

- **Principle:** to validly waive the right to repayment of retrocessions, the client must be informed of:
 - ▶ **Essential parameters of arrangement** between independent asset manager and custodian bank (calculation parameters); **and**

 - ▶ **Foreseeable amount of expected retrocessions** (e.g. through communication of percentage ranges in relation to assets under management)

III. Step 3: Decision of 29 August 2011 (2/2)

■ Lessons:

- ▶ Disclosure of potential conflicts of interest resulting from retrocessions required for inexperienced clients. Not compulsory for sophisticated investors
- ▶ Communication of calculation parameters differentiated by product classes is insufficient to obtain a valid client waiver
- ▶ On this point, civil law varies from FINMA regulatory guidelines

IV. A. Step 4: Facts & lessons (1/3)

- **Decision of 30 October 2012 (4A_127/2012)** : Client had signed discretionary management agreement with bank. Bank received retrocessions from management companies (funds and structured products). Waiver in the asset management agreement did not disclose foreseeable amount of expected retrocessions. Client sued the bank in repayment of these retrocessions

IV. A. Step 4: Facts & lessons (2/3)

■ Principles:

- ▶ Retrocessions received by a bank must be repaid to the client if there is a mandate contract without a valid waiver
- ▶ Trailer fees also must be repaid to the client if there are potential conflicts of interest
- ▶ Supreme Court left the question open whether banks may be compensated for their effective costs of distribution services
- ▶ Supreme Court ruled that no distinction must be made between payments from third party intermediaries and payments made within the same banking group



All retrocessions must be passed on to clients

IV. A. Step 4: Facts & lessons (3/3)

■ Lessons:

- ▶ Not only independent asset managers but also **banks** must return retrocessions to clients
- ▶ **Conflicts of interest** are inherent to trailer fees
- ▶ **Potential conflict of interest** suffices, there is no need to determine whether the conflict has impacted or not the client's portfolio

IV. B. FINMA Newsletter 41 (26 November 2012)

- **FINMA** expects banks to:
 - ▶ Take into account Swiss Supreme Court decision 4A_127/2012 of 30 October 2012
 - ▶ Be **proactive** → contact and inform clients of regulatory impact of Swiss Supreme Court decisions
 - ▶ Provide contact within the bank for further information
 - ▶ Inform client upon request about retrocessions received
- **FINMA** will examine and if required amend **Guidelines on Asset management** (Circular 2009/1)

IV. C. SBA's reaction

- FINMA has no legal basis to issue the abovementioned requirements
- FINMA intervenes in the private relationship between banks and clients
- Banks are not consumer protection associations



Ask for a reexamination of the FINMA's newsletter

V. Conclusion – In brief

	IAM	Bank – Funds/Structured products	Bank – Intra-group
Decision 1	<ul style="list-style-type: none"> IAM's restitution duty of retrocessions (e.g. finder's fees) Express waiver based on full and true information 	–	–
Decision 2	–	<i>No restitution of trailer fees</i>	–
Decision 3	<ul style="list-style-type: none"> Confirmed Decision 1 Specification of waiver 	–	–
Decision 4	–	<i>Restitution of trailer fees and other retrocessions</i>	<i>Restitution of trailer fees and other retrocessions</i>

V. Conclusion – What next?

- Waivers
- Statute of limitation / time-barred period?
- Investment Advisory Agreement?
- Execution-only?

Thank you



Alexander Troller & Nicolas Ollivier
LALIVE

atroller@lalive.ch nollivier@lalive.ch
www.lalive.ch



LALIVE

LALIVE & AFBS Roundtable

The Aftermath of the Retrocession Saga

Sandrine Giroud

11 December 2012 – Geneva



LALIVE

Plan

- I. Interaction with the client
 - A. Duty to be proactive?
 - B. Risks
 - C. Statute of limitation
 - D. Waiver
- II. Scope of the mandate
- III. Check list for clients' restitution requests
- IV. New fee models
- V. Conclusion

I.A. Interaction with the client – Duty to be proactive?

- Swiss Supreme Court Decision (4A_127/2012 of 30 October 2012)
 - ▶ **Mandate (Art. 394 of the Swiss Code of Obligations)**
 - Duty of loyalty
 - Duty of account of agency
 - ▶ **Contractual duty** to return retrocessions
- FINMA Newsletter 41 (2012) – 26 November 2012
 - ▶ **Regulatory duty** to return retrocessions
 - ▶ Legal basis ?
Guarantee of the **proper conduct of business operations**

I.B. Interaction with the client – Risks

- **Civil liability**
 - ▶ Contractual liability based on mandate

- **Criminal liability?**
 - ▶ Misappropriation (Art. 138 of the Swiss Criminal Code)
 - ▶ Criminal mismanagement (Art. 158 of the Swiss Criminal Code)
 - ▶ Private corruption (Art. 4a of the Unfair Competition Act)



I.C. Interaction with the client – Statute of limitation

■ Duration

- ▶ **Rule:** ordinary statute of limitation in contractual matters → **10 years**
- ▶ **Exception 1.1:** periodic payments → **5 years**
- ▶ **Exception 1.2:** violation of information duty (contractual liability) → **10 years**
- ▶ **Exception 2:** civil action offence for which criminal law envisages a longer limitation period → **criminal statute of limitation**

■ Starting point

- ▶ End of the mandate?
- ▶ As of payment of the retrocessions?

■ Interests

- ▶ Due on any sums forwarded with delay to the principal (Art. 400(2) CO)
→ in principle: **5%** (Art. 104 CO)

I.D. Interaction with the client – Waiver: for the past

- Possibility to ask the client to ratify its waiver *a posteriori*
 - ▶ General rules of the Swiss Code of Obligations
 - ▶ Information needs to be specific

I.D. Interaction with the client – Waiver: for the future

	Waiver conditions	Examples
Decision 1	<ul style="list-style-type: none"> Express waiver Truly <u>and</u> fully informed 	
FINMA Circular (2009/1)	<ul style="list-style-type: none"> Written contract Calculation parameters <u>or</u> spread of third party's inducements → must differentiate various product classes, insofar as possible 	
Decision 2	–	–
Decision 3	<ul style="list-style-type: none"> Express waiver Calculation parameters <u>and</u> foreseeable amount of expected retrocessions 	<ul style="list-style-type: none"> Calculation parameters differentiated by product classes Percentage ranges of the assets under management
Decision 4	<ul style="list-style-type: none"> Fund agreement between the bank/distributor and the fund direction not valid → contract with oneself (as representative and cocontractor) 	<u>insufficient</u> to state the maximal amount of the expected trailer fees

II. Scope of the mandate

	Discretionary management	Advisory management	Execution-only
Contract	Mandate	Mandate	<ul style="list-style-type: none"> • <u>Truly execution-only</u>: deposit contract (Art. 472 CO) → no mandate • <u>Not truly execution-only</u>: commission contract (Art. 425 CO) → indirect application of mandate provisions
Legal framework	<ul style="list-style-type: none"> • Case law SFSC • FINMA Newsletter 41 (2012) 	<ul style="list-style-type: none"> • Case law SFSC by analogy? • FINMA Newsletter 41 (2012) by analogy? 	–
Duty to return retrocessions	YES	YES	PROBABLY YES <u>if</u> <ul style="list-style-type: none"> • Trust/implied advice relationship • Transactions linked to an underlying mandate relationship

III. Check list for clients' restitution requests

- ☑ **Triage:** qualify the relationship with the client
 - ▶ Discretionary management?
 - ▶ Advisory management?
 - ▶ Execution-only?

- ☑ Determine the **legal basis for the request of information**
 - ▶ Mandate or not?

- ☑ Determine the **statute of limitation**
 - ▶ 5 years, 10 years, more?

- ☑ Check if **valid waiver**
 - ▶ Duty to provide information exists even in case of a valid waiver
 - ▶ If not: obtain ratification / waiver for the future

IV. New fee models

- Remuneration **to be agreed** between the advisor and the customer instead of being determined by a provider
- **Performance**-based remuneration
- **Advice**-based fee (e.g. UK Retail Distribution Review)
- **Charges** compensation
 - ATF 4A_127/2012 and 4A_141/2012 of 30 October 2012
 - Procedural failure to establish/prove the distribution charges (e.g. staff, IT, logistics, marketing, legal compliance related costs)

V. Conclusion

- Back to the basics:
Mandate implies a **duty of information, diligence and loyalty**
 - ▶ Transparency
 - ▶ Avoidance of conflicts of interest

- New **fee models** based on:
 - ▶ Agreement with the client
 - ▶ Advice provided
 - ▶ Performance

- Better documentation of **charges**

Thank you



Sandrine Giroud
sgiroud@lalive.ch
www.lalive.ch



LALIVE

LALIVE & AFBS Roundtable

Future regulations in Switzerland and Europe

Dr Simone Nadelhofer

11 December 2012 – Geneva



LALIVE

Plan

- I. MIFID / MIFID II**
 - A. Transparency**
 - B. Prohibition of retrocessions in the future?**
- II. UK: Retail Distribution Review (RDR)**
- III. Switzerland**
 - A. FINMA Discussion Paper of October 2010**
 - B. Future Financial Services Act**
 - C. New Collective Investment Schemes Act**
 - D. New Insurance Contract Act**

I. MIFID I

- **Markets in Financial Instruments Directive 2004/39/EC**
 - ▶ Third party inducements subject to:
 - clear **disclosure** to the client **prior** to the provision of the service;
 - benefit is designed to **enhance the quality** of the service to the client; and
 - no impair of compliance with the firm's duty to act in the **best interests** of the client.

I. MIFID II

- **MIFID II:** legislative process is ongoing
 - ▶ **EU Commission:**
Proposes **ban on retrocessions** (incl. inducements of any kind) for
 - independent advice;
 - portfolio management.
 - ▶ Ban confirmed by **EU Parliament** on 26 October 2012
 - ▶ **Trilogue** between Council, Parliament and Commission in the first half of 2013
- **Implementation** in EU Member states not earlier than 2015

II. UK FSA's retail distribution review (RDR)

- Aims at enhancing **consumer confidence** in the retail investment market
- Applies to **advised sales**
- Effective as of **1 January 2013**
- Ban on conflicted remuneration structures (including commissions and volume based payments)
 - ▶ Applies to both **independent and restricted advice**
 - ▶ Applies to firms advising **retail clients** in the UK on retail investment products
- Similar initiatives in the **Netherlands**
 - ▶ **total ban**, i.e. also for execution-only business

III. Switzerland

- **FINMA Discussion Paper of October 2010**

Regulation of the Production and Distribution of Financial Products to Retail Clients new **Financial Services Act** and potentially an interim Ordinance on Rules of Business Conduct

- Proposal of a general **Financial Services Act**

- ▶ **28 March 2012**: Federal Department of Finance, with the assistance of the Federal Office of Justice FINMA commence work on a project to prepare the legal basis and submit a consultation draft to the Federal Council by autumn 2013;
- ▶ **November 2013**: Planned adoption of the consultation draft by the Federal Council.

- **In the interim**: Ensure compliance, if necessary by means of **enforcement**, of supervised financial services providers with the existing obligations at the point of sale (including avoidance of conflicts of interest; transparency on retrocessions; etc.) .

III. Switzerland

- **Article 20 rev Collective Investment Schemes Act**

- ▶ Effective February 2013;
- ▶ Imposes **full transparency** on retrocessions etc.

- **Article 66 rev Insurance Contract Act**

- ▶ Imposes **full transparency** on retrocessions etc. to insurance brokers.

III. Switzerland

- **FINMA's Strategic Goals 2013 to 2016**
 - ▶ align its regulatory activities closer with **international standards** in the next strategic period (i.e. MIFID II etc.);
 - ▶ focus on important core issues in its international activities.

- **International / EU regulations on retrocessions will impact Swiss legislation**
 - ▶ Retrocession ban?
 - ▶ Enhanced transparency?
 - ▶ Retroactive restitution of retrocessions to customer?

Thank you



Dr Simone Nadelhofer
snadelhofer@lalive.ch
www.lalive.ch



LALIVE