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The most recent decision of the Swiss Federal Supreme Court confirms: also banks need to reimburse retrocessions to their clients

A new decision of the Swiss Federal Supreme Court confirms principle of restitution of retrocessions

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The Swiss Federal Supreme Court (the Court) confirmed its practice that retrocessions received by asset managers have to be refunded to their clients. According to the Court's decision of October 30, 2012, not only asset managers (as it has been the case since the leading case of 2006) but also banks which, according to an asset management agreement invest the entrusted assets into funds and structured financial products, need to comply with this practice. It is, thereby, irrelevant whether the financial products where offered by affiliated companies or external providers.

In the present case, the bank client claimed from the bank the restitution of all payments the banks received (especially from funds provider) based on an asset management agreement in connection with his deposited assets, which the bank client inherited from his late father.

The bank denied any right of restitution regarding retrocessions which it received from affiliated companies or external providers, as it also denied any duty of accountability. Furthermore, the bank argued that it was not allowed to deliver any distribution fee to the final investor based on financial regulations according to the Federal Law on Collective Schemes and the former Federal Law on Investment Funds. The dispute may, therefore, not be resolved merely based on art. 400 para. 1 of the Swiss Code of Obligations (CO), since a supervisory prohibition to do so is in place. This issue was not further commented by the Court, as it would not have had a material impact on the final decision.

The Court stated that a bank is bound by a double contractual relationship; on the one hand, it manages assets of its clients based on a mandate in the sense of art. 394 ss. CO, and, on the other hand, it distributes units in investment funds. The bank receives commission payments as a distributor of fund participations, which are directly charged to the investor's account. It also receives a percentage of the management fee which the fund administration charges to the fund's assets, which are periodically levied for the management of the fund and the distribution of the units. This part of the administration commissions, which is redistributed as compensation to the distributor, is defined as retrocession (Bestandespflegekommission). The latter is being calculated based on the value of the entire portfolio at due date; the rate of the retrocessions in percentages is then multiplied by the volume of assets. The bank is, hence, not paid per individual transactions, per asset unit or per client, but based on the total assets under management. Consequently, the bank receives from the fund administration, whose products are distributed by the bank, allowances based on the total amount of the bank customers' assets in the funds.

The Court reasoned that, against the views of the bank and some legal authorities, there is indeed an inner connection between the orders placed and the pecuniary advantage, since it may not be considered as a circumstantial consequence of the contractual duties of the asset management agreement between the bank and its customer. There is, in the view of the Court, a conflict of interest, even if the retrocession also covered some distribution costs. A different result may have arisen if there had been a different kind of remuneration, which directly covered distribution expenses (e.g. money laundering investigations, distribution of marketing or legal documents).

The Court, however, retained that a bank client may indeed waive his restitution rights, if the agreements comply with the supervisory and contractual obligations.

Restitution is also applicable to retrocessions from affiliates

The Court analysed the possible different legal treatment of retrocessions which a bank may receive from affiliated companies. According to the court of lower instance, any remuneration paid by an affiliated company does not qualify as payment between two separate legal entities; a banking group was considered an economic entity, whereby it is a requirement for the application of art. 400 para. 1 CO that the payment is received from an entity outside the group. The Court did, however, not concur with the lower instance court's global reference to an economic method of approach. It does, in the Court's view, not exclude the restitution of retrocessions received from an affiliated company. Group law has not been formally and generally codified in Switzerland, just selectively, as in art. 663e para. 1 CO regarding consolidated financial statements for groups. But it never granted the status of legal entity to a group of companies. The legal independence of affiliated companies has been acknowledged despite the existence of group financial statements; each affiliated company answers independently for its liabilities, irrespective of their nature. Also from a fiscal point of view, the business dealings between affiliated companies are treated as dealt between legally and economically independent companies. There are, nevertheless, exceptions regarding the triple taxation of the income from group investments.

Thus, a bank may not just invoke the economic entity of the group and deny the restitution of retrocessions by referring to the fact that the payment was made by an affiliated company. The asset management agreement was concluded between the bank client, as the investor, and the bank, not the banking group, since it lacks the status of a legal entity. The bank client may not be deprived of his rights as provided by the law; his entitlements may not be restricted due to so-called "economic realities".

There is a conflict of interest in case of retrocessions, regardless of being a group company or a third party. If a bank takes an investment decision based on an asset management agreement and if it receives retrocessions for these investments, the client's interest is at stake. This conflict also exists if group-internal financial products are involved since the investment decisions may be induced by the bank's own financial interest and not the client's.

Hence, the bank has also to reimburse recessions received from affiliated companies based on the duty of restitution according to art. 400 para. 1 CO.

Any actions required by the banks?

The duty of restitution pursuant to art. 400 para. 1 CO is, according to the Court, not compulsory. A bank client may waive these rights contractually; the banks have still an option to make an arrangement in this sense.

The principle duty of a bank, which still wants to rely on retrocessions, will be to draft the agreements in a legally binding way. It is not sufficient to refer to the highest possible amount of the retrocession. The client needs to know the parameters based on which the total amount of retrocessions are calculated in order to compare them with the asset management fees agreed with the bank. This includes at least the basic values of the current agreements in place with third parties as well as the amount of the expected compensations. These criteria are even met in case of funds and structured financial products if the amount of the expected retrocessions is illustrated as a band width in percentage based on the assets under management. Therewith, the client is able to understand the dimension of a possible waiver in advance regarding the total costs of the asset management and the possible conflict of interest due to the incentive structure. Furthermore, the bank should seek a separate compensation for effective distribution costs (money laundering investigations, distribution of marketing or legal documents) which in any event cannot be a percentage of the assets involved.

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