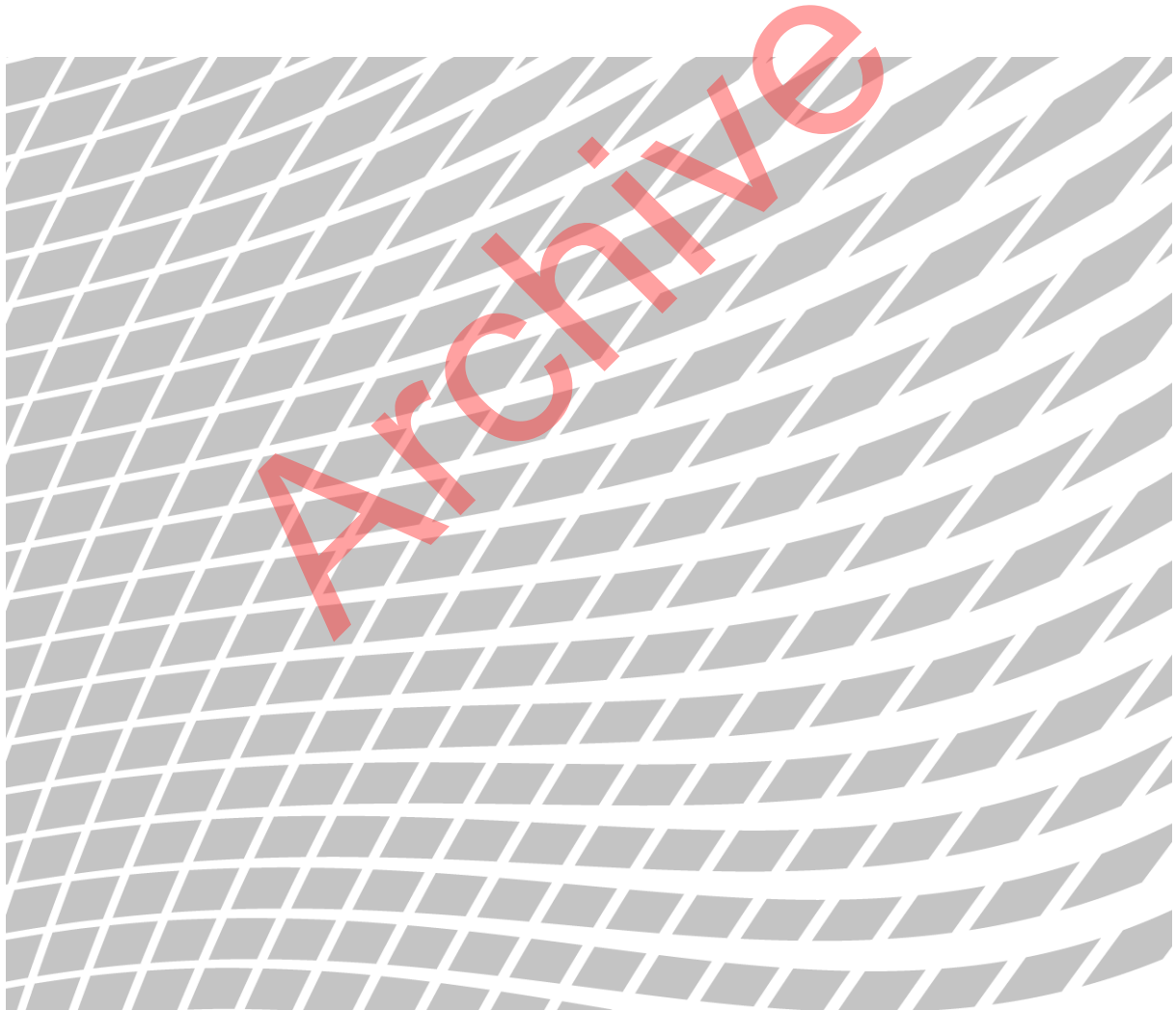


Supervisory Measures - Retrocessions

Banks



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1 Introduction

Trailer fees received by banks for asset management services belong to the clients. This landmark decision was taken by the Federal Supreme Court on 30 October 2012. In its role as regulator, it does not fall within FINMA's remit to decide and enforce civil law claims between supervised institutions and their clients. In terms of regulation, however, FINMA does expect the banks to take adequate precautionary measures.

Banks often have dual contract relationships: while, on the one hand, they manage securities portfolios comprising various investment products for their clients under asset management agreements, banks also hold distribution agreements with providers of collective investment schemes and structured products who delegate the distribution of these products to the banks based on these agreements. Banks receive what are known as trailer fees in their capacity as distributor of financial products. These are part of the management fee and are not paid out for a transaction but rather for keeping the fund in the clients' investment portfolios.

Under Article 400 para. 1 CO, the agent is obliged at all times upon request to account for the management of his business activities and reconstitute all the assets to the principal which are directly related to the execution of the order. In accordance with a previous ruling of the Supreme Court (BGE 132 III 460 and 137 III 393), the duty of restitution includes retrocessions acquired by an external asset manager from third parties. That court decision did not, however, clarify whether trailer fees qualify as retrocessions to be restituted to the clients. It was also unclear whether retrocessions deriving from group companies have to be restituted.

In its recent decision (decision 4A_127/2012 of 30 October 2012), the Civil Law Division of the Supreme Court has confirmed the above issues. The Court also concluded that the principles deriving from the decision on the duty of restitution of retrocessions and reimbursements also apply to banks acting as asset managers for their clients, if the banks acquire investment funds and structured products for their clients for which they then receive trailer fees.

This Newsletter summarises from a regulatory perspective the requirements for supervised institutions arising directly from the court decision.

2 Key elements of the Supreme Court's decision

The facts leading to this court decision were as follows: in line with the terms of an asset management agreement between the bank and the claimant (a client of the bank), the bank managed the client's securities against a commission, investing a considerable part of them in investment funds and structured products. On the other hand, the bank distributed fund certificates for external financial product providers and its affiliated group companies. The bank received trailer fees for distributing funds, i.e. a percentage of the management fee charged periodically by the fund management company to the fund.

The resulting decision made by the Court infers the following important conclusions regarding the relationship between asset managing banks and their clients:

- trailer fees received from third parties belong to the clients if the compensation is directly related to the asset management agreement;
- payments received from third parties are directly related to the asset management agreement if the likelihood arises that the agent may not take the clients' interests adequately into consideration;
- the duty of restitution also applies to intra-group payments;
- provision for a client waiver is possible once the principles deriving from the previous court decisions are adhered to.

The Supreme Court's recent decision does not address in depth whether the duty of restitution includes commissions made specifically to investment fund distributors for distribution expenses incurred. Moreover, for procedural reasons, the court decision does not comment on the possibility banks may have of charging costs incurred as reimbursable expenses.

The court decision neither comments on advisory mandates, which in principle also fall under the legal provisions for mandates in general. It remains open as to whether the duty of restitution also applies to "execution only" client relationships.

3 Enforcing client claims under civil law

As of today, it is probable that many bank clients are affected by the Supreme Court's decision. It will also have an impact on numerous banks that receive reimbursements from third parties (or from within the group) for asset management activities carried out for their clients. In accordance with the Supreme Court's decision, asset management agreements between banks and their clients qualify as a mandate (Art. 394ff. CO). Any claims concerning the restitution of trailer fees must therefore be asserted under civil law and enforced if necessary.

4 Supervisory measures taken by FINMA

In its role as regulator, it does not fall within FINMA's remit to assess and enforce claims made under civil law between supervised institutions and their clients. Nonetheless, as part of the supervisory requirement to assure proper business conduct, supervised institutions must systematically uphold their obligations under civil law, i.e. banks must be managed and organised in such a way as to guarantee an overall level of compliance with their contractual obligations.

Therefore, FINMA expects the banks concerned to adopt the following precautionary measures:

- take promptly account of the 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 point within the bank with which they can then get in touch for further information;
- inform the 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. FINMA will also evaluate whether it will be necessary to make adjustments to FINMA Circular 2009/1 "Guidelines on asset management".

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