

Swiss Banking &  
Private Wealth Management

Eric Stupp | Nedim Peter Vogt  
Editors

Peter Ch. Hsu

# Finder's Fee, Commissions and Similar Arrangements

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Volume 1

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## Abbreviations

art.	Article
AS	Official Register of Swiss Federal Laws and Ordinances
AVO	Ordinance on Supervision of Private Insurance Enterprises [Verordnung über die Beaufsichtigung von privaten Versicherungsunternehmen (Aufsichtsverordnung; AVO)] of 9 November 2005; SR 961.011
BankA	Swiss Federal Act on Banks and Savings Banks [Bundesgesetz über die Banken und Sparkassen (BankG)] of 8 November 1934, SR 952.0
BBI	Official Federal Gazette
BVG	Federal Act on Professional Old Age Pensions, Survivors' Pensions and Invalidity Assistance [Bundesgesetz über die berufliche Alters-, Hinterlassenen- und Invalidenvorsorge; BVG] of 25 June 1982, SR 831.40
BVV 2	Implementing Ordinance to the Pension's Act [Verordnung über die berufliche Alters-, Hinterlassenen- und Invalidenvorsorge (BVV 2)] of 18 April 1984, SR 831.441.1
CA	Swiss Federal Act on Cartels and other Restrictions of Competition [Bundesgesetz über Kartelle und andere Wettbewerbsbeschränkungen (KAG)] of 6 October 1995, SR 251
CC	Swiss Civil Code [Schweizerisches Zivilgesetzbuch (ZGB)] of 10 December 1907, SR 210
cf.	Confer; compare
CISA	Swiss Federal Act on Collective Investment Schemes (CISA) [Bundesgesetz über die kollektiven Kapitalanlagen, KAG], of 23 June 2006 (enters into force on 1 January 2007)
CO	Swiss Code of Obligations [Bundesgesetz betreffend die Ergänzung des Schweizerischen Zivilgesetzbuches (OR)] of 30 March 1911, SR 220
cons.	Consideration
Diss.	Dissertation
Ethical Rules VSV (1999)	Ethical Rules of the Association of Swiss Asset Managers for the exercise of independent asset management [Standesregeln des Verbands Schweizerischer Vermögensverwalter für die Ausübung der unabhängigen Vermögensverwaltung], 1999 Version
fig.	Figure
FMA	Federal Medicine Act [Bundesgesetz über Arzneimittel und Medizinprodukte] of 15 December 2000, SR 812.21
fn.	Footnote
FOPI	Federal Office for Private Insurance [Bundesamt für Privatversicherung; BPV]
IAM	Investment Asset Manager

IFA	Swiss Federal Act on Investment Funds [Bundesgesetz über die Anlagefonds, AFG] of 18 March 1994, SR 951.31
MLA	Swiss Federal Act for the Prevention of Money Laundering in the Financial Sector [Bundesgesetz zur Bekämpfung der Geldwäscherei im Finanzsektor (GWG)] of 10 October 1997, SR 955.0
no./N	Number
NZZ	Neue Zürcher Zeitung
p., pp.	Page[s]
para.	Paragraph
PC	Swiss Penal Code [Schweizerisches Strafgesetzbuch (StGB)] of 21 December 1937, SR 311.0
SBVg	Swiss Bankers Association [Schweizerische Bankiervereinigung]
SESTA	Swiss Federal Act on Stock Exchanges and Trading in Securities [Bundesgesetz über die Börsen und den Effektenhandel (BEHG)] of 24 March 1995, SR 954.1
SFA	Swiss Fund Association
SFBC	Swiss Federal Banking Commission
SFT	Swiss Federal Tribunal
SFTD	Decision of the Swiss Federal Tribunal [BGE]
UCA	Federal Act Against Unfair Competition [Bundesgesetz über den unlauteren Wettbewerb, UWG] of 19 December 1986, SR 241
VAG	Insurance Supervision Act [Bundesgesetz betreffend die Aufsicht über Versicherungsunternehmen (Versicherungsaufsichtsgesetz, VAG)] of 17 December 2004, SR 961.01
VSV	Association of Swiss Asset Managers [Verband schweizerischer Vermögensverwalter]
ZSR	Swiss Law Review [Zeitschrift für Schweizerisches Recht]

## A. Introduction

The law suit brought by Eliot Spitzer, Attorney General of the State of New York, against the world's largest insurance broker and consultant Marsh & McLennan Companies, Inc./Marsh Inc. ("Marsh") in October 2004 shocked the insurance industry.<sup>1</sup> The Spitzer Indictment mentioned also other insurers such as ACE, AIG, The Hartford, and Munich American Risk Partners as participants in the bid rigging scheme. The principal allegation was that Marsh had received or solicited so-called *contingent commissions* for hundreds of millions of dollars in consideration of receiving business and protection from competitors. This was particularly serious since Marsh had always emphasised in public that it acted in the interests of its customers and not of the insurers.<sup>2</sup> An e-mail sent by one of Marsh's global broking executives and cited in the Indictment sums up the aim and the effect of this business policy: "We [Marsh] need to place our business in 2004 with those [insurance companies], that have superior financials, broad coverage and pay us the most."<sup>3</sup> Subsequently investigations were conducted and further law suits brought against other exponents of the insurance industry. In the meantime settlements have been concluded with Marsh<sup>4</sup> and several other companies. – The problem as such remains topical, also outside the USA, and other sectors are affected too. In Switzerland, the recent judgment of the Swiss Federal Tribunal concerning the obligation of independent asset managers to deliver up commissions has given rise to much discussion.<sup>5</sup>

<sup>1</sup> Cf. the Indictment filed by Eliot Spitzer, Attorney General of the State of New York, of 14 October 2004, with the Supreme Court of the State of New York, County of New York, [http://www.oag.state.ny.us/press/2004/oct/oct14a\\_04\\_attach1.pdf](http://www.oag.state.ny.us/press/2004/oct/oct14a_04_attach1.pdf) (last visited 22 June 2006; "Spitzer Indictment").

<sup>2</sup> Cf. the quotation in Spitzer Indictment, p. 2: "We are our clients' advocate, and we represent them in negotiations. We don't represent the [insurance companies]."

<sup>3</sup> Spitzer Indictment, p. 12; emphasis in the original.

<sup>4</sup> Press Release New York State Insurance Department of 31 January 2005, <http://www.ins.state.ny.us/press/2005/p0501311.htm> (last visited: 22 June 2006); Agreement Between the Attorney General of the State of New York and the Superintendent of Insurance of the State of New York, and Marsh & McLennan Companies, Inc., Marsh Inc. and their subsidiaries and affiliates [...], dated 30 January 2005, [http://www.nacubo.org/documents/business\\_topics/Financial\\_Statements/Agreement.pdf](http://www.nacubo.org/documents/business_topics/Financial_Statements/Agreement.pdf) (last visited 22 June 2006).

<sup>5</sup> SFT judgment 4C.432/2005 of 22 March 2006. Cf.: Hsu/STUPP, pp. 202 et seq.; MANUEL ARROYO, Practice of the Swiss Federal Tribunal regarding the account of commissions and finder's fees in the context of an asset management agreement [Praxis des Bundesgerichts zur Herausgabe von Retrozessionen und Finder's Fees im Rahmen eines Vermögensverwaltungsvertrages], ZBJV 142 (2006), pp. 625 et seq.; MEINRAD BALLMER/MARCO ZANCHI, Kickback sinners sail close to the wind [Kickback-Sünder stehen mit einem Bein im Gefängnis], Sonntags-Zeitung of 23 July 2006, p. 48; MARCO ZANCHI/MEINRAD BALLMER/IGOR KRAVARIK, Mystery-monger resist [Geheimniskrämer wehren sich], SonntagsZeitung of 16 July 2006, p. 55; MARCO ZANCHI/MEINRAD BALLMER, Banks face liability for billions [Milliardenrisiken für die Banken], Sonntags-Zeitung of 9 July 2006, p. 52; JAMES ROSSITER, Swiss banks facing £22 billion claims over 'kickbacks', Evening Standard, 4 July 2006; MEINRAD BALLMER/MARCO ZANCHI, This is how investors are tricked [So werden Anleger über den Tisch gezogen], SonntagsZeitung of 2 July 2006, p. 61; SABINE KILGUS/ROLF KUHN, The Swiss Federal Tribunal rules that commissions belong to the customer [Das Bundesgericht spricht Retrozessionen dem Kunden zu], Jusletter of 26 June 2006, <http://www.weblaw.ch/jusletter/Artikel.asp?ArticleNr=4853> (last visited 10 July 2006);

What are here at issue are payments or other benefits (commissions) granted by a provider of services or products to an intermediary, such commissions being, in fact, a portion of the commissions, fees, or costs that the provider charges to the customer (in German so called *Retrozessionen*; hereinafter "Commissions"). Other German terms for such Commissions are *Retrokommissionen*, *Provisionen*, *Vermittlungskommissionen*<sup>6</sup>, *Bonif*, *Bestandespflegekommissionen*<sup>7</sup>, *Rückvergütungen*, *Rabatte*. Depending on the circumstances, the word kickbacks<sup>9</sup> might be the most appropriate description of the phenomenon. The German term *Retrozessionen* (literally "re-assignments") is misleading since no assignment in the legal sense of art. 164 et seq. of the Swiss Code of Obligations ("CO") is involved.<sup>10</sup>

The standard situation in which Commissions are paid is a three-party relationship between (i) the principal (customer), (ii) the agent (intermediary), who receives the Commission, and (iii) the provider of services or products, who pays the Commission.<sup>11</sup> The agent has a fiduciary duty towards the principal, e.g. by virtue of the parties' contractual relationship. Such fiduciary duty may, for example, derive from the law of mandate that applies to the contractual relationship.<sup>12</sup> It is conceivable, but not necessary, that the provider also has a fiduciary duty towards the principal (fig. 1).

This three-party relationship typically leads to problems: The payments of Commissions by the provider of services or products to the agent may involve the risk of interference with the fiduciary relationship between the principal and the agent. Commissions can thus lead to a conflict of interests for the agent, be it because he becomes a servant of two masters, or because he puts his own interests before those

RASHID BAHAR, Commissions belong to the customer [Les rétrocessions reviennent au client], Centre de Droit Bancaire et Financier, actualité no. 446 of 22 June 2006, [http://www.unige.ch/droit/cdbf/article.php3?id\\_article=446&lang=](http://www.unige.ch/droit/cdbf/article.php3?id_article=446&lang=) (last visited 10 July 2006); id., In asset management, Commissions belong to the customer [Dans la gestion de fortune, les rétrocessions reviennent au client], Le Temps of 10 July 2006, no. 2535, p. 21; MARKUS FELBER, To whom do kickbacks belong? [Wem gehören Retrozessionen?], NZZ of 20 June 2006, no. 140, p. 23; ERMES GALLAROTTI, Commissions belong to the customers [Retrozessionen stehen den Kunden zu], NZZ of 20. June 2006, no. 140, p. 28.

<sup>6</sup> MEINRAD BALLMER/MARCO ZANCHI, The Swiss Federal Tribunal puts a stop to illicit practices [Das Bundesgericht schiebt illegalen Praktiken einen Riegel vor], Sonntagszeitung of 2 July 2006, p. 61.

<sup>7</sup> WIEGAND/ZELLWEGER-GUTKNECHT, p. 43.

<sup>8</sup> Trailer Fees, cf. the SFA Guidelines on Transparency with regard to Management Fees of 7 June 2005, II. B.3.

<sup>9</sup> Cf. for example Guideline pursuant to § 35 IV Securities Transactions Act to implement §§ 31 and 32 of the Act with respect to commission transactions, self-trading for third parties and commission transactions of brokers [Richtlinie nach Paragraph 35 IV WpHG zur Konkretisierung der §§ 31 und 32 WpHG für das Kommissionsgeschäft, den Eigenhandel für andere und das Vermittlungsgeschäft der Wertpapierdienstleistungsunternehmen] (Bundesanzeiger no. 165 of 4 September 2001, p. 19217; the guideline replaces that of 9 May 2000), B.1.1, that mentions "Kick-Back-Agreements". HESS, p. 1431; DEN OTTER, Investment Fund Act, Art. 12 para. 2 N 7.

<sup>10</sup> DE CAPITANI, fn. 5; DEN OTTER, Investment Fund Act, Art. 12 para. 2 N 7.

<sup>11</sup> Cf. Spitzer Indictment, pp. 4 et seq.

<sup>12</sup> Or cf. in employment law, the three-party relationship employer-employee-service provider, in which the employee has a fiduciary duty towards his or her employer (art. 321a CO).

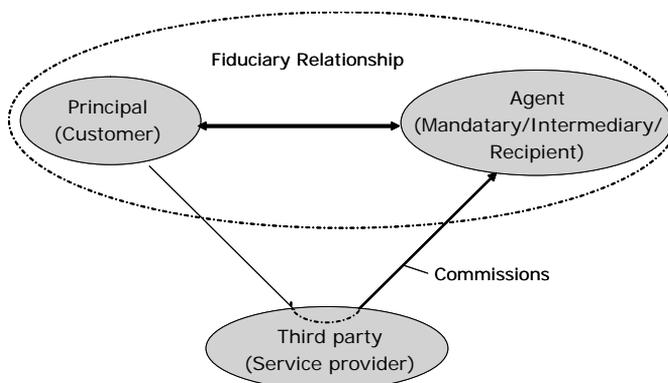


fig. 1

of the principal. Commissions thus engender a typical conflict of interest situation, or principle-agent problem.<sup>13</sup>

Commissions are paid for various reasons and justified by diverse arguments, for instance (i) as a means of acquiring and retaining customers, (ii) as a means of passing on cost savings for bulk customers (as rebate), or (iii) as compensation for certain legitimate, non-conflicting services such as inquiries undertaken or advice or support given by the recipient of the Commissions. Within groups of companies Commissions are sometimes used as a means for transferring profits.

Commissions involve various aspects of law including civil law, laws against unfair competition, penal law, regulatory regulations<sup>14</sup>, fiscal law<sup>15</sup>, competition law<sup>16</sup>, etc.

We shall begin the examination of the topic by focussing on the example of Commissions in the field of independent asset management, where Commissions are widespread (cf. B).<sup>17</sup> Then we shall analyse other areas, most of them involving distributive services in a broad sense: Commissions in multistage securities and foreign exchange trading (cf. C), in the investment funds industry (cf. D), in the insurance

<sup>13</sup> BRETTON-CHEVALLIER, p. 153; cf. VON DER CRONE, pp. 241 et seq. on the principle-agent problem in corporate law.

<sup>14</sup> For instance in the areas of banking and investment funds.

<sup>15</sup> Cf. for example with regard to commissions and Value Added Tax brochure no. 14 issued by the Federal Tax Administration, Berne September 2000, p. 80. We shall not dwell on VAT-aspects here.

<sup>16</sup> Art. 7 para. 1 lit. b of the Swiss Federal Act on Cartels ("CA"): Illicit behaviour of an enterprise with a controlling share of the market includes the discrimination of competitors with regard to prices or other business terms, for instance by granting rebates. Questions of competition law shall not be addressed here, since these tend to arise more in connection with rebates than with commissions in the proper sense.

<sup>17</sup> A presentation dealing with commissions might be structured either according to the various legal aspects of the three-party relationship, so that in each section the practical implications and examples are examined, or according to the various practical examples examined from various legal angles. The latter approach is more user friendly, but tends to lead to repetition.

industry (cf. F)<sup>18</sup>, in connection with listed investment companies (cf. G), in asset management for pension funds (cf. H), in the distribution of pharmaceutical products (cf. I), in the auction business (cf. J1), and with regard to lawyers (cf. J2). In some of these areas there is already legislation in the form of explicit restrictions, prohibitions and disclosure obligations, such as for instance in the area of asset management for pension funds (art. 53a lit. a BVG and art. 48g BVV 2) or of distribution of pharmaceutical products (art. 33 FMA).<sup>19</sup>

The remarks concerning Commissions in the area of independent asset management hold true in the main also for the other examples discussed here. So as to avoid unnecessary repetition, we shall generally confine ourselves to pointing out particular features of the other examples.

<sup>18</sup> There are certain parallels between insurance and shipping brokerage: an independent shipping broker finds the appropriate shipping capacity for the transport of the principal's goods. It is customary in the trade that the shipping broker's fee is paid by the shipper (cf. for instance <http://www.hanseatic-lloyd.de/corporate/news/archiv/onBoard03/artOnBoard0905-01.html>; last visited 22 June 2006).

<sup>19</sup> Cf. BREITENSTEIN, pp. 34 ff.

## B. Independent Asset Management

### I. The Widespread Nature of Commissions

Commissions are widespread in the area of independent asset management.<sup>20</sup> Since asset management is a service offered by many banks and securities dealers, Independent Asset Managers (hereinafter "IAMs") are their competitors. However, for some time banks have been aware that securities custody and executing customer orders for securities trading also generate proceeds so that IAMs should be treated as partners rather than competitors.<sup>21</sup> In independent asset management, Commissions are so widespread that there is considerable pressure on the banks to pay IAMs Commissions in order to be able to compete with other banks for the securities custody business.

A survey carried out by the Swiss Federal Banking Commission involving 22 representative banks (and an additional institution, but not including UBS AG and Credit Suisse) showed that about 10% of the entire customer assets of around CHF 503 billion held in custody by these institutions (i.e. about CHF 50 billion) is managed by IAMs. On average, around one third of the proceeds generated by these institutions on the deposited assets is paid to the IAMs in the form of Commissions,<sup>22</sup> along with further benefits ("Soft Commissions"<sup>23</sup>). The survey also showed that most of the banks delegate the identification of customers pursuant to anti-money laundering legislation to the IAMs. This at least may justify the payment of some form of compensation.<sup>24</sup>

In total, IAMs manage an estimated CHF 300 billion in Switzerland.<sup>25</sup> Assuming that other banks, similarly to the ones included in the abovementioned survey, also pass on

<sup>20</sup> NYBERG, p. 304, notes that commissions are a central source of income for many asset managers.

<sup>21</sup> WIEGAND/ZELLWEGER-GUTKNECHT, p. 39.

<sup>22</sup> Annual Report of the Swiss Federal Banking Commission 2004, pp. 47 et seq.; cf. also the estimate by BRETTON-CHEVALLIER, p. 153, fn. 610.

<sup>23</sup> Cf. B.IV.2.

<sup>24</sup> Cf. B.II; cf. HESS, pp. 1428 et seq.

<sup>25</sup> An estimated 8–10% of the total assets managed in or from Switzerland are managed by IAMs (Zufferey Report, III. Partial Report of the expert committee appointed by the Federal Counsel, Enhancement of the prudential supervision [III. Teilbericht der vom Bundesrat eingesetzten Expertenkommission, Erweiterung der prudentiellen Aufsicht, Folgearbeit zum Schlussbericht der Expertengruppe Finanzmarktaufsicht], February 2005, <http://www.efd.admin.ch/d/dok/berichte/2005/02/finma.pdf> (last visited 22 June 2006), p. 9. The Association of Swiss Asset Managers [Verband Schweizerischer Vermögensverwalter, "VSV"] estimates that at least between CHF 300 to 400 billion are managed by IAMs in Switzerland ([http://www.vsv-asg.ch/hm/htm\\_d/unabhaengig.htm](http://www.vsv-asg.ch/hm/htm_d/unabhaengig.htm); last visited 22 June 2006). The Swiss Bankers Association [Schweizerische Bankiervereinigung, "SBVg"] estimates that the members of the VSV alone manage assets of at least CHF 100 billion (<http://www.swissbanking.org/home/akteure.htm>; last visited 22 June 2006); for the situation in 2003 cf. BRETTON-CHEVALLIER, Liability, p. 254, with references. HANS GEIGER/CHRISTIAN BÜHRER, Well-established independent asset managers [Etablierte unabhängige Vermögensverwalter], NZZ of 21 February 2006, no. 43, p. 25, refer

approximately one third of the proceeds generated by the services in connection with the customer assets to IAMs in the form of Commissions, the economic importance of Commissions in the business of independent asset management is considerable.

## II. Motives for Paying Commissions

Commissions are paid for various reasons and justified by diverse arguments:

A primary aim is to acquire and retain customers. By offering Commissions, a custodian bank provides the IAM with an incentive to deposit the customers' assets under his management and to conduct the securities trading transactions for the client with that bank.<sup>26</sup> For this reason it is important to draw a line between legitimate customer retention and private bribery.

Commissions are also sometimes declared as rebates for important customers and justified by cost savings.<sup>27</sup> While this argument explains why the Commission is paid, it does not explain why payment is made to the IAM (i.e. agent) rather than directly to the bank's customer, bearing in mind that the customer of the provider of services or products is, in fact, primarily the principal and not the agent.

In some cases Commissions can be justified as compensation for non-conflicting services legitimately rendered by the recipient to the customer. This is for instance the case where a custodian bank compensates the IAM for the delegated task of identifying the customer pursuant to anti-money laundering legislation.<sup>28</sup>

Partly Commissions are considered as compensation for advisory or supportive services provided by the recipient. In the typical set-up of independent asset management it is the function of the IAM and not of the bank to advise and take care of the customer. The IAM accordingly bears the responsibility and liability for these services. The custodian bank receives the instructions from a professional IAM who represents the customer and is deemed to be experienced in making investments. This reduces the responsibility and liability of the custodian bank<sup>29</sup> and justifies a payment to the IAM for his services.<sup>30</sup> However, the IAM renders these services to the customer, and as the customer's agent he is primarily responsible to the customer, his principal, to

to an estimate that CHF 500 billion are managed by IAMs in Switzerland. Cf. also BORER-BENZ, pp. 107 et seq.

<sup>26</sup> WIEGAND/ZELLWEGER-GUTKNECHT, p. 43; DE CAPITANI, p. 28.

<sup>27</sup> ROTH, Commentary SESTA, Art. 11 N 148, mentions for instance in connection with commissions in securities transactions that the customers would not benefit from such bulk rebates were they to conclude the transaction directly with the third party broker rather than with their own broker; EMCH/RENZ/ARPAGAU, p. 553.

<sup>28</sup> Cf. art. 3 et seq. Swiss Federal Act for the Prevention of Money Laundering in the Financial Sector of 10 October 1997, SR 955.0 ("MLA").

<sup>29</sup> EMCH/RENZ/ARPAGAU, p. 553.

<sup>30</sup> Cf. F. below for compensation arrangements in connection with the distribution of insurance products.

whom he owes a fiduciary duty and by whom he is normally compensated under the asset management agreement. In order to avoid conflicts of interests it is preferable that the IAM be directly (and exclusively) paid by his customer and not (additionally) by Commissions from the custodian bank.<sup>31</sup>

### III. The Three-Party Relationship (Overview)

The three-party relationship<sup>32</sup> customer-IAM-bank in the area of independent asset management can be described as follows (fig. 2):

- **Relationship between the customer and the IAM:** The IAM concludes an asset management agreement with the customer, usually in writing. In this agreement the IAM undertakes, for consideration, in compliance with the duties of an agent, to manage actively, professionally and continuously the assets entrusted to him for asset management.<sup>33</sup> Between the IAM and the customer there is a fiduciary principal-agent relationship. To enable the IAM to perform his functions, the customer grants a management power of attorney to the IAM that is disclosed to the bank.<sup>34</sup>
- **Relationship between the customer and the bank:** The customer and the bank typically enter into a contractual relationship regarding the account and custody. In addition, the bank carries out securities transactions for the customer. The duties of the bank towards the customer are essentially restricted to administrative tasks of a purely technical nature; the bank undertakes to properly manage in a technical sense the assets placed in its custody and to carry out securities transactions carefully and promptly.<sup>35</sup> Within this typical set-up of independent asset management, the bank's function is exclusively one of custody and execution of transaction orders, while it is the IAM who manages the assets. As a rule the customer pays the bank custody and brokerage fees for its services.<sup>36</sup>
- **Relationship between the Bank and the IAM:** Vis-à-vis the bank the IAM primarily acts as the customer's agent, pursuant to the management power of attorney conferred on him by the customer, the contents of which have been disclosed to the bank. On this basis the bank effects the securities transactions ordered by the IAM on behalf of the customer and renders bank statements etc. In addition, the bank and the IAM usually enter into a cooperation or framework agreement. Under such agreement the bank pays the IAM Commissions. The IAM, in turn, brings customers to the bank, thus generating business. It is, how-

<sup>31</sup> "He who pays the piper, calls the tune." Or, in German, "Wes Brot ich ess, des Lied ich sing", attributed to Karl Marx.

<sup>32</sup> DIETZI, p. 196; CRESPI-HOHL, p. 2.

<sup>33</sup> WIEGAND/ZELLWEGER-GUTKNECHT, pp. 40 et seq.

<sup>34</sup> Cf. below B.V.

<sup>35</sup> GENONI, p. 26; WIEGAND/ZELLWEGER-GUTKNECHT, p. 41.

<sup>36</sup> Cf. B.VI below.

ever, the IAM who looks after the customers and is responsible for investment advice and asset management. The bank is freed from these tasks.<sup>37</sup>

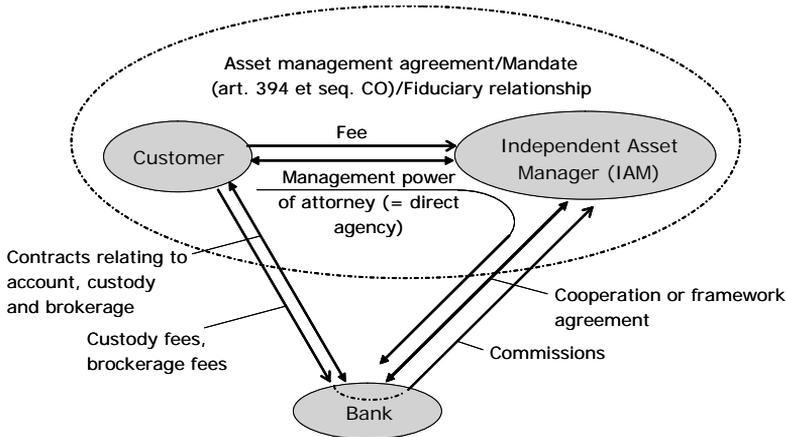


fig. 2

These individual legal relationships between the customer, the IAM and the bank will be examined in more detail below in B.IV.–B.VI., albeit in a different order.

## IV. Relationship between the Bank and the IAM

### 1. Management Power of Attorney and Cooperation Agreement

As a rule the customer grants a management power of attorney to the IAM.<sup>38</sup> This is a restrictive power of attorney entitling the IAM to carry out the transactions that asset management typically involves.<sup>39</sup> The contents of the power of attorney are disclosed to the bank, usually on a form prepared by the latter and signed by the customer. The IAM acts thus as the customer’s agent. The bank carries out the securities transactions ordered by the IAM as the customer’s agent, provides statements of account etc. The mere fact that the contents of the power of attorney conferred by the customer on to the IAM are disclosed to the bank does not lead to a contractual relationship between the IAM and the bank.<sup>40</sup>

<sup>37</sup> Cf. B.VI below.

<sup>38</sup> It is also possible that the customer grants a general power of attorney to the IAM that is disclosed to the bank, while internally, i.e. between the customer and the IAM, the powers of the IAM are restricted (GUTZWILLER, p. 43).

<sup>39</sup> Based on a management power of attorney an IAM cannot, as a rule, conclude real estate transactions, draw cash amounts or order payments to be made to third parties (WATTER, Duties, p. 1177).

<sup>40</sup> SFT judgment 4C.387/2000 of 15 March 2001 cons. 2c. Critical: WIEGAND/ZELLWEGER-GUTKNECHT, p. 41.

However, in practice the bank and the IAM usually, in addition, enter into a cooperation or framework agreement. In such agreement they agree on modalities of cooperation and assume various obligations such as the key obligation of the bank to pay Commissions.

Typically, the IAM undertakes to introduce customers to the bank and to perform the task, delegated by the bank, of identifying the customer in compliance with anti-money laundering legislation.<sup>41</sup> Often cooperation agreements will also contain provisions concerning the information to be provided and services to be rendered by the IAM to the customer. Such provisions, for example, provide for the undertaking of the IAM to take care of the customer, the undertaking of the IAM to inform the customer of the commission arrangements between the bank and the IAM and other disclosure duties, and the obligation of the IAM to stipulate in the agreement with the customer to whom the Commissions shall accrue. Often the IAM will also be bound to comply with the Guidelines of the Swiss Bankers Association for Asset Management Mandates and the Ethical Rules for Independent Asset Management of the Swiss Association of Asset Managers (“Ethical Rules VSV”). Finally, the IAM will often undertake to indemnify the bank for any damage caused by his conduct.

The primary duty of the bank under the cooperation agreement is to pay Commissions to the IAM. The cooperation agreement often describes in detail the prerequisites and modalities of calculation and payment of Commission payments and Soft Commissions.

Cooperation agreements also usually explicitly state that the bank is not and need not be aware of the customer’s investment profile and the investment strategy agreed between the customer and the IAM, and specify that the bank has no supervisory duties. As a rule the bank will also explicitly decline any liability for the IAM’s conduct.

## **2. Forms and Modes of Calculation of Commissions**

Commissions are conferred in various forms. A distinction can be drawn between actual payments and so-called Soft Commissions.

Banks pay IAMs Commissions in the form of payments comprising, for example, a part of the custody fees, brokerage fees, ticket-fees, or all-in fees charged to and received from the customers (i.e. Commissions in a narrow sense), and Commissions on the net asset value of customer deposits or as (one-time) payments for the introduction of new customers, new customer assets, or new customer loans (finder’s fees).<sup>42</sup>

Often the cooperation agreement does not specify the nature of the consideration or services underlying Commissions, but this will usually be apparent from the agreed

<sup>41</sup> Cf. Annual Report of the Swiss Federal Banking Commission 2004, p. 48.

<sup>42</sup> EMCH/RENZ/ARPAGAU, p. 554; HESS, p. 1432; DE CAPITANI, p. 29.

mode of calculation. The basis for the calculation might for instance be the fees charged by the bank to, and received from, the customer. Accordingly, Commissions are calculated as a percentage of fees for the execution of securities transactions or for the custody of assets, or of the all-in-fees. Sometimes Commissions are based on the bank's distribution commissions. In the case of investment funds these are in effect Commissions on Commissions.

Commissions in the range of 25–35% of the fees are common in practice,<sup>43</sup> while economically particularly attractive IAMs may receive up to 50% of the bank's fees.<sup>44</sup>

Finder's fees are (usually one-time) payments that are often calculated as a percentage of (initially or newly) deposited net assets of customers. Other Commissions are calculated, for example, as a percentage per year of the annual average of the net asset value of the customer's assets deposited with the bank or of the amount invested in certain investment products.<sup>45</sup> Often such payments will only be granted if the total deposited assets surmount a specified threshold.

These modes of calculation show that Commissions are primarily paid in consideration of introducing and retaining customers, i.e. so as to commit the IAM as a source of business.

Along with Commissions IAMs often receive Soft Commissions, also known as indirect commissions<sup>46</sup> or soft money.<sup>47</sup> These take various forms, none of which are directly pecuniary.<sup>48</sup> Such Soft Commissions are for instance the free provision of access to financial information and analysis. A further Soft Commission sometimes offered by banks is the provision of free legal or fiscal advice, or online access to the customer's cash and custody accounts with the bank and the possibility of placing orders directly on a dedicated line. Sometimes computer hardware<sup>49</sup> and software (e.g. management and accounting software) are provided free of charge.<sup>50</sup> Some banks have in-

<sup>43</sup> Cf. also the result of the Swiss Federal Banking Commission's Survey published in Annual Report of the Swiss Federal Banking Commission 2004, pp. 47 et seq.

<sup>44</sup> ROGER TRUNZ, A "steady hand" helps to save fees. A way for more effective management of private assets ["Ruhige Hand" hilft beim Gebührensparen, Ein Weg zur effektiveren Verwaltung von Privatvermögen], NZZ of 2 June 2003, no. 125, Supplement "Geld und Anlage", p. 22; cf. MEINRAD BALLMER/MARCO ZANCHI, The Swiss Federal Tribunal puts a stop to illicit practices [Das Bundesgericht schiebt illegalen Praktiken einen Riegel vor], Sonntagszeitung of 2 July 2006, p. 61.

<sup>45</sup> Sometimes further differentiated by the various types of investment funds, e.g. investment funds investing in bond, stocks, or real estate, or differentiated between the bank's own investment funds and investment funds that are distributed by the bank on the basis of a distribution agreement between the bank and the fund.

<sup>46</sup> WIEGAND/ZELLWEGER-GUTKNECHT, p. 42.

<sup>47</sup> Hereinafter we shall use the term Soft Commissions.

<sup>48</sup> Cf. ROTH, Commentary SESTA, Art. 11 N 185 et seq.

<sup>49</sup> Cf. Financial Services Authority, Policy Statement, Reforming Polarisation: Implementation, Feedback on CP04/3 (A menu for being open with consumers and made text), Policy Statement, 04/27, November 2004, p. 21, concerning the prohibition of giving as a present IT hardware that is not indispensable for the operation of the software.

<sup>50</sup> WIEGAND/ZELLWEGER-GUTKNECHT, p. 42; cf. SFT judgment 4C.447/2004 of 31 March 2005 cons. 4.1.

stalled special desks for IAMs. Another form of Soft Commissions are invitations to training seminars, with travel and accommodation costs reimbursed.<sup>51</sup>

It is difficult to allocate Soft Commissions to individual customer relationships. They can be of considerable value and they play an important role in practice, but hitherto they have hardly been addressed by legislation or other rules in Switzerland.

Some of these perks also benefit the bank and help save costs, e.g. the provision of online access to the customer's cash and custody accounts with the possibility of placing orders directly. To this extent it is doubtful whether such perks can really be qualified as Soft Commissions of the IAMs.

### 3. Legal Nature of the Commission Arrangement

Cooperation agreements with commission arrangements are as a rule qualified as a synallagmatic contract *sui generis*<sup>52</sup> and mixed contract<sup>53</sup>. The legal nature varies depending on the terms and the circumstances.<sup>54</sup> The contract is a mixed agreement where it contains further elements such as the duty of the IAM to identify the customer in compliance with anti-money laundering legislation, or the duty of the bank to provide the IAM with services at special rates.<sup>55</sup>

The cooperation agreement is not a form of partnership since the bank and the IAM do not pursue a common aim.<sup>56</sup> Neither does it belong to the family of distribution agreements. For where an IAM introduces a new customer to a bank, his primary intention is the furthering of the interests of his clients – or this is what he, in fact, should aim for because of his fiduciary relationship with the customer. That the bank thereby gains a new customer is merely a side effect.<sup>57</sup>

The cooperation agreement is not an agency agreement in the meaning of art. 418 et seq. CO, since the IAM is (or should be) primarily the representative and guardian of the interests of the customer for whom he concludes transactions based on the asset management agreement. Were he an agent in the sense of art. 418 et seq. CO, he would have a fiduciary duty towards the bank and be obliged to conclude transactions

<sup>51</sup> Cf. Financial Services Authority, Consultation Paper 05/5, Bundled brokerage and soft commission arrangements: proposed rules, March 2005; cf. Financial Services Authority, Policy Statement, Bundled brokerage and soft commission arrangements, Feedback on CP05/5 and final rules, July 2005. Both papers are available at [http://www.fsa.gov.uk/pages/Library/Policy/CP/2005/05\\_05.shtml](http://www.fsa.gov.uk/pages/Library/Policy/CP/2005/05_05.shtml) (last visited 22 June 2006).

<sup>52</sup> WIEGAND/ZELLWEGE-GUTKNECHT, p. 42.

<sup>53</sup> SFT judgment 4C.447/2004 of 31 March 2005 cons. 3.2; DE CAPITANI, p. 28; as to the legal nature cf. BRETTON-CHEVALLIER, pp. 58 et seq.; DEN OTTER, Investment Fund Act, Art. 12 para. 2 N 7.

<sup>54</sup> HESS, p. 1432.

<sup>55</sup> DE CAPITANI, p. 28.

<sup>56</sup> BRETTON-CHEVALLIER, pp. 60 et seq.

<sup>57</sup> SFT judgment 4C.447/2004 of 31 March 2005 cons. 3.2 uses the expression in French "effet réflexe"; BRETTON-CHEVALLIER, p. 63.

on behalf and in the interest of the latter.<sup>58</sup> The legally specified aim of the rules governing agency agreements and the IAM's fiduciary duty and duty of care towards its customer preclude qualifying the cooperation agreement as an agency agreement.<sup>59</sup>

The cooperation agreement is not a contract of brokerage in the meaning of art. 412 et seq. CO. On the one hand, cooperation agreements are intended to be of duration, while the contract of brokerage involves the conclusion of *one* particular transaction. On the other hand, the IAM concludes e.g. stock exchange transactions himself as the customer's agent.<sup>60</sup> A further obstacle to the qualification as a contract of brokerage between the IAM and the bank is the fiduciary duty of the IAM towards his customer.<sup>61</sup>

The activities of the IAM can be qualified in the broadest sense as services rendered to the bank. Therefore – and this is decisive – commission arrangements are directly or indirectly subject to the rules governing mandate (art. 394 et seq. CO).<sup>62</sup> Accordingly, the Commissions can be qualified as agreed remuneration in the meaning of art. 394 para. 3 CO.<sup>63</sup>

#### 4. Validity of the Commission Arrangement

##### a. Starting Point

There is a risk (or it is even intended by the person granting Commissions!) that payment of Commissions to an IAM will influence the latter in the exercise of his discretion, thus affecting the fiduciary relationship between the IAM and the customer. In view of this the question is whether commission arrangements can be legal at all, which will not be the case if they have an illicit content or violate *bonos mores* and are thus null and void.<sup>64</sup> We shall examine the question of *contra bonos mores* in the meaning of art. 20 para. 1 CO (cf. B.IV.4.b) and “private bribery” in the meaning of art. 4a UCA (cf. B.IV.4.c).

The question whether commission arrangements are valid under Swiss private law is of relatively small practical relevance since pursuant to art. 66 CO “that which was given with the intention of obtaining an unlawful or immoral result can not be re-

<sup>58</sup> Art. 418c para. 1 CO. DE CAPITANI, p. 29; BRETTON-CHEVALLIER, pp. 63 et seq.

<sup>59</sup> SFT judgment 4C.447/2004 of 31 March 2005 cons. 3.2; BRETTON-CHEVALLIER, p. 64. Intermediaries are subject to the supplementary provisions regulating the contract of brokerage; cf. the discussion of this type of contract below.

<sup>60</sup> DE CAPITANI, p. 29; HESS, p. 1432, submits that in the case of finder's fees, i.e. where the bank pays the IAM a one time commission for the introduction of new customers, the agreement should be qualified as a brokerage agreement. Pursuant to art. 412 para. 2 CO this contract type is generally subject to the provisions governing mandate.

<sup>61</sup> Cf. SFT 124 III 480 et seq. concerning insurance brokers (cf. below F.III).

<sup>62</sup> Art. 394 para. 2 OR; DE CAPITANI, p. 29; HESS, p. 1432; cf. SFT judgment 4C.447/2004 of 31 March 2005 cons. 3.2.

<sup>63</sup> DE CAPITANI, p. 29; DEN OTTER, Investment Fund Act, Art. 12 N 7. The Swiss Federal Tribunal has held that an agreement between the IAM and the customer regarding commissions and similar payments is not a fee agreement, even if the result of the payments is to increase the compensation received by the IAM (SFT judgment 4C.432/2005 of 22 March 2006 cons. 4.3).

<sup>64</sup> Art. 20 para. 1 CO.

claimed". Commissions that have already been paid can thus in principle not be recovered even if the commission agreement is held to be illegal or immoral.

b. *contra bonos mores*

In principle contracts are only binding on the parties (i.e. in an asset management agreement the customer and the IAM). The fact that undertakings given by the IAM as consideration for Commissions might violate the contractual rights of another party (i.e. those of the IAM's customer) does not make such agreement illegal because of the principle of privity of contract. This is why courts and writers generally hold that agreements inciting a party to violate its contractual obligations towards a third party are not illegal<sup>65</sup> in the meaning of art. 41 para. 1 CO.<sup>66</sup> Only the existence of "special circumstances" might violate *bonos mores* in the meaning of art. 20 para. 1 CO, such as is for instance the case where the offering party acts with the intention of damaging the third party.<sup>67</sup>

By offering Commissions a bank does not act with the intention of causing damage to the customer, but rather to procure advantages for itself, yet the courts have held bribery agreements to be *contra bonos mores*.<sup>68</sup> Hence, since a commission arrangement might under certain circumstances be qualified as bribery, it cannot be excluded that it will be null and void. Whether this is the case will depend on circumstances, such as the parties' intentions, the amount involved and maybe even also *de facto* on whether such arrangements are common, albeit this is difficult to determine. It is therefore probably appropriate to have recourse to the notion of "private bribery" under the Unfair Competition Act.<sup>69</sup>

c. Unfair Competition Act

i. *The Problem viewed from Various Angles*

Commissions may lead to problems particularly when they are neither passed on to the customer nor disclosed to him:

From the customer's perspective Commissions are unacceptable if the IAM as recipient concludes a contract with the bank for the customer because he receives Commissions from such bank although other banks that grant no or lower Commissions to the IAM offer the same service at more favourable conditions (fig. 3).<sup>70</sup>

<sup>65</sup> GAUCH/SCHLUEP/SCHMID/REY, N 725.

<sup>66</sup> BAUDENBACHER, Art. 4 N 1.

<sup>67</sup> SFTD 114 II 97 et seq.; cf. 108 II 305; 102 II 340; GAUCH/SCHLUEP/SCHMID/REY, N 725.

<sup>68</sup> SFTD 119 II 384.

<sup>69</sup> Cf. below, B.IV.4.c.

<sup>70</sup> A further example of a drawback for the customer is where the recipient of the commission neglects to negotiate more favourable terms for the customer or concludes unnecessary transactions in order to generate more commissions ("churning").

From the point of view of a competitor it is unfair that an IAM should conclude transactions with the bank from which he receives Commissions instead of with the competitor, even though the latter offers the same service on equally good or even better terms.

Furthermore, commission arrangements pose a macro-economic problem, because transactions are not concluded with the providers offering the best terms but with those who pay (most) Commissions, and this leads to a suboptimal allocation of resources.

The above remarks apply generally to private bribery and corruption.

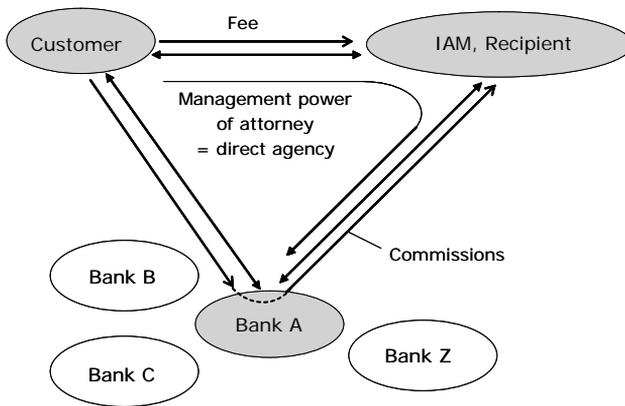


fig. 3

ii. "Private Bribery"

Characteristic for bribery is a three-party constellation in which the recipient of money or other benefits has a fiduciary duty towards the victim.<sup>71</sup> A basis for corruption is the exercise of power in the name of another, and accordingly corruption is an agency problem.<sup>72</sup> It was seen above that such three-party relationships are characteristic for situations in which commission arrangements exist.

The new provision art. 4a UCA,<sup>73</sup> that came into force on 1 July 2006, is in several respects stricter than its predecessor art. 4 lit. b old UCA (former provision). Unlike

<sup>71</sup> "It is essential that there be a three-party relationship in which one of the perpetrators has a general fiduciary duty towards the victim." Green Paper [Botschaft über die Genehmigung und die Umsetzung des Strafrechts-Übereinkommens und des Zusatzprotokolls des Europarates über Korruption (Änderung des Strafgesetzbuches und des Bundesgesetzes gegen den unlauteren Wettbewerb)] of 10 November 2004, BBl 2004, p. 7011 ("Green Paper on Corruption").

<sup>72</sup> MÜLLER, p. 59; BAUDENBACHER, Art. 4 N 41.

<sup>73</sup> Cf. Federal resolution [Bundesbeschluss über die Genehmigung und die Umsetzung des Strafrechtsübereinkommens und des Zusatzprotokolls des Europarates über Korruption] of 7 October 2005 (AS 2006 2371 2374), BBl 2005, p. 5967; 2004, p. 6983.

the former provision, the provision art. 4a para. 1 UCA covers not only active bribery but also passive bribery. Pursuant to art. 4a para. 1 UCA a person acts unfairly who:

- “offers, promises or confers an inappropriate benefit on an employee, associate, agent or other auxiliary of a third party in the private sector in connection with such person’s work or business activity in consideration of a breach of duty or of an act or omission that is in such person’s discretion for the benefit of such person or a third party.” (art. 4a para. 1 lit. a UCA; active private bribery);
- “as an employee, associate, agent or other auxiliary of a third party in the private sector in connection with his work or business activity in consideration of a breach of duty or of an act or omission that is in his discretion for his benefit or for the benefit of a third party asks for, accepts the promise for, or accepts an inappropriate benefit.” (art. 4a para. 1 lit. b UCA; passive private bribery).

In the typical set-up of independent asset management the IAM as agent is both a potential target in the meaning of art. 4a para. 1 lit. a UCA and a potential actor in the meaning of art. 4a para. 1 lit. b UCA, since he has a fiduciary duty towards his customer under the asset management agreement.<sup>74</sup>

An inappropriate benefit<sup>75</sup> is a tangible or intangible benefit to which the recipient is not entitled. In this connection the Federal Council’s Green Paper refers expressly to the agent’s duty under the law of mandate to deliver up pursuant to art. 400 para. 1 CO, and gives as an example of inappropriate benefits any benefits which the agent fails to deliver up under this provision,<sup>76</sup> i.e. in our case Commissions to which the IAM is not entitled. Whether the agent is entitled to a benefit is determined by law, contract and possibly also by trade usage.<sup>77</sup> The Swiss Federal Tribunal has held that in the business of independent asset management no trade usage exists entitling IAMs to retain Commissions.<sup>78</sup> However, the IAM, for example, has a right to keep the Commissions if they were granted to him as compensation for legitimate services which do not generate conflicts of interest or if he has contractually so agreed with his customer.

The provision art. 4a para. 2 UCA now explicitly stipulates that benefits which have been contractually approved by the affected third party concerned are not inappropriate. The Federal Council’s Green Paper defines these as any benefits explicitly or implicitly agreed between the parties (i.e. here the IAM and the customer)<sup>79</sup>, explicit mention in a contractual term not being required.<sup>80</sup> The Federal Council’s Green Paper actually already indicated that a ratification of the benefit and waiver of the right to

<sup>74</sup> Cf. above in B.IV.4.c for further details.

<sup>75</sup> The expression “inappropriate benefit” replaces the wording “reductions to which there is no legal entitlement” used in the former provision, without entailing a material change (Green Paper on Corruption, p. 7011).

<sup>76</sup> Green Paper on Corruption, p. 7011. There, reference is also made to the duty of an employer to hand over to his employer everything which he has received from third parties through his work, with the exception of tips (art. 321b CO).

<sup>77</sup> Green Paper on Corruption, p. 7011; BAUDENBACHER, Art. 4 N 46.

<sup>78</sup> SFT judgment 4C.432/2005 of 22 March 2006 cons. 4.3.

<sup>79</sup> Green Paper on Corruption, p. 7011.

<sup>80</sup> *ibid.*

delivery of Commissions by the customer in advance is admissible, and this was confirmed in the recently reported decision of the Swiss Federal Tribunal with regard to the law on mandate.<sup>81</sup>

In our view, a ratification by global acceptance of general term and conditions should also be possible. Thus, if the IAM stipulates with the customer in the asset management agreement that he is entitled to keep Commissions, the latter are not an inappropriate benefit as provided for in art. 4a para. 2 UCA. Furthermore, with regard to active bribery, Commissions should also not qualify as an inappropriate benefit if the third party (i.e. the customer) knows of, tolerates, and approves the granting of Commissions irrespective of whether the IAM and the customer have separately entered into an agreement regarding the waiver to deliver up the Commissions.

The former provision art. 4 lit. b old UCA required that the benefits also be of such a nature as to have the potential to incite the recipients to violate their duties in the performance of their work or business activities. Under the new provision art. 4a para. 1 UCA, it is sufficient if the inappropriate benefit is conferred (or in the case of passive bribery: accepted) for an act or an omission that constitutes a breach of the recipient's duties or that is in the latter's discretion. This also covers cases where a person under a fiduciary duty exercises its discretion in favour of the bribing party without thereby committing a breach of duty.<sup>82</sup> Consequently, it covers also cases where a person accepts from a selection of several *equal* offers the one where the offering party is prepared to pay a Commission.

The actor must confer (or in the case of passive bribery: accept) an inappropriate benefit *for* a violation of a duty or an act or omission that is in the discretion of the recipient. This is not the case where and to the extent Commissions have been conferred/accepted for legitimate, non-conflicting services, or arguably if the agent has no discretion, e.g. in case of finder's fees, if the customer instructs the agent from the beginning (without the agent's previous advice or recommendation) to deposit the asset with a certain bank.

Art. 4a para. 2 UCA explicitly states that small, socially accepted benefits do not constitute inappropriate benefits. The concept of "small, socially accepted benefits" is the same as in art. 322<sup>octies</sup> of the Swiss Penal Code ("PC").<sup>83</sup> Furthermore, assistance in drawing the line can be found in the laws and guidelines in legislation concerning Commissions in connection with the dispensing of pharmaceutical products.<sup>84</sup> However, given the amounts of Commissions paid in practice these will seldom be justifiable by the argument that they are socially acceptable.

<sup>81</sup> SFT judgment 4C.432/2005 of 22 March 2006 cons. 4.2; cf. B.V.3.b.

<sup>82</sup> Green Paper on Corruption, p. 7011. Under the old law, too, it was considered a breach of duty if the IAM allowed the exercise of his discretion to be influenced by the received benefit, BAUDENBACHER, Art. 4 N 50.

<sup>83</sup> Green Paper on Corruption, p. 7011; cf. for the acceptance of the usual presents by an employee: SFT, in SJ 115 (1993) p. 369.

<sup>84</sup> Cf. below I.

Consequently, if a bank confers Commissions on the IAM and the IAM accepts such Commissions in consideration of a breach of its duty or an act or omission that is in the IAM's discretion (e.g. choice of the bank's own financial products instead of others<sup>85</sup>), the bank might be guilty of active private bribery and the IAM of passive private bribery if the Commissions qualify as an inappropriate benefit and the other prerequisites have been fulfilled.

### *iii. Legal Consequences, Standing to Sue, Damage*

The civil sanction system of the law against unfair competition provides for a number of remedies: orders to desist, orders to set aside and declaratory orders confirming the illegality of the commission arrangement. Of primary interest in connection with Commissions are the reparatory remedies for damages, *tort moral* and delivery up of profits.<sup>86</sup>

In principle standing to sue lies with the market participants, e.g. other banks offering the services in question and who are thus competitors of the bank paying Commissions.<sup>87</sup> However, customers too have standing to sue if their economic interests have been threatened or violated.<sup>88</sup>

The suit is directed against persons who trade unfairly in the meaning of art. 2 to 4 UCA, e.g. the person paying or the person accepting the Commissions.<sup>89</sup>

The damage suffered is not simply equivalent to the sum of the Commissions. Rather, the customer can, for example, claim in damages the difference between the services of the provider that paid the Commissions and the services of a provider which did not pay Commissions and was, therefore, not chosen.

### *iv. Penal Sanctions*

Provided a complaint is brought, both active and passive bribery can lead to the penal sanctions of imprisonment or a fine of up to CHF 100'000 (art. 4a para. 1 in conjunction with art. 23 UCA).<sup>90</sup> The former art. 4 lit. b old UCA did not cover passive bribery, so the new provision art. 4a para. 1 lit. b UCA has filled a gap.<sup>91</sup> A complaint can be filed by any person having standing to file a civil action pursuant to art. 9 et seq. UCA, for instance a competitor bank offering the same services, or a customer whose economic interests have been threatened or infringed.

<sup>85</sup> More problematic is, for example, if a bank grants higher Commissions on its own products than on products that it solely distributes or on other products of third parties.

<sup>86</sup> Art. 9 UCA.

<sup>87</sup> Art. 9 para. 1 UCA.

<sup>88</sup> Art. 10 UCA.

<sup>89</sup> Suits against the principal: art. 11 UCA; art. 55 para. 1 CO. Liability of legal entities: art. 55 para. 2 CC.

<sup>90</sup> Art. 23 UCA.

<sup>91</sup> This resulted *e contrario* from art. 23 in conjunction with art. 2 UCA.

The revised criminal law provision for companies art. 102 para 2 PC<sup>92</sup> lists the crime of bribery as a criminal offence that is relevant under the provision.

In the case of active bribery, the company may, in addition to the actor, be criminally liable if it is established that it did not take all required and reasonable organizational measures to prevent the active bribery.<sup>93</sup> This may be relevant if the bank's offering or payment of Commissions constitutes a violation under art. 4a para. 1 lit. a UCA.

In the case of passive bribery the company could only be criminally liable if no natural person can be held accountable for the bribery because of the inadequate organisation of the company (so called subsidiary criminal liability of a company). This may, for example, be relevant, if the IAM is a company and the acceptance of Commissions constitutes a violation under art. 4a para. 1 lit. b UCA.

Under art. 102 PC a fine of up to CHF 5 million can be imposed on the company.

#### *v. Risk Management Possibilities for Independent Asset Managers and Banks*

Private bribery in the meaning of art. 4a para. 1 UCA presupposes an inappropriate benefit. If the IAM validly agrees with the customer that he is entitled to keep the Commissions the benefit is ratified and thus no longer "inappropriate" (art. 4a para. 2 UCA), and the risk of committing the offence of private bribery can thus be avoided.

## **V. Relationship between the Customer and the Independent Asset Manager**

### **1. Asset Management Agreement**

In the typical independent asset management set-up the IAM concludes an asset management agreement with the customer that qualifies essentially as a mandate in the meaning of art. 394 et seq. CO.<sup>94</sup> Under the Ethical Rules VSV (1999 version) the asset management agreement must be in writing.<sup>95</sup> The IAM undertakes for monetary consideration to carefully and loyally manage the assets entrusted to him according to the terms of the agreement.<sup>96</sup> He has the duty to actively, professionally and continuously manage the customer's assets,<sup>97</sup> to observe secrecy and avoid conflicts of interest.<sup>98</sup>

<sup>92</sup> In force since 1 July 2006.

<sup>93</sup> MARKUS STEUDLER, Corruption: Those who do not take preventive measures will be punished [Korruption: Wer nicht vorbeugt, wird bestraft], NZZ am Sonntag of 30 July 2006, 26.

<sup>94</sup> SFT judgment 4C.432/2005 of 22 March 2006 cons. 4.1; SFT judgment 4C.18/2004 of 3 December 2004 cons. 1.1; SFT judgment 4C.151/2001 of 23 October 2001 cons. 2; SFTD 124 III 155 cons. 2b; 119 II 333 cons. 5a; 115 II 62 cons. 1; CRESPI-HOHL, p. 8; GUTZWILLER, p. 14, GROSS, p. 162.

<sup>95</sup> Ethical Rules VSV (1999 version), art. 10.

<sup>96</sup> Art. 394 para. 1 CO in conjunction with art. 398 para. 2 CO.

<sup>97</sup> WIEGAND/ZELLWEGER-GUTKNECHT, pp. 40 et seq.

<sup>98</sup> GUTZWILLER, p. 14.

The IAM is bound to account for his management activities (art. 400 CO) and has duties to inform, provide statements of account and deliver up.<sup>99</sup> Certain duties to inform derive also from the general statutory fiduciary duty imposed by the law governing mandate.<sup>100</sup>

## 2. Duty to Inform and Account

### a. General Rules under the Law of Mandate

Legal scholars generally recognise that an IAM is in principle obliged to inform his customer of any Commissions received, unless it is otherwise agreed between the parties.<sup>101</sup>

It is less clear whether the IAM is only obliged to do so when requested by the customer (“passive duty to inform”) or whether he must inform him spontaneously.<sup>102</sup>

The duties to inform and account pursuant to art. 400 para. 1 CO are as a rule secondary duties arising from the mandate.<sup>103</sup> The statutory wording provides that the agent has to inform the principal *at the latter’s request* at all times about his conduct of the mandate, thus suggesting a passive duty to inform.

However, some writers submit that under art. 400 para. 1 CO the agent has a duty to spontaneously inform, at least in certain situations such as for instance where information is necessary in the interests of a proper execution of the mandate, in particular with a view to avoiding or mitigating damage.<sup>104</sup> Other writers submit that such a passive duty to inform results from the agent’s general fiduciary duty rather than from art. 400 para. 1 CO.<sup>105</sup> In their opinion, it results from the general fiduciary duty that the agent must spontaneously inform his principal on the suitability of the mandate, the costs and risks and the chances of success and that he must in principle inform his principal about all aspects which might be of relevance for the latter.<sup>106</sup> As far as Commissions are concerned, this entails disclosing the amount of Commissions and their method of calculation, so that the principal can assess the agent’s costing mechanism because the principal must be put in a position to be able to distinguish between costs connected with the asset management and those which arise from the

<sup>99</sup> The title “Duty to Account” is too narrow since art. 400 also provides for an obligation to deliver up (BSK OR I-WEBER, Art. 400 N 1). Cf. the comparable provision in employment law, art. 321b para. 1 CO (STREIFF/VON KAENEL, Art. 321b N 1).

<sup>100</sup> Cf. the employee’s duty of care and to account and deliver up under Swiss labour law, art. 321a, 321b and 339a para. 1 CO; cf. SFT, in SJ 115 (1993), p. 369. Cf. BOHRER-BENZ, pp. 69 et seq.

<sup>101</sup> WIEGAND/ZELLWEGGER-GUTKNECHT, p. 43; cf. HOPT, Legal Problems, p. 157.

<sup>102</sup> BASSI, p. 28; BRETTON-CHEVALLIER, p. 154; WIEGAND/ZELLWEGGER-GUTKNECHT, p. 43.

<sup>103</sup> It is only a primary duty where the gathering of information is the object of the mandate.

<sup>104</sup> GAUTSCHI, Mandate, Art. 400 N 23c; BASSI, p. 28; cf. also BSK OR I-WEBER, Art. 400 N 2, where it is submitted that the agent has a duty to spontaneously and actively inform the principal about his conduct of the mandate.

<sup>105</sup> FELLMANN, Art. 400 N 66; WIEGAND/ZELLWEGGER-GUTKNECHT, p. 43; for the fiduciary duty under labour law cf. STREIFF/VON KAENEL, Art. 321a N 4.

<sup>106</sup> SFTD 115 II 62 cons. 3a; SFT judgment 4C.186/1999 of 18 July 2000 cons. 2a.

effected transactions. Furthermore, such information is necessary to enable the principal to identify conflicts of interest and breaches of duty.<sup>107</sup>

Consequently, and in the absence of an agreement to the contrary, an IAM is in principle obliged under the general rules of mandate law to spontaneously inform the customer about commission arrangements.<sup>108</sup> Such information must be timely, correct and complete.

#### b. The Specified Fiduciary Duties under SESTA

As a rule, IAMs are not securities dealers, so that the rules of conduct stipulated in art. 11 Swiss Federal Act on Stock Exchanges and Securities Trading ("SESTA")<sup>109</sup> do not directly apply to them, and accordingly neither do the Rules of Conduct for Securities Dealers issued by the Swiss Bankers Association ("SBA Rules of Conduct for Securities Dealers")<sup>110</sup>, which specify in more detail the duty to inform, the duty of care and the fiduciary duty prescribed by art. 11 SESTA.<sup>111</sup>

Various writers are of the opinion that even persons who are not securities dealers should be held to the same strict duty of care (art. 11 lit. b SESTA) when providing services in the fields of asset management and investment advice and consequently subject to a duty to inform under the law of mandate. Thus the rules of conduct take on the character of a usage generally prevailing in securities dealing.<sup>112</sup> It seems that the courts confirm the applicability *per analogiam* of these rules of conduct to IAMs.<sup>113</sup> It is therefore logical to apply also art. 11 lit. a and c SESTA and the Rules of Conduct for Securities Dealers issued by the Swiss Bankers Association *per analogiam* in order to determine the concrete nature of duty to inform and the fiduciary duty, and as a result IAMs also have a duty to spontaneously inform<sup>114</sup> the customer about Commission under this provision.

<sup>107</sup> BRETTON-CHEVALLIER, p. 155.

<sup>108</sup> WIEGAND/ZELLWEGER-GUTKNECHT, pp. 43 et seq.; cf. BRETTON-CHEVALLIER, pp. 154 et seq.

<sup>109</sup> Swiss Federal Act on Stock Exchanges and Securities Trading ["Bundesgesetz über die Börsen und den Effektenhandel"] of 24 March 1995, SR 954.1 ("SESTA").

<sup>110</sup> Rules of Conduct for Securities Dealers of the Swiss Bankers Association [Verhaltensregeln für Effektenhändler bei der Durchführung des Effektenhandelsgeschäftes, Richtlinien der Schweizerischen Bankiervereinigung] of 22 January 1997 ("SBA Rules of Conduct for Securities Dealers"), para. 2 of the preamble. These rules of conduct issued by the Swiss Bankers Association are part of the minimum standard of self-regulation recognised by the Swiss Federal Banking Commission (SFBC Circular 04/2, Self-Regulation as a Minimum Standard [Selbstregulierung als Mindeststandard] of 21 April 2004).

<sup>111</sup> ROTH, Commentary SESTA, art. 11 N 30.

<sup>112</sup> KÜNG/HUBER/KUSTER, Commentary SESTA, Art. 11 N 11; NOBEL, 1997, §8 N 112; cf. NOBEL §10 N 72.

<sup>113</sup> SFTD 124 III 155; WEBER, Liability, pp. 254 et seq.

<sup>114</sup> Vgl. ROTH, Commentary SESTA, Art. 11 N 135 with regard to the duty to swiftly and spontaneously account under art. 11 para. 1 lit. b SESTA and art. 7 of the SBA Rules of Conduct for Securities Dealers.

## c. Contractual Waiver

We have seen above that the duty to inform and account is a basis for the principal to exercise his right to delivery up.<sup>115</sup> Mainly writers following an older view submit that, similarly to art. 541 para. 2 CO, such right can not be completely waived;<sup>116</sup> According to them a complete waiver of the principal of his right to demand an account is contrary to *bonos mores* and null and void (art. 20 para. 1 CO)<sup>117</sup>. Consequently, the same would apply to a general waiver in advance by the customer of his right to an account of received Commissions.

The principal is, however, at liberty to refrain from demanding an account on a case to case basis. FELLMANN submits that the agent can be directed not to provide the principal with any further information,<sup>118</sup> and that the customer can thus waive in advance in the asset management agreement the IAM's duty resulting from the general law of mandate to spontaneously inform the customer about Commissions. This does, however, presuppose that the customer is generally aware of the fact that the IAM is receiving Commissions. In the light of the recent judgment of the Swiss Federal Tribunal, the widespread practice of not disclosing Commissions to customers does not appear sufficient to establish a general usage of an advance waiver of the right to spontaneous information. A tacit waiver of such right is only conceivable under special circumstances and presupposes the clear awareness of the customer that the IAM is receiving Commissions.<sup>119</sup> IAMs are therefore recommended to request their customers expressly waive their right to spontaneous information. In our view, the customers, in principle, can validly waive this right in the general terms and conditions of business.

The duties to inform and deliver up are closely related. According to the recent judgment of the Swiss Federal Tribunal a customer can only waive his right to delivery up provided he is sufficiently informed thereof.<sup>120</sup>

This limits *de facto* the possibility of a waiver of the right to spontaneous information. It is unsure to what extent the customer can waive his right to information about commission arrangements *upon demand* in the meaning of art. 400 para. 1 CO. However, at least a waiver of a *detailed* account should be valid.

The same probably applies to the duty to spontaneously inform under art. 11 SESTA which might apply *per analogiam* to IAMs. Even if this duty to inform as such is generally regarded as being mandatory, an advance waiver of the right to be spontaneously informed should be valid provided the customer has been informed of the fact that the IAM will be receiving Commissions. Again, it is questionable to what extent

<sup>115</sup> FELLMANN, Art. 400 N 60.

<sup>116</sup> BSK OR I-WEBER, Art. 400 N 2 and N 21; GAUTSCHI, Mandate, Art. 400 OR N 38; ZR (2002), p. 100.

<sup>117</sup> FELLMANN, Art. 400 N 58.

<sup>118</sup> FELLMANN, Art. 400 N 59.

<sup>119</sup> Cf. SFT judgment 4C.432/2005 of 22 March 2006 cons. 4.3.

<sup>120</sup> Cf. B.V.3.c

the customer can waive his right to information about Commissions *upon demand*. Again, at least a waiver of a *detailed* account should be valid. Furthermore, it is submitted that to the extent a waiver of the right to information *upon demand* would not be considered admissible, the customer should at least be bound to exercise his right *bona fide* within a reasonable deadline.<sup>121</sup>

### 3. Obligation to Deliver up

#### a. General Rules under the Law Applicable to Mandates

Under art. 400 para. 1 OR the agent is obliged to deliver up to the principal all things received for whatever reason in the course of carrying out the mandate. This provision is designed to ensure that the agent neither gains nor loses anything from the mandate apart from his fee. He must deliver up all assets which have an intrinsic connection with the execution of the mandate and may only keep such assets which he receives solely on the occasion of such execution.<sup>122</sup> The obligation to deliver up thus also includes indirect benefits which accrue to the agent from third parties by virtue of his executing the mandate. Such benefits include for instance rebates, commissions and "*pots-du-vin*"<sup>123</sup>. Bulk rebates must be passed on to the principal *pro rata*. It makes no difference whether it is the third party's intention that the benefit accrue exclusively to the agent or not.<sup>124</sup> Therefore, an IAM must in principle deliver up Commissions received in the course of carrying out the mandate to the principal unless the parties have agreed otherwise.<sup>125</sup>

Monetary Commissions can be paid on, Soft Commissions either delivered up *in natura* (for instance passing on financial information for the customer) or compensated by a sum of money.

In the absence of an agreement to the contrary the agent is obliged to deliver up everything acquired which is not necessary for the execution of the mandate immediately,<sup>126</sup> i.e. he has in principal a spontaneous and immediate obligation to deliver up.<sup>127</sup>

<sup>121</sup> Cf. WATTER, Net Basis, p. 192.

<sup>122</sup> SFT judgment 4C.125/2002 of 27 September 2002 cons. 3.1.

<sup>123</sup> SFT judgment 4C.432/2005 of 22 March 2006 cons. 4.1; SFT judgment 4C.125/2002 of 27 September 2002 cons. 3.1. Cf. the duty to deliver up *pots-du-vin* in labour law, STREIFF/VON KAENEL, Art. 321a N4 and N7 and Art. 321b N2; BRÜHWILER, p. 62; STAEHELIN/VISCHER, Art. 321b N3; cf. SFT, in SJ 115 (1993), p. 369.

<sup>124</sup> SFT judgment 4C.432/2005 of 22 March 2006 cons. 4.1; 4C.125/2002 of 27 September 2002 cons. 3.1; SFTD 80 IV 55 et seq.; FELLMANN, Art. 400 N 128 et seq. with references; BSK OR I-WEBER, Art. 400 N 14.

<sup>125</sup> SFT judgment 4C.432/2005 of 22 March 2006 cons. 4.1.

<sup>126</sup> Cf. SFTD 91 II 442, 451 cons. 5; SFT judgment 4C.125/2002 of 27 September 2002 cons. 3.1.

<sup>127</sup> FELLMANN submits that the words "upon demand" in Art. 400 para. 1 CO only apply to the duty to account, and not to the obligation to deliver up (FELLMANN, Art. 400 N 158).

b. The Obligation to Deliver up is not Mandatory Law

Writers have not been in agreement as to whether the obligation to deliver up is mandatory law.

Some authors, particularly in older works, submit that the obligation to deliver up is a result of the altruistic nature of mandate and therefore mandatory law, so that an advance waiver (of a future right) is invalid<sup>128</sup> since it would violate art. 27 para. 2 CC. According to this view a waiver is not valid until the customer knows what and how much he is relinquishing and has the intention of so doing. According to these authors, such waivers *ex post* qualify as termination of the mandate *contrario consensu* in the meaning of art. 115 CO and, therefore, the principal must have full knowledge (i.e. complete and correct information concerning the Commissions) and the will to waive the obligation to deliver up.<sup>129</sup> Other authors submit that the obligation to deliver up is *ius cogens*, but allow an agreement that all Commissions received remain with the agent as part of his *fee*.<sup>130</sup> This is not an advance waiver *stricto sensu*, but here too the principal must have knowledge about the basis for the calculation and the amount of Commissions and the will to allocate the Commissions to the IAM as fee.

In more recent writings authors such as FELLMANN have submitted that the obligation to deliver up under art. 400 para. 1 CO is not *ius cogens* and can, therefore, be waived.<sup>131</sup> The Swiss Federal Tribunal also adheres to this view, but imposes strict conditions on a valid waiver. It has found that art. 400 CO does not expressly prohibit a waiver and that there are no grounds for considering the obligation to deliver up non-waivable; in consequence, even a waiver of future benefits would be valid. However, there are limits resulting from the altruistic nature of mandate, and these cannot be altered by agreement. Such altruistic nature is not affected where the obligation to deliver up is a secondary duty only and keeping Commissions forms an additional part of the agent's fee. Nevertheless, here too the obligation to deliver up remains a central element of the altruistic nature of the mandate and is so closely related to the agent's duty to account that it is in fact the logical consequence thereof. In addition, Commission can lead to conflicts of interest, since, for example, churning generates additional income. The Swiss Federal Tribunal has held along with more recent writers that for this reason it is necessary to require "[...] that the principal is fully and correctly informed of Commissions to be expected, and that his will to waive their delivery up must result clearly from the agreement."<sup>132</sup>

<sup>128</sup> The mere fact that the customer is aware that the IAM receives commissions does not necessarily eliminate the conflict of interest and allow him to detect churning by the IAM and protect himself accordingly (cf. BRETTON-CHEVALLIER, p. 155).

<sup>129</sup> GAUTSCHI, Mandate, Art. 400 N 38d.

<sup>130</sup> HOFSTETTER, p. 119.

<sup>131</sup> FELLMANN, Art. 400 N 154. FELLMANN notes that the contract can lose its "altruistic" element and its characterisation as a mandate. It is, however, questionable whether the rules of mandate then still apply at all. ROTH, Commentary SESTA, Art. 11 N 150. Cf. DE CAPITANI, p. 27; WATTER, Duties, p. 1177 fn. 27; cf. on labour law STAEHELIN/VISCHER, Art. 321b N 8 and STREIFF/VON KAENEL, Art. 321b N 6, pursuant to which the obligations to account and deliver up can be waived.

<sup>132</sup> SFT judgment 4C.432/2005 of 22 March 2006 cons. 4.2 with reference to EMCH/RENZ/ARPA-GAUS, pp. 554 et seq.; DE CAPITANI, p. 27.

c. Contractual Waiver

i. *No General Usage to the Effect that Keeping Commissions is a Usual Form of Remuneration*

According to the practice of the Swiss Federal Tribunal there is no general usage in the business of independent asset management to the effect that the customer waives his right to deliver up and that keeping Commissions is a usual form of remuneration of the IAM.<sup>133</sup> The mere fact that keeping Commissions is widespread does not make such sums “usual remuneration” as a matter of trade or local custom in the meaning of art. 394 para. 3 CO.<sup>134</sup> The Swiss Federal Tribunal has referred in this context to art. 10 in conjunction with art. 7 Appendix B of the Ethical Rules VSV (1999 version), stating that pursuant to these provisions IAMs must disclose all such benefits to the customer<sup>135</sup> and stipulate in the agreement with the customer to whom the Commissions shall accrue. It should be noted that the Ethical Rules VSV (1999 version) only provide that the agreement must contain a clause stipulating “[...] to whom these benefits shall accrue and *whether* they must be disclosed.”<sup>136</sup> In this respect, the reasoning of the Swiss Federal Tribunal is not fully convincing. However, noting that it is court practice that such rules of conduct can be consulted as an aid in the interpretation of agreements inasmuch as they are an expression of trade custom, the Swiss Federal Tribunal concludes that there is no usage pursuant to which the agent need not, in the absence of an agreement to the contrary, deliver up Commissions received as a result of asset management. Consequently, an agreement is necessary which reflects the informed intention of the customer to completely or partially waive his right to receive such Commissions.<sup>137</sup>

ii. *Tacit Waiver*

Only with reticence can tacit waiver of the right to delivery up of Commissions be inferred from the fact that the customer has not intervened and demanded payment. The Swiss Federal Tribunal has held that the customer must be fully and correctly informed of what Commissions are to be expected, and that his intention to waive such Commission must result clearly from the agreement.<sup>138</sup> The mere fact that the customer might be able to estimate the sums at stake solely based on the approximate

<sup>133</sup> SFT judgment 4C.432/2005 of 22 March 2006 cons. 4.2.

<sup>134</sup> SFT judgment 4C.432/2005 of 22 March 2006 cons. 4.2, citing SFTD 120 V 515 cons. 4b/bb.

<sup>135</sup> SFT judgment 4C.432/2005 of 22 March 2006 cons. 4.3.

<sup>136</sup> Art. 10 Ethical Rules VSV (1999 version). The Swiss Federal Tribunal has followed the interpretation of this rule suggested by EMCH/RENZ/ARPAGAUS p. 554, which extends beyond the wording of this provision. Cf. however the text version in French of art. 10 no. 56 Ethical Rules VSV (1999 version) that slightly differs from the text in German: “[...] le contrat de gestion écrit doit contenir des dispositions relatives au bénéficiaire de ces prestations et des dispositions relatives aux obligations de reddition de compte sur ces prestations [...]”.

<sup>137</sup> SFT judgment 4C.432/2005 of 22 March 2006 cons. 4.3. Since the Swiss Federal Tribunal refers to the ethical rules it might be interesting to look at their development and analyse whether a general usage to the effect that keeping Commissions is a usual form of remuneration existed in former times, cf. B.V.4.

<sup>138</sup> SFT judgment 4C.432/2005 of 22 March 2006 cons. 4.2 with reference to various writers.

amount of the assets under management, the common practice of such revenues and the amount of the specifically agreed asset management fee does not constitute sufficient knowledge of the accrued Commissions to infer a tacit waiver. The Swiss Federal Tribunal reasoned that the amount of Commissions depends on additional factors such as the number of transactions and the agreement on the scale of such Commissions. It has held it necessary that the IAM ensures that the customer is aware (i) of the specific agreement with the bank regarding the amount of Commissions and (ii) of the probable incidence of transactions on which such commissions will be paid to the IAM as additional compensation for his managing the assets.<sup>139</sup>

For the assumption of a tacit waiver of Commissions by the customer it is therefore insufficient that the latter is aware of how these are calculated (e.g. 35% of transaction fees for a given type X and 20% for a given type Y). It is, however, sufficient if the amount of the Commissions can be determined by multiplying the calculation basis by the *prospective* number of transactions. The customer thus acquires knowledge constituting a sufficient basis for a waiver once he is aware of the factors allowing him to calculate the approximate sum of Commissions which the IAM will receive, and the total amount need not to be stated in advance in dollar and cents. As a result, in our view, an indication that the Commissions will amount to (or up to) around 2% of the assets under management should suffice, since in such cases the customer can calculate the amount in question with considerable accuracy. Taking assets under management as a criterion prevents the sort of manipulation by the IAM which is possible if the Commissions are calculated as a percentage of total transaction fees. Also, the customer is always in a position to recognise changes in the amount of assets under management and the impact of such changes on the management effort of the IAM may even correlate in the long run.

It is submitted that it would therefore also be sufficient if the IAM defines the Commissions as a *maximum* percentage of the assets under management or in another comprehensible formula. This is corroborated by the fact that the disclosure of maximum amounts in percentages were originally provided for in the SFA Guidelines on Transparency with regard to Management Fees recognised by the Swiss Federal Banking Commission as a minimum standard in the area of investment funds. This requirement has since even been slackened further.<sup>140</sup>

### *iii. Express Waiver*

It is recommended that an IAM should only keep Commissions provided he has concluded an express waiver agreement with the customer, and not rely on (what might not in fact be) a tacit agreement.

<sup>139</sup> SFT judgment 4C.432/2005 of 22 March 2006 cons. 4.5.

<sup>140</sup> The transparency guideline did not even go that far, in that commissions are only one of various possible components of distribution costs which needed not be further specified provided the maximum amount of the total distribution costs is indicated, cf. D.II.3.

Whether the stringent requirements regarding the customer's knowledge for a tacit waiver as determined in the recent decision of the Swiss Federal Tribunal equally apply to the express waiver is unclear.

It is submitted that it is justified to adopt a less stringent approach with regard to the extent of the knowledge which the customer must have in the event of an express waiver than for a tacit one. For in the former case the customer is clearly confronted with the question of Commissions from the onset and has the possibility of seeking further information from the IAM prior to waiving or refusing to waive his right altogether.

Commissions may give the IAM negative incentives (the Swiss Federal Tribunal mentioned in its decision churning as a potential result of the negative incentives<sup>141</sup>). However, a supervision of the activity of the asset manager may substantially reduce the risk of abuse (e.g. examination of the bank statements, including the positions regarding costs and fees, on a regular basis).

It should, actually, be sufficient for an express waiver if the IAM informs the client that he receives Commissions and expressly offers to the customer to inform him about the composition and the prospective amount of the Commissions upon request. If the customer does not take this expressly offered opportunity to receive information, he acts inconsistently if he subsequently claims that he did not have sufficient knowledge of the Commissions to validly waive them.

Until there is more court practice IAMs are, however, recommended to inform customers of all factors necessary for determining the approximate amount of Commissions which they expect to receive and intend to retain. It is submitted that in the event of an explicit waiver it is sufficient that the customer is, for example, informed of the *maximum* Commissions expressed as a percentage of the managed assets or in another comprehensible formula. Furthermore, it should not be necessary to specify the manner of calculation, e.g. whether the Commissions are calculated according to the transactions effected or according to the volume of assets under management, or to specify the Commissions regarding the various types of investment products. However, the customer should also be informed that Commissions may lead to certain conflicts of interest.<sup>142</sup> Ideally, some of the negative incentives deriving from the conflict of interest could be mentioned as examples.

#### *iv. Waiver in the General Terms and Conditions*

The Swiss Federal Tribunal did not have to decide in its recent decision whether a customer can waive the right to demand delivery up of Commissions in the general terms and conditions of the IAM. In our view, such a waiver in the general terms and conditions would be valid. The Swiss Federal Tribunal indicated in its decision that the customer's intention to waive the delivery up of Commissions must *clearly* result from

<sup>141</sup> SFT judgment 4C.432/2005 of 22 March 2006 cons. 4.2.

<sup>142</sup> This in view of art. 11 SESTA and art. 8 para. 2 of the Rules of Conduct Swiss Bankers Association, which require that conflicts of interest be disclosed.

the agreement. This, however, does not necessarily imply that the clause of the waiver and allocation of the Commissions to the IAM must be dealt with in a prominent position and graphically highlighted in the general terms and conditions or even be explained to the customer in order that it become part of the contractual agreement, as it is, depending on the circumstances, for example required for the choice of jurisdiction in the general terms and conditions.<sup>143</sup> Nevertheless, until there is specific court practice on this point, the IAM is advised to take such measures so as to ensure that the customer's will in this respect will be considered as clearly reflected in the agreement. For reasons of practicability the information necessary for, or requested by, the customer to assess the approximate amount at stake can also be provided in a separate document, so that in the event of changes the general terms and conditions need not be changed as well.

#### 4. Ethical Rules

Convention IV of the Swiss Bankers Association and the rules of conduct of the Association of Swiss Asset Managers reflect a notable development of the practical approach to the obligations to inform about and to deliver up Commissions:

Pursuant to Convention IV of the Swiss Bankers Association concerning uniform fee structure for open securities custody accounts, which is no longer in force, a bank was only allowed to pay Commissions to fiduciaries and asset managers provided these had undertaken in writing not to pass on such Commissions in any form to their customers.<sup>144</sup>

The Ethical Code of the Association of Swiss Asset Managers (1989 version), which is also no longer in force, implied that Commissions would be kept by IAMs. The commentary to the code noted that if an IAM receives Commissions on transactions he may not undertake any unnecessary restructuring of the portfolio contrary to its customers' interests in order to increase the amount of Commissions.<sup>145</sup> This only makes sense if it is presumed that Commissions are not passed on to customers.

The Ethical Rules VSV (1999 version), today in force, provide that the IAM's remuneration must be regulated in a written asset management agreement. If the IAM re-

<sup>143</sup> SFTD 118 Ia 297; 109 Ia 57; 104 Ia 278 et seq. – Under the so called "Ungewöhnlichkeitsregel" an unusual provision in the general terms and conditions may not become part of the agreement, if the party to the agreement globally accepts the general terms and conditions and did not and reasonably had not to expect such a provision at the time. However, a party may not invoke the Ungewöhnlichkeitsregel e.g. if the party points out the graphically highlighted provision to the other party (Pra. 87, 1998, No. 9, 55).

<sup>144</sup> Art. 10 Convention IV: "Repayments can be made to fiduciaries and investment managers [...] provided that they a) conduct all stock exchange transactions in connection with the portfolio with the bank in question and b) undertake to the bank in writing not to pass on the commissions to the customer in any form whatsoever."

<sup>145</sup> Art. 3 of the 1989 version of the Ethical Code and Commentary of 4 March 1996 sec. 3.02: "S'il perçoit des commissions ou rétrocessions de commissions sur les opérations qu'il effectue, il s'abstiendra d'effectuer sur les comptes gérés tout mouvement intempestif dans le but d'augmenter ces commissions ou rétrocessions de manière contraire aux intérêts de ses clients."

ceives Commissions, rebates etc. the agreement must stipulate what information is necessary and to whom such benefits shall accrue.<sup>146</sup> Given that it is unclear to what extent it is admissible to waive the passive duty to inform (i.e. upon demand) under the law of mandate, it is questionable whether the rule providing that the agreement must specify *whether* such benefits must be disclosed complies in all instances with the law of mandate.<sup>147</sup> If the wording of the rules is taken at face value, it would appear possible to agree in a management agreement in advance that no benefits need be disclosed, not even at the customer's request.<sup>148</sup>

Thus, while Commissions were formerly kept secret under the Ethical Rules and were supposed not to be passed on to the customer,<sup>149</sup> the current trend is towards transparency and the conclusion of a clear agreement regarding the allocation of Commissions.<sup>150</sup> This development has continued since the implementation of the 1999 version of the Rules, and with it the awareness of the parties concerned of the problems caused by Commissions has increased.

It is not to be expected that IAMS will be subjected to a regulatory authority in Switzerland in the foreseeable future.<sup>151</sup> However, it cannot be excluded that there will be increased pressure to regulate the question of Commissions in the ethical rules, or even in special legislation, as has already been the case in other areas.<sup>152</sup> What is to

<sup>146</sup> Ethical Rules VSV (1999 version), implementing provision sec. 48 (cf. also appendix B no. 7): "If a member receives repayments, commissions, credits and other benefits from third parties in connection with the management of customer assets, the written management agreement must specify to whom such benefits accrue and whether they must be disclosed."

<sup>147</sup> Cf. however the slightly differing text in the French version of the provision.

<sup>148</sup> Cf. however B.V. 2.c.

<sup>149</sup> Following the reasoning of the Swiss Federal Tribunal in its recent judgment 4C.432/2005 of 22 March 2006 cons. 4.3, that ethical rules may be consulted as an aid in the interpretation of agreements inasmuch as they are an expression of trade custom, one might even conclude that there used to be a general usage to the effect that keeping Commissions was a usual form of remuneration.

<sup>150</sup> Cf. SFT judgment 4C.432/2005 of 22 March 2006 cons. 4.2 where the Swiss Federal Tribunal held that such general usage does not exist in the business of independent asset management by referring to the Ethical Rules VSV (1999 version).

<sup>151</sup> The Federal Council has made it known that for the time being it does not envisage introducing supervision of IAMS for collective foreign assets (ERMES GALLAROTTI, No plans for future supervision of asset managers [Auch künftig keine Aufsicht über Vermögensverwalter], NZZ of 21 October 2005, no. 246, p. 25). An Expert Commission chaired by Ulrich Zimmerli had left the question of the desirability of such supervision open (ERMES GALLAROTTI, No decision on the supervision of asset managers [Kein Entscheid zur Aufsicht über die Vermögensverwalter], NZZ of 23 February 2005, no. 45, p. 25). Cf. the possibility for asset managers of foreign funds to voluntarily opt for a supervision in art. 13 para. 4 KAG.

<sup>152</sup> Cf. for instance in legislation on pharmaceuticals (below sub I) or asset management for pension funds (below sub H) or the supervisory efforts of the Financial Services Authority (FSA): FSA, Consultation Paper 05/5, Bundled brokerage and soft commission arrangements: proposed rules, March 2005, [http://www.fsa.gov.uk/pages/Library/Policy/CP/2005/05\\_05.shtml](http://www.fsa.gov.uk/pages/Library/Policy/CP/2005/05_05.shtml) (last visited: 22. Juni 2006); cf. Financial Services Writerity, Policy Statement, Bundled brokerage and soft commission arrangements, Feedback on CP05/5 and final rules, July 2005 [http://www.fsa.gov.uk/pages/Library/Policy/CP/2005/05\\_05.shtml](http://www.fsa.gov.uk/pages/Library/Policy/CP/2005/05_05.shtml) (last visited 22 June 2006); cf. in Germany the Guideline pursuant to § 35 IV Securities Transactions Act to implement §§ 31 and 32 of the Act with respect to commission transactions, self-trading for third parties and commission transactions of brokers [Richtlinie nach Paragraph 35 IV WpHG zur Konkretisierung der §§ 31 und 32 WpHG für das Kommissionsgeschäft, den Eigenhandel für andere und das Vermittlungsgeschäft der Wertpapierdienstleistungsunternehmen] (Bundes-

be expected is that the practice of the Swiss Federal Tribunal with regard to the obligation to deliver up under the law of mandate<sup>153</sup> will have considerable repercussions.

## 5. Unclear Cases and Risk Management Possibilities

### a. Finder's Fees

It is true that the choice of bank and the opening of an account are services provided by IAMs which merit remuneration. However, direct remuneration from the customer is more appropriate than (additional) remuneration from the bank, since the latter can lead to conflicts of interest.

Writers disagree as to whether one-off finder's fees<sup>154</sup> for the introduction of new customers are subject to the obligation to deliver up under the law of mandate. This obligation covers only what the agent has received in the course of executing the mandate, and not benefits received from third parties because of the mandate but lacking an intrinsic connection with it.<sup>155</sup> Several writers submit that the introduction of customers is not intrinsically connected with the execution of transactions on behalf of these.<sup>156</sup> They submit that the activity generating finder's fees is not asset management but customer acquisition for the bank and thus finder's fees do not have to be delivered up under the law of mandate.

However, FELLMANN submits that there *is* an intrinsic connection between the introduction and the mandate in cases where there is a risk that the benefit might induce the IAM to fail to adequately attend to his customer's interests (i.e. where a conflict of interests exists),<sup>157</sup> for instance because an IAM chooses Bank A rather than Bank B because the latter pays more Commissions, although Bank B offers comparable or better conditions for the customer. However, once the IAM has chosen the bank, the risk of conflicts of interest tends to abate. Some IAMs decide to work exclusively with one bank for the duration, and in such cases it might be doubtful whether there is a causal link between the receipt of the finder's fee and the choice of the bank.

The Swiss Federal Tribunal has held that finder's fees, like other Commissions, are in principle subject to obligations to inform and deliver up under the law of mandate pursuant to art. 400 para. 1 CO in cases where the agent advised the principal to deposit the managed assets with a certain bank.<sup>158</sup> Accordingly, finder's fees would not have to be delivered up if the customer instructs the IAM (without being so advised by the

anzeiger no. 165 of 4 September 2001, p. 19217; the guideline replaces that of 9 May 2000), Part B no. 1.2.

<sup>153</sup> SFT judgment 4C.432/2005 of 22 March 2006.

<sup>154</sup> EMCH/RENZ/ARPAGAUS, p. 554.

<sup>155</sup> FELLMANN, art. 400 N 127.

<sup>156</sup> DE CAPITANI, p. 29; WIEGAND/ZELLWEGER-GUTKNECHT, p. 45; BRETTON-CHEVALLIER, p. 168.

<sup>157</sup> FELLMANN, Art. 400 N 128.

<sup>158</sup> SFT judgment 4C.432/2005 of 22 March 2006 cons. 4.1. Contra DE CAPITANI, p. 29; BRETTON-CHEVALLIER, p. 159 and pp. 167 et seq.; cf. WIEGAND/ZELLWEGER-GUTKNECHT, p. 45.

latter) to use a particular bank and the IAM nevertheless receives a finder's fee.<sup>159</sup> However, strictly speaking this is not a finder's fee. The question as to whether it is to be deemed another benefit arising from the execution of the mandate subjected to the obligation to deliver up would require further examination. The risk of conflict of interests would, however, be reduced in this case.

The choice of bank can indeed be considered as part of the asset management activities, similarly to the asset manager's obligation to advise the customer on the investment guidelines. Furthermore, the fact that finder's fees may lead to conflicts of interests indicates the existence of an intrinsic connection. Consequently, it is justifiable to consider finder's fees as a rule subjected to the obligation to deliver up.

Even if (contrary to the practice of the Swiss Federal Tribunal) finder's fees did not have to be delivered up, the IAM would still be obliged to inform the customer of the existence and mode of calculation of a finder's fee and the advantages and disadvantages of that particular bank. This obligation results from his general fiduciary duty and from the potential conflicts of interests involved.<sup>160</sup>

#### b. Remuneration for Legitimate Services which do not Generate Conflict Situations

No problems arise as long as payments are made or benefits conferred in consideration of legitimate services which do not lead to conflicts of interest, such as for tasks normally assumed by the bank and which are not primarily in the interest of the customer, e.g. remuneration paid for identification of the customer under anti-money laundering legislation.

In practice it is, however, difficult to determine whether and to what extent Commissions have been granted for such legitimate services or for other motives.

#### c. Lump Sum Remuneration

Commissions in the form of lump sum remuneration do not as a matter of law dispense the agent from his obligation to deliver up under the law of mandate. Practically, however, it is difficult for the customer to make a claim since an allocation to an individual mandate will often be difficult.

#### d. Further possibilities for Dealing with Commissions

There are a number of possibilities for an IAM to deal with the Commissions received, and these entail various degrees of risk:

- a) There is no problem if the IAM accounts to the customer for the Commissions received and passes them on entirely, thus discharging his duties under the man-

<sup>159</sup> Cf. judgment 4 U 156/03 of the *Hanseatisches Oberlandesgericht*, rendered on 23 June 2004, p. 10, regarding the causal lien.

<sup>160</sup> BRETTON-CHEVALLIER, p. 167.

date. Administratively the easiest way is for the bank to credit the customer directly with the Commissions as a form of rebate.<sup>161</sup> Here the IAM receives no Commissions at all.

- b) There is also no problem if the Commissions are allocated to the IAM, who then renders an account of them vis-à-vis the customer and treats them as a partial fee payment from the customer, i.e. as a form of set-off. Economically the result is the same as in a) above.
- c) An IAM can agree with the customer that Commissions form part of his fees:
  - (a) There is no problem if the IAM completely discloses all Commissions and the customer waives these retrospectively.
  - (b) On the other hand, agreements allocating Commissions to the IAM from the onset, without these having to be disclosed in any form to the customer or without at least having offered to the client the opportunity to receive such information, are likely to be invalid since the customer has no idea of what he is waiving in advance and has not been offered any such information.
  - (c) As explained above, it might suffice as a waiver if the IAM offers to inform the customer about the Commissions upon request prior to the waiver, even if the customer does not make use of such opportunity. However, until there is more court practice IAM's should take a more cautious approach.
  - (d) Advance waivers are less of a problem if the IAM at least informs the customer of the basis of calculation and the prospective amounts of Commissions expected. In our view it is, for example, sufficient to indicate maximum amounts in percentages of a determined or determinable amount.
  - (e) There are even less problems if the customer has the choice between a) paying a higher fee to the IAM who passes on Commissions received, or b) paying a lower fee to the IAM and allowing the latter to keep the Commissions. This option makes it clear to the customer that Commissions are paid, and might in some instances even give him an idea of the dimensions involved.<sup>162</sup>

## 6. Advice to Customers

Customers wishing to obtain information regarding the remuneration and possible conflicts of interest of their IAMs are advised to avail themselves of their right to information under the law of mandate. Particularly in cases where an IAM does not ad-

<sup>161</sup> EMCH/RENZ/ARPAGAUS, p. 554.

<sup>162</sup> Cf. also the remuneration models mention in FSA Policy Statement 04/27: a) "Paying by fee": The customer pays a fee, and all commissions are either set-off against the fee or passed on to the customer; b) "Paying by commission" (or product charges): The customer pays no fee up front, but lets the IAM keep the commissions, the amount of which shall be disclosed to the customer prior to an investment, albeit only at the customer's prior request; c) "Paying by a combination of commission and fee": The customer pays a fee in addition to the commissions kept by the IAM (FSA, Reforming Polarisation: Implementation, Feedback on CP04/3 [A menu for being open with consumers and made text], Policy Statement 04/27, November 2004, Appendix 1 pp. 45 et seq., p. 53).

here to the agreed investment guidelines or indulge in churning such requests for information will prove enlightening and place certain pressure on the IAM.<sup>163</sup> Information can be requested retroactively within the statute of limitation of 10 years (pursuant to art. 127 CO) which runs from the point when the mandate is carried out or terminated.<sup>164</sup>

The customer must exercise his right to demand that the IAM account for the Commissions in good faith. It must be reasonable for the IAM to render account.<sup>165</sup> The customer might, for example, not act in good faith if he has not asked the IAM to render account for years and does not indicate that he expects this later.<sup>166</sup>

## 7. Penal Law Aspects

### a. Misappropriation

The objective elements of the offence of misappropriation pursuant to art. 138 no. 1 para. 2 PC are fulfilled when "someone uses assets entrusted to him illicitly for himself or another".<sup>167</sup> "Entrusted assets" may include those received from third parties.

To the extent that an IAM is obliged to deliver up Commissions under the law of mandate, the question is whether these are entrusted to him, particularly since that the bank might not necessarily have paid them to him with this intention. For the payer of Commissions it might be irrelevant whether the IAM keeps them or delivers them up to his customer, or he even intended that they are kept by the IAM.

The courts have for instance ruled in the following cases that Commissions had not been "entrusted" to the recipient and had therefore not been misappropriated: Commissions kept by a liquidator in breach of his duties,<sup>168</sup> Commissions in the form of investment fund certificates received by a manager of an investment fund,<sup>169</sup> down payments on heating costs made to the landlord,<sup>170</sup> or Commissions from suppliers which were not passed on by the manager of a restaurant to the owner provided that the parties had no agreement on this but such agreement is customary.<sup>171</sup>

<sup>163</sup> Cf. the motions in SFT judgment 4C.432/2005 of 22 March 2006 sub A.

<sup>164</sup> MEINRAD BALLMER/MARCO ZANCHI, The Swiss Federal Tribunal puts a stop to illicit practices [Das Bundesgericht schiebt illegalen Praktiken einen Riegel vor], *SonntagsZeitung* of 2 July 2006, p. 61. If the IAM is a "legal agent" in the meaning of art. 128 no. 3 CO the statute of limitation is five years.

<sup>165</sup> FELLMANN, Art. 400 N 78 et seq.

<sup>166</sup> FELLMANN, Art. 400 N 83; BSK OR I-WEBER, Art. 400 N 8.

<sup>167</sup> Professional asset managers fall under the qualified offence pursuant to art. 138 no. 2 PC (BSK StGB II-NIGGLI/RIEDO, Art. 138 N 166 et seq.).

<sup>168</sup> SFTD 80 IV 55.

<sup>169</sup> SFTD 103 IV 227.

<sup>170</sup> SFTD 109 IV 24.

<sup>171</sup> OGer. ZH, 16.12.1947, ZR 47 (1948) no. 106. However, in another case commissions received from suppliers by a hotel manager which he did not pass on to his employers contrary to agreements or the trade custom obliging him to do so were qualified as "entrusted assets" (SFTD 106 IV 257, 259 et seq.).

In view of these cases it is therefore doubtful whether (wrongly) failing to pass on Commissions fulfils the offence of misappropriation in the meaning of art. 138 no. 1 PC.<sup>172</sup>

#### b. Disloyal Management

Where conduct fulfils both the offences of disloyal management (art. 158 PC) and of misappropriation (art. 138 PC), the culprit is punished for the latter offence.<sup>173</sup> Since we have seen above that it is subject to doubt whether (wrongly) failing to pass on Commissions fulfils the offence of misappropriation in the meaning of art. 138 no. 1 PC, it remains to be examined whether such conduct qualifies as disloyal management in the meaning of art. 158 no. 1 PC, the basis for the agency being the asset management agreement.

There have been cases qualifying bribes taken by an organ of a housing cooperative<sup>174</sup> and Commissions on the sale of a building accepted by an investment fund manager<sup>175</sup> as disloyal management in the meaning of art. 158 PC. These cases certainly display similarities with the case where IAMs have kept back commissions, a conduct which therefore might in certain circumstances also be qualified as disloyal management.<sup>176</sup>

## VI. The Relationship between the Bank and the Customer

### 1. The various Functions and the Qualification of the Contractual Relationship

Typically, the IAM will assume the function of asset manager, while the bank confines itself to custodial services and the technical execution of orders. The bank's tasks and duties towards the customer, including its duties to inform, are therefore essentially confined to administrative acts of a purely technical nature, for instance for:<sup>177</sup>

- the proper technical management of the deposited assets, including the collection of interest, dividends and repayments on deposited securities and attending to the technical aspects of the exercise of subscription options or their sale;<sup>178</sup>
- the careful and prompt execution of orders to buy and sell securities;
- correct accounting, including providing proper account and depot statements;
- the careful custody and handing back of deposited assets.

<sup>172</sup> DE CAPITANI, p. 34 fn. 44 submits that this already constitutes a misappropriation.

<sup>173</sup> BSK StGB II-NIGGLI/RIEDO, Art. 138 N 195; BSK StGB II-NIGGLI, Art. 158 N 155.

<sup>174</sup> StrafGer BS, 17.3.1953, SJZ 50 (1954) 227, no. 122.

<sup>175</sup> SFTD 103 IV 227.

<sup>176</sup> Regarding the penal law aspects under the Unfair Competition Act, cf. B.IV.4.c.iv.

<sup>177</sup> GENONI, p. 26; WIEGAND/ZELLWEGGER-GUTKNECHT, p. 47.

<sup>178</sup> GENONI, p. 26.

However, the custodian bank is not in principle obliged to ensure that the deposited assets retain their economic substance.<sup>179</sup>

As a rule the customer pays the bank custody fees and commissions for the execution of securities transactions.

The contractual relationship between the bank and the customer has various elements: the agreement concerning the custody and technical management of securities is a mixed contract with elements of bailment (art. 472 et seq. CO) and mandate (art. 394 et seq. CO). Agreements to buy or sell securities involve a purchase and sale agreement with the third party, combined with a commission agreement pursuant to art. 425 para. 1 CO or a mandate or, if the bank acts on its own account, a purchase and sale agreement (art. 436 para. 3 OR) or a mixed agreement to which rules taken from the law governing the contracts of commission and purchase and sale apply.<sup>180</sup> Making payments from a bank account is a contractual agreement to which essentially the law of mandate applies (art. 394 et seq. CO). To summarize, ultimately mainly the provisions of the law of mandate apply to the contractual relationship.

## 2. Duty to Inform about Commissions

### a. Preliminary Remarks

Writers are not in agreement as to what extent a bank is obliged to inform customers of the existence and contents of a commission arrangement. Some writers submit that there is no duty to do so, since the arrangement is *res inter alios* (cf. b). Other writers submit that there is a duty to inform, suggesting as the legal basis the bank's general duty of care and its fiduciary duty (cf. c), pre-contractual duties (cf. d), the rules applicable to commission agreements (cf. f) and art. 11 SESTA and art. 7 and 8 SBA Rules of Conduct for Securities Dealers. It is the latter provisions which probably provide the soundest basis for a duty to spontaneously inform about commissions arrangements.

### b. Commission Agreement as *res inter alios*

Reputable authors are of the opinion that the information obligations arising from a cash and custody account relationship are confined to the elements of the transactions to be performed, for example the proper technical management of the deposited assets and the carrying out of orders to buy and sell securities, and that there are no information obligations regarding extraneous matters or third party relationships. DE CAPITANI submits that commission agreements between banks and IAMs are an extraneous matter and thus *res inter alios*, and concludes that the bank has no obligation under the account and custody account relationship to inform the customer about commission arrangements.<sup>181</sup>

<sup>179</sup> Among many cf. DIETZI, pp. 197 et seq.; GENONI, p. 26.

<sup>180</sup> WATTER, Net Basis, pp. 183 et seq.

<sup>181</sup> DE CAPITANI, p. 32.

### c. General Duty of Care and Fiduciary Duty of the Bank

Were the theory of the general bank contract [*Allgemeiner Bankvertrag*], which is prevalent in Germany, to apply in Switzerland, banks would be obliged to inform about the commission arrangements. According to this theory the initiation of a lengthy relationship with a bank generally establishes a qualified fiduciary relationship between the bank and the customer, which is not split up into individual contracts.<sup>182</sup> Applied to Swiss law this would mean that due to the enduring relationship with the customer the bank would have a general duty of care and fiduciary duty under art. 398 para. 2 CO in all business conducted for the customer, irrespective of the nature of the individual transactions, and would therefore be obliged in general to take the customer's interests comprehensively into account, advise him accordingly and inform him of all important matters which might be of relevance, including the existence of commission agreements with his IAM.

Since the concept of the "general bank contract" has been rejected by courts and in legal writings in Switzerland,<sup>183</sup> there is no such general obligation to inform under Swiss law.

It should be pointed out that the relationship between the bank and the customer might form the basis for jurisdiction in consumer matters in the meaning of art. 13 Lugano Convention, with the result that a customer domiciled in a country abroad which has ratified the Lugano Convention might be able to bring an action against a bank with seat in Switzerland at his domicile.<sup>184</sup> This might also entail that a foreign law is applicable to the contract.<sup>185</sup>

### d. Pre-contractual Obligation to Inform

Does a custodian bank have a pre-contractual obligation to inform a customer of the commission arrangement agreed with his IAM? If so, it would be liable for breaches of such obligation if the prerequisites of damage (i.e. adequate causal lien between the failure to inform and the damage suffered, and fault) are all fulfilled.

The German Supreme Court has held that a custodian bank does have a pre-contractual obligation to draw customers' notice to commission agreements.<sup>186</sup> For by offer-

<sup>182</sup> HOPT, pp. 393 et seq.; cf. ROTH, FS Kleiner, pp. 15 et seq., DE CAPITANI, p. 32.

<sup>183</sup> ROTH, FS Kleiner, pp. 15 et seq.; ROTH, Commentary SESTA, Art. 11 N 11 and N 63. Only a few writers, for example DE BEER, submit that these principles should also apply under Swiss law (DE BEER, p. 126; cf. HOPT, Legal Problems, p. 142).

<sup>184</sup> Judgment 4 U 156/03 of the *Hanseatisches Oberlandesgericht*, rendered on 23 June 2004; see: For the first time a German Court takes jurisdiction over investor suits against Swiss banks [Erstmals bejaht ein Oberlandesgericht (OLG) deutschen Gerichtsstand für Anlegerklagen gegen Schweizer Banken], in: recht-in.de, [http://www.recht-in.de/urteile/urteilzeigen.php?u\\_id=113886](http://www.recht-in.de/urteile/urteilzeigen.php?u_id=113886) (last visited 11 July 2006).

<sup>185</sup> If the private international law of the court seized limits the choice of law and refers to rules of a foreign law, these will apply even if the parties have subjected their agreement to Swiss law. This can lead to unpredictable risks in connection with Commissions.

<sup>186</sup> German Supreme Court [BGH], judgment of 19 December 2000 (XI ZR 349/99, Cologne, WM 6/2001), p. 298.

ing Commissions the custodian bank gives the IAM an incentive to act in his own interest rather than that of the customer when choosing the bank and contemplating the quantity and scope of transactions to be effected. Consequently, the bank has a duty to inform the customer of this risk to the interests of the customer who has been introduced to it by the IAM prior to the conclusion of the contract.

Under the Swiss law governing custody agreements the bank does not have a general and comprehensive duty of care and fiduciary duty resulting in a general duty to advise and to disclose commission arrangements (cf. above c). There is even less reason to assume that pre-contractual duties to this effect exist. Besides, the fact that a commission arrangement is in place will seldom constitute a fact of such relevance as to influence the customer's decision to conclude an agreement with the IAM, even though it might not be excluded that it could influence the customer's approach to the terms of such agreement. Finally, it should be noted that it is above all the duty of the IAM, and not the bank, to inform the customer of a commission arrangement<sup>187</sup>. For these reasons a bank does not have a pre-contractual duty to disclose commission arrangements with an IAM to the customer.

#### e. Commission Contract

WIEGAND/ZELLWEGER-GUTKNECHT submit that the bank has a duty to inform about commission arrangements in connection with securities transactions which results directly from the rules governing the contractual type known as the commission contract:<sup>188</sup> They are of the opinion that the Commissions are not remuneration for an effected transaction, but expenditure in the meaning of art. 431 para. 1 CO that a bank pays as commissioner when effecting a securities transaction. Expenditure must be reimbursed by the customer,<sup>189</sup> but the commissioner must render a detailed account. Therefore, if a bank charges the customer the entire commissions as such pursuant to art. 432 CO, although a part of them accrue to the IAM, it breaches its duty to inform pursuant to art. 426 para. 1 CO. A general reference to the possibility of paying Commissions in a banking form would not satisfy the legal requirements of art. 426 para. 1 CO. Therefore, these authors come to the conclusion that the Commissions must be disclosed specifically.<sup>190</sup>

It is, however, doubtful whether Commissions can be considered as expenditure in the meaning of art. 431 para. 1 CO, for as a rule they are not made in the interests of the client, but would rather be unnecessary costs or general costs which can not be charged to the customer as expenditure.<sup>191</sup> Thus, for instance, remuneration paid to the IAM for the delegated task of identifying the customer pursuant to anti-money

<sup>187</sup> DE CAPITANI, p. 33.

<sup>188</sup> WIEGAND/ZELLWEGER-GUTKNECHT, p. 46.

<sup>189</sup> Art. 431 para. 1 CO.

<sup>190</sup> WIEGAND/ZELLWEGER-GUTKNECHT, p. 46.

<sup>191</sup> Cf. BSK OR I-VON PLANTA/LENZ, Art. 431 N 1: It is inadmissible to declare general costs of the commissioner as expenditure.

laundering legislation is not unnecessary cost, but rather part of the commissioner's general costs which can not be charged to the customer.

f. Duty to Inform Based on Art. 11 SESTA and the SBA Rules of Conduct for Securities Dealers

i. *Duty to Spontaneous Inform*

The soundest basis for the duty of a bank or securities dealer to disclose the commissions arrangements is art. 11 SESTA, which is given added profile by art. 7 and 8 Rules of Conduct for Securities Dealers of the Swiss Bankers Association ("SBA Rules of Conduct for Securities Dealers").

Under art. 11 SESTA a securities dealer has a duty to inform, a duty of care and a fiduciary duty towards his customer. This provision has elements of both public and private law.<sup>192</sup> It specifies the principles derived from the law of mandate applicable to securities dealers and thus reiterates the private law norms. In addition it has an independent significance which is particularly important where transactions are subject to the law of sale and purchase rather than to the law of mandate.<sup>193</sup> The SBA Rules of Conduct for Securities Dealers give added profile to the duties generally set out in art. 11 SESTA.<sup>194</sup>

Under art. 7 para. 1 Rules of Conduct for Securities Dealers, which relate to transparent accounting, a securities dealer must in the absence of an agreement to the contrary spontaneously inform his customers in the transaction statement about the transaction costs, i.e. in particular commissions, fees, dues, expenses etc. A securities dealer must inform his customer of the cost structure of the transactions and adhere to such standard of transparency when reckoning up. Several writers<sup>195</sup> submit that this includes a duty to disclose Commissions, failure to do so being a breach of contract which can incur liability for damages.

The securities dealer can, however, agree with the customer that he will provide a statement with a lump cost sum instead of a detailed breakdown,<sup>196</sup> specifying which parts of the entire transaction costs are covered by such sum.<sup>197</sup> Some authors submit

<sup>192</sup> BSK BEHG-HERTIG/SCHUPPISSER, Art. 11 N 8; KÜNG/HUBER/KUSTER, Commentary SESTA, Art. 11 N 7; NOBEL, Finanzmarktrecht, p. 389.

<sup>193</sup> Some writers assume that art. 11 SESTA merely duplicates the civil law rules (KÜNG/HUBER/KUSTER, Commentary SESTA, Art. 11 N 8; LANGHART, Rahmengesetz, pp. 349 et seq. and p. 357). However, in view of transactions which are subjected to the law of purchase and sale it must be assumed that the duties set out in art. 11 SESTA constitute an independent civil law system which apply to security transactions regardless of their legal qualification (ROTH, Commentary SESTA, Art. 11 N 28, cf. also Art. 11 N 23).

<sup>194</sup> Preamble to the Rules of Conduct for Securities Dealers; ROTH, Commentary SESTA, Art. 11 N 30.

<sup>195</sup> BSK BEHG-HERTIG/SCHUPPISSER, Art. 11 N 70 and 93; BRETTON-CHEVALLIER pp. 165 et seq.; cf. WIEGAND/ZELLWEGER-GUTKNECHT, p. 46.

<sup>196</sup> Art. 7 para. 2 SBA Rules of Conduct for Securities Dealers; for accounting on a net basis cf. WATTER, Net Basis, pp. 181 et seq.

<sup>197</sup> SBA Rules of Conduct for Securities Dealers, commentary ad Art. 7 N 19.

that even in the latter case the bank must indicate that Commissions were involved, due to the conflict of interest issue (cf. below).<sup>198</sup>

Under art. 8 para. 1 SBA Rules of Conduct for Securities Dealers a securities dealer must take the measures necessary to avoid conflicts of interests between himself or his employees and his customers, so that as either to exclude such conflicts or ensure that these are unable to cause damage to customers. If, exceptionally, it is not possible to avoid a conflict of interests, the securities dealer must disclose this in a suitable form (art. 8 para. 2 SBA Rules of Conduct for Securities Dealers). Commission arrangements normally cause a conflict of interest for the broker or bank, who also profits from the higher fees, and therefore such arrangements must be disclosed to the customer.<sup>199</sup>

Thus art. 7 and 8 SBA Rules of Conduct for Securities Dealers may oblige securities dealers and banks to disclose commission arrangements to customers, this duty being spontaneous<sup>200</sup> and as such in principle mandatory.<sup>201</sup> Consequently, the customer must at least be informed about the fact that Commissions are being granted. However, it is questionable whether the customer must be informed in details about commissions arrangements.<sup>202</sup> A waiver for a detailed disclosure of Commissions can be assumed if the parties agreed on a lump cost sum instead of a detailed breakdown. Furthermore, the disclosure of the fact that commissions arrangements exist should also be possible in general terms and conditions.

Finally, the custodian bank has no duty under the law of mandate to account to the customer of the IAM with regard to Commissions paid to the latter, because it is the bank which pays such Commissions, and the bank is not the party receiving them as a result of the mandate. Therefore, the duty to deliver up under art. 400 para. 1 CO does not apply to commission arrangements between the bank and the IAM.<sup>203</sup>

## *ii. The Special Case of Finder's Fees*

Finder's fees have no direct connection with the execution of securities transactions, and therefore the information obligations resulting from the SESTA are not applicable. BRETTON-CHEVALLIER further submits that banks have no obligation to inform customers of finder's fees since these do not affect their interests.<sup>204</sup>

<sup>198</sup> Vgl. BSK BEHG-HERTIG/SCHUPPISSER, Art. 11 N 93 and N 70 and N 99.

<sup>199</sup> BSK BEHG-HERTIG/SCHUPPISSER, Art. 11 N 70 und N 93; cf. ad Art. 11 para. 1 lit. a SESTA, DE CAPITANI, p. 35.

<sup>200</sup> ROTH, Commentary SESTA, Art. 11 N 135.

<sup>201</sup> BSK BEHG-HERTIG/SCHUPPISSER, Art. 11 N 73; cf. ROTH, Commentary SESTA, Art. 11 N 92 et seq.

<sup>202</sup> An argument in favour of their admissibility is for instance that it is possible under art. 7 para. 2 Rules of Conduct to account on a lump sum basis, and that under certain circumstances security transactions on a net basis are possible; cf. WATTER, Net Basis, pp. 191 et seq.

<sup>203</sup> BREITENSTEIN, p. 24.

<sup>204</sup> BRETTON-CHEVALLIER, p. 168. *Contra* German Supreme Court [BGH], Judgment of 19 December 2000 (XI ZR 349/99, Cologne, WM 6/2001), p. 297 (cf. above B.VI.2.d).

However, finder's fees can lead to conflicts of interest for the IAM when choosing the custodian bank if the IAM has discretion in such choice. Furthermore, they may be problematic in view of art. 4a para. 1 UCA.<sup>205</sup> Banks should therefore ensure that IAMs inform the customers of finder's fees and reach an agreement with the customers as to their allocation.

### 3. The Bank's Right to Inform the Customer

The bank also has the right to inform the customer of the commission arrangement.<sup>206</sup> The IAM has no legitimate interest in secrecy or discretion on the part of the bank,<sup>207</sup> and the fact that the bank informs the customer of his legal right to information does not cause legally relevant damage to the IAM.

In practice one still encounters cooperation agreements between banks and IAMs in which the parties undertake to observe secrecy. There are various reasons for such agreements: The banks will wish to avoid that the IAMs seek competing offers for Commissions from other banks, and certain IAMs will want to keep the Commissions secret from the customers.

Where secrecy clauses are included in cooperation agreements the reservations should always be made that (i) the IAM has the right and obligation to inform the customer of the cooperation agreement and the Commissions and (ii) the bank has the right at its own discretion to inform the customer at any time.

Even where such reservations are not made the bank will not be liable for damages in the event of a breach of the secrecy undertaking, since as a rule the IAM will not suffer legally relevant damage. For the customer has simply been made aware of his contractual right that he enforces if he demands the Commissions from the IAM, or makes a deduction from the IAM's fees. Furthermore, the bank will hardly be liable for damages for loss of customers or damage to reputation, since as a rule the causal lien will be broken by contributory negligence on the part of the IAM.<sup>208</sup>

### 4. The Consequences for Banks of Having Paid Commissions

#### a. Good Faith with regard to Management Powers of Attorney

Under the law of agency the custodian bank has various obligations. It must observe the limits of a power of attorney disclosed to it. However, it can, provided it acts in good faith, rely on the validity and contents of such power of attorney even if in the internal relationship between the customer and the IAM the latter has less far-reach-

<sup>205</sup> Cf. B. IV.4.c.

<sup>206</sup> DE CAPITANI, p. 32–34.

<sup>207</sup> DE CAPITANI, p. 34. It should, however, be further examined whether such disclosure complies with the Swiss Banking Secrecy (art. 47 BankA).

<sup>208</sup> WIEGAND/ZELLWEGER-GUTKNECHT, p. 47.

ing powers and the IAM oversteps these (art. 33 para. 3 CO). Good faith is presumed under art. 3 para. 1 CC, and it is for the customer to prove the contrary.

A bank acts in bad faith if it notices, or should have noticed, that the conduct of the IAM is contrary to the customer's will (art. 3 para. 2 CC). However, the bank does not have a general duty to investigate whether the IAM is acting contrary to the customer's interests. Its good faith is only destroyed under certain circumstances.

A bank acts in bad faith if it or its representatives have knowledge, or should have gained knowledge, of the fact that the IAM has overstepped the internal power of attorney of his customer. This might be the case where a IAM mainly carries out transactions in which he himself has an interest and which are manifestly not in the customer's interest, e.g. where the IAM concentrates on investments in funds which he himself distributes, and the bank is aware thereof, or where the IAM churns<sup>209</sup> the customer's account by buying and selling securities without any obvious economic reason but merely to generate Commissions. If a bank pays an IAM Commissions, it is aware of a potential incentive of the IAM to churn. Therefore, commission arrangements can under certain circumstances mean that the bank can be held to be in bad faith with regard to acts of the IAM which are not covered by the customer's power of attorney. However, the custodian bank will not as a rule be aware of the customer's financial position, so that intensive transaction activity is not *eo ipso* a sign of churning or conduct contrary to the customer's interest.

If a bank carries out in bad faith orders given by an IAM in the absence of a power of attorney, the customer is not bound thereby. If the customer fails to ratify such acts, the IAM – albeit a *falsus procurator* – might nevertheless evade liability by showing that the bank knew or should have known of the absence of power.<sup>210</sup>

#### b. Joint and Several Liability

To the extent a bank has a duty to inform a customer of a commission arrangement and it breaches such duty, it risks incurring liability for damage adequately caused by such breach if it is at fault. It will be jointly and severally liable in the meaning of art. 50 para. 1 CO<sup>211</sup> if other persons were also in breach of duty and the bank was aware, or should have been aware, thereof.<sup>212</sup> It is not necessary that the culprits made an appointment.<sup>213</sup> Fault includes *dolus eventualis* and negligence; the latter

<sup>209</sup> Cf. the definition in Swiss Federal Banking Commission, Draft December 2003, Swiss Federal Banking Commission-RS OX/[...], Rules of Conduct in the Market [Marktverhaltensregeln] no. 62 and Appendix 1, [www.ebk.admin.ch/d/archiv/2003/20031216/rs031216\\_01d.pdf](http://www.ebk.admin.ch/d/archiv/2003/20031216/rs031216_01d.pdf) (last visited 22 June 2006); [www.ebk.admin.ch/d/archiv/2003/20031216/rs031216\\_02d.pdf](http://www.ebk.admin.ch/d/archiv/2003/20031216/rs031216_02d.pdf). In French this is called "Barattage".

<sup>210</sup> Art. 39 para. 1 CO.

<sup>211</sup> BSK OR I-SCHNYDER, Art. 50 N 5. This norm also applies to contracts by virtue of art. 99 para. 3 CO.

<sup>212</sup> SFTD 115 II 45; BSK OR-I SCHNYDER, Art 50 N 5.

<sup>213</sup> BSK OR I-SCHNYDER, Art. 50 N 5.

might consist in acting in conjunction with the main culprit by rendering the latter a service which can be used to commit a tort.<sup>214</sup>

There can be jointly caused damage and joint fault where a bank is in breach of its duties to inform and acts in bad faith since it knows, or ought to know, that an IAM is keeping back Commissions from a customer. By entering into a commission arrangement with the IAM the bank contributes to the possibility of the customer suffering damage. There is an adequate causal lien if in the normal course of events and pursuant to normal expectations it can be assumed that if Commissions are paid to the IAM he will withhold them from the customer.<sup>215</sup>

In principle the bank is entitled to assume based on art. 3 para. 1 CC that the IAM will fulfil his duties towards the customer and deliver up the Commissions or obtain permission to keep them, and the bank is not obliged to inquire whether this is the case.<sup>216</sup> However, with regard to the question of good faith an explanation is probably necessary for the fact that the Commissions are credited to the IAM rather than directly to the customer. Particular problems arise from secrecy clauses which do not contain a reservation that the customer must be informed.<sup>217</sup> It should also be noted that the bad faith of bank representatives who look after the custody accounts managed by an IAM is attributed to the bank itself.

The joint conduct of the bank and the disloyal IAM can thus under certain circumstances lead to joint and several liability of both pursuant to art. 50 para. 1 CO.

The damage for which the bank might be held liable is confined to that caused by the IAM's failure to deliver up the Commissions and, if the IAM has been indulging in churning, for direct damage caused thereby, e.g. the unnecessarily generated fees.

In the cited judgment of the German Supreme Court the court held that a bank's obligations to inform of commission arrangements has the additional function of furnishing the customer with additional means of assessing the trustworthiness of his business partners. Consequently, failure to inform conceals the IAM's untrustworthiness.<sup>218</sup> This reasoning is not convincing, since a bank can generally rely on an IAM acting in compliance with the law. It also leads to the untenable result that the bank might be held liable for any damage caused by the IAM's breaches of duty, for instance also for the damage caused by investments in options by the IAM contrary to the policy agreed with the customer, although such investments are completely unrelated to the commission arrangements.

<sup>214</sup> OFTINGER/STARK, p. 102 N 327; DE CAPITANI, pp. 36 et seq.

<sup>215</sup> DE CAPITANI, p. 36.

<sup>216</sup> DE CAPITANI, p. 37.

<sup>217</sup> Cf. above B.VI.3.

<sup>218</sup> German Supreme Court [BGH], judgment of 19 December 2000 (XI ZR 349/99, Cologne, WM 6/2001), p. 298.

## 5. Penal Law Aspects

By paying Commissions to IAMs rather than directly to the customer the bank ultimately enables the IAM to commit the offence of disloyal management.<sup>219</sup> Indeed, such conduct might even be construed as directly abetting the offence provided the other requirements such as the intent are given. Even the omission to inform the customer might be qualified as abetting disloyal management. A duty to take action can hardly be derived from the fiduciary duty towards the customer, but conceivably by omission, for by paying Commissions to the IAM the bank creates a risk to the customer's assets, and it might be argued that the bank has a duty to ensure that such risk does not materialise.

In our view, this would be an unjustified extension of the protection offered by penal law, since the duty to deliver up is as a rule purely a matter of civil law, and penal law should not be used here to create a comprehensive duty of the bank to protect the customer's economic interests.

## 6. Risk Management Possibilities for Banks

Commission arrangements entail various risks for banks. These are primarily of a financial nature, for when problems arise the IAM is often insolvent or has disappeared. Damaged customers perceive the bank as a deep pocket. Furthermore, there is a risk of a damage of the bank's reputation and indeed that of the whole industry. There might also be a risk that the bank will have its licence withdrawn for having failed to enjoy good reputation and ensure a proper business.<sup>220</sup> Finally, there might be penal law consequences.

A bank might envisage the following risk management possibilities:

- i) The safest and simplest method for a bank is not to pay Commissions to the IAM, but instead charge the customer less fees or credit him directly with a rebate.<sup>221</sup> However, in the current market climate a bank which does not offer Commission will be at a competitive disadvantage.
- ii) Various measures can help to reduce the risks associated with Commissions:
  - (a) The cooperation agreement between the bank and the IAM should contain a clause in which the IAM explicitly undertakes to inform the customer about the Commissions and to either pass Commissions on to the customer or conclude an agreement entitling him to keep them.

<sup>219</sup> Cf. above B.V. 7.

<sup>220</sup> Art. 3 para. 2 lit. c Banking Act. Cf. for instance the Ordinances of the Swiss Federal Banking Commission of 31 May 2000 re "Snake Trading" (SFBC Bulletin 41/2000, p. 31), of 30 March 2000 re Bank B concerning Front Running (SFBC Bulletin 40/2000, pp. 24 et seq.), and of 27 November 2002 (SFBC Bulletin 43/2003, pp. 87 et seq.).

<sup>221</sup> Cf. EMCH/RENZ/ARPAGAUS, p. 554.

- (b) To be on the safe side the bank may ask the IAM for confirmation that he has informed the customer about the Commissions and either passed the Commissions on to the customer or concluded an agreement entitling him to keep them. Where such confirmation shows that all Commissions have been passed on, the IAM has not in effect received any Commissions at all (cf. [i] above).
  - (c) In the customer's management power of attorney, mention should be made that the customer is aware and agrees that the bank will pay Commissions and that the IAM is obliged to inform the customer accordingly and to account for them or conclude an agreement with the customer on this point.<sup>222</sup> It would be preferable to also indicate the mode of calculation and the approximate amount of the Commissions. This, however, might be difficult in practice. The power of attorney is usually granted on a form provided by the bank, which can prepare the appropriate wording in advance. For the sake of clarity it should also be mentioned that the bank has no supervisory duties with regard to orders, instructions, directions and transactions of the IAM.
  - (d) If care is taken with the models for calculating Commissions, conflicts of interest and false incentives can be avoided or reduced. For example, Commissions calculated on the basis of the assets under management cause less problems than those based on transaction fees, particularly if these are progressive and thus invite churning.<sup>223</sup>
  - (e) No problems are caused by payments for legitimate services performed by the IAM which do not cause any conflicts of interest, such as remuneration for identifying the customer in compliance with the anti-money laundering legislation. Therefore it might be expedient to include reasons for such payments in the agreement.
  - (f) In practice, flat fees are sometimes used in order to make it difficult for customers to make claims because it is not possible to allocate individual amounts to transactions. Here the bank might be accused of deliberately thwarting an allocation, and if one has to be made, it will prove accordingly difficult.
- iii) Several banks have introduced an internal monitoring system for Commissions as an additional control of the business of asset management by IAMs,<sup>224</sup> particularly for customers who instruct their bank to hold mail: All Commissions paid to IAMs are collated on a monthly basis. Where the Commissions are conspicuously high the bank examines how they were generated and whether the transactions carried

<sup>222</sup> Example of a clause: "I [the customer] am aware that the bank will pay the agent commissions [in the maximum amount of approximately X% of the total assets under management] based on the fees charged to me, and that it is exclusively the duty of the agent to disclose such commissions to me. The bank is expressly released from such duties."

<sup>223</sup> As to churning, cf. above B.VI.4.a.

<sup>224</sup> In its survey the Swiss Federal Banking Commission found that one third of the surveyed banks manages IAMs centrally. The others use a decentralised risk limitation and supervisory system or a mixed system. The Swiss Federal Banking Commission has found that generally the controls employed are as a rule commensurate with the legal and operational risks, so that measures were only necessary in a few cases. As to the operational risks of asset management, the survey concluded that there was no need for the Swiss Federal Banking Commission to intervene (Annual Report of the Swiss Federal Banking Commission 2004, pp. 47 et seq.).

out by the IAM were in the customer's presumed interest. If this is not the case, the matter is first taken up with the IAM, who if necessary is given a warning. In a further step the customer is contacted and informed of the bank's concerns.<sup>225</sup> Some banks require that hold mail customers must sign their custody account statements annually or when they appear at the bank. This provides the bank with a certain comfort, particularly with regard to the danger of churning. However, in some cases it will be difficult to contact hold mail customers with a view to obtaining a signature. Furthermore, there is no legal duty to introduce an internal monitoring system.

## 7. Banks as Recipients of Commissions

There are situations where the banks receive Commissions as a result of custody or broker operations, for instance from other securities dealers (cf. C) or from investment funds in the form of Trailer Fees (cf. D.II.2). In such cases the bank in principle has a duty to inform, account and deliver up the Commissions to the customer based on art. 400 para. 1 CO and art. 11 SESTA unless otherwise agreed with the customer.

## VII. Summary

In independent asset management Commissions in the form of payments or *in natura* (Soft Commissions) are widespread.

Cooperation agreements between the bank and the IAM are synallagmatic contracts *sui generis* and mixed contracts directly or indirectly subjected – and this is decisive – to the law of mandate (art. 394 et seq. CO). As long as the commission arrangement is not a form of bribery it will not be *contra bonos mores* in the meaning of art. 20 para. 1 CO. Under certain circumstances, the commission arrangement might be unfair in the meaning of art. 4a UCA and thus null and void if the IAM keeps the Commissions without having first concluded an agreement entitling him to do so with the customer. The legal effect of nullity is, however, of reduced practical significance since art. 66 CO precludes the recovery due to nullity of Commissions paid *sine causa*.

Art. 4a UCA entails further risks for IAMs and banks, including risks of a penal law nature. It is therefore advisable that the IAM and the customer reach express or implicit agreement on the allocation of the Commissions.

<sup>225</sup> If the bank has reason to assume that transactions effected by the IAM are not covered by the power of attorney, it should not simply refuse to carry them out and remain passive, but must immediately contact the IAM or the customer. Contrary to the judgment of the Cour de Justice de Canton de Genève of 13 February 2004 in the matter Banque X c. T. (CARLO LOMBARDINI, Tiers-Gérant et Art. 11 LBVM, Relevant 2004 N. 5–1, pp. 3 et seq.) it should in principle be sufficient that the bank immediately informs the IAM that due to its suspicions no further transactions will be carried out until the matter has been clarified with the customer.

In principle IAMs have a duty, derived from the law of mandate, to spontaneously inform and account to their customers. However, it is submitted that a customer may waive in advance his right to *spontaneous* information provided he is aware that there is a commission arrangement in place. Practical limitations result from the fact that the customer must have sufficient knowledge of the commission arrangement (or at least having been offered the opportunity to be informed) before he can validly waive his right to demand delivery up of the Commissions. If a customer waives his right to demand delivery up of the Commissions, he will as a rule implicitly waive his right to spontaneous information. It is unclear to what extent the customer can in advance validly waive his right to information *upon demand*. To the extent such waiver were not possible, it is submitted that the customers should exercise such right *bona fide* within a reasonable deadline.

Furthermore, under the law of mandate an IAM is in principle obliged to deliver up Commissions received as a result of his management of assets. The Swiss Federal Tribunal has held that there is no trade usage in the business of independent asset management pursuant to which the customer is considered to have waived delivery up of Commissions and that these be deemed "usual remuneration" in the meaning of art. 394 para. 3 CO of the IAM. However, a waiver is possible provided the customer is "fully and correctly" informed of what Commissions are to be expected and his will to waive his right results clearly from an agreement. A tacit waiver of the customer of his right to receive the Commissions can only be assumed under special circumstances. It is, for example, necessary that the customer has knowledge of the specific agreement with the bank regarding the amount of Commissions and of the probable incidence of transactions on which such Commissions will be paid to the IAM as additional compensation for his managing the assets. If the IAM wishes to keep the Commissions he is therefore advised to obtain an express waiver from the customer.

In our view, it is justified to adopt a less stringent approach with regard to the extent of the knowledge which the customer must have in the event of an express waiver than for a tacit one. It should actually be sufficient for an express waiver if the IAM informs the client about the fact that he receives Commissions and if he expressly offers to the customer to inform him upon request about the composition and the prospective amount of the Commissions even if the customer does not take this expressly offered opportunity to receive information. Until there is more court practice IAMs are, however, recommended to inform customers of all factors necessary for determining the approximate maximum range of Commissions which they expect to receive. It is submitted that it is sufficient if the customer is, for example, informed of the maximum range of Commissions expressed as a percentage of the managed assets or in another comprehensible formula. Furthermore, the customer should also be informed in general terms that Commissions might lead to conflicts of interest. It should also be possible to agree that the Commissions be allocated to the IAM in general terms and conditions.

It is a disputed issue to what extent a bank which pays Commissions is obliged to inform the customer. Under Swiss law banks do not have a general duty to advise its customers similar to that which results from the so-called general bank contract un-

der German law. The soundest basis for a duty of the bank to inform the customer of the Commissions is probably provided by art. 11 SESTA and art. 7 and 8 SBA Rules of Conduct for Securities Dealers. Commission arrangements can cause a bank particular problems if they lead to churning, for in such situations the bank is well aware of the IAM's own interest.

The following practical Commission cases are further examples which allow an analysis of the issues at stake. In some cases signs of specific regulatory responses to the problems involved have already emerged.

## C. Commissions in Multistage Securities and Foreign Exchange Trading

### I. Starting Point

It is common, particular in cross border transactions, that securities and foreign exchange transactions are executed using a number of brokers (multistage securities and foreign exchange transactions). As a rule the third party broker pays the directly mandated bank or securities dealer (“broker”) Commissions.<sup>226</sup>

The situation can be described as follows: the customer instructs his broker to conduct a transaction in securities, e.g. the purchase or sale of foreign securities. The broker does not execute the order himself, but mandates another broker (“third-party broker”) in his own name but for the account of his customer, who then concludes the transaction (e.g. on a stock exchange) with another party. The third-party broker usually receives a fee for executing the order, and pays part of such fee as Commission to the broker from whom he received the order, or alternatively provides the latter with a Soft Commission, for instance in the form of research material paid for by the third-party broker (fig. 4).

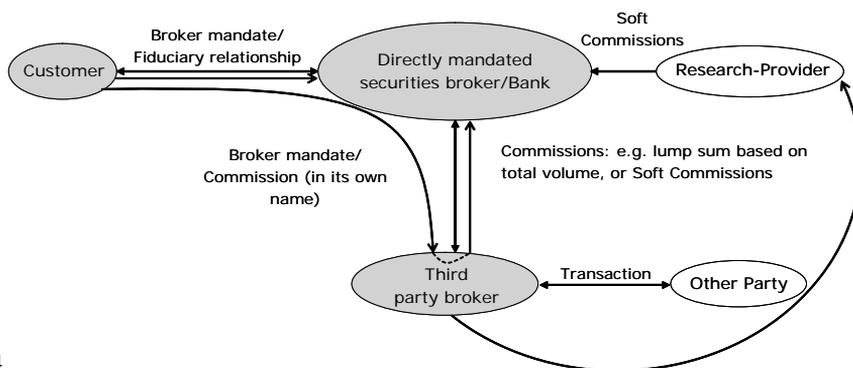


fig. 4

### II. Obligation to Inform

The issue is whether a securities dealer or bank has a duty to inform the customer of the Commissions that it receives from a third-party broker. Particularly, the provisions art. 11 SESTA and the SBA Rules of Conduct for Securities Dealers are relevant

<sup>226</sup> Cf. SFBC Circular 98/2 of 1 July 1998, no. 59.

to the duty of the broker to inform the customer about Commissions in multistage securities and foreign exchange transactions.<sup>227</sup>

The duty of care pursuant to art. 11 para. 1 lit. b SESTA obliges brokers to effect best execution of the customers' orders<sup>228</sup> and to provide transparency.<sup>229</sup> The duty to provide transparency is given added profile by art. 7 SBA Rules of Conduct for Securities Dealers. The provision specifies the information with which the broker must spontaneously provide the customer when accounting for the transaction in the absence of an agreement to the contrary.<sup>230</sup> This rule provides that the broker must at least indicate the number of securities traded, the price (including any surcharges or reductions compared with the market price in off-exchange transactions), the place of execution and the transaction costs. The customer must (again in the absence of an agreement to the contrary) be provided with a detailed statement of the effectively paid third-party Commissions, fees, dues and costs.<sup>231</sup> It probably can be implied from this that the broker must disclose Commissions received from a third-party broker.

Instead of providing a detailed statement of the individual transaction costs a broker can agree to account for his services and the services of third parties on a lump sum basis (art. 7 para. 2 SBA Rules of Conduct for Securities Dealers).<sup>232</sup> By agreeing to a lump sum the broker avoids having to account in detail for Commissions received from third party brokers.<sup>233</sup> Nevertheless, some writers submit that the broker must at least inform the customer that he is receiving Commissions, since these lead to potential conflicts of interest in that it might influence the broker's choice of third-party brokers.<sup>234</sup> Art. 8 para. 2 SBA Rules of Conduct for Securities Dealers is a further basis for a duty of the broker to inform the customer about Commissions received.

Finally, it should be pointed out that brokers must, at the customer's request, provide the information necessary to understand how the transaction was executed and to judge whether the broker observed the care required by art. 11 para. 1 lit. b SESTA.<sup>235</sup> Such information includes Commissions received.

The effective costs can be calculated without difficulty if the third-party broker pays the Commissions immediately after the transaction. If such Commissions are calculated and paid later, it is technically virtually impossible to allocate Commissions paid

<sup>227</sup> Above in B.VI.2.f the issue was whether art. 11 SESTA obliges a bank or a securities dealer to inform the customer of commissions it paid to the IAM.

<sup>228</sup> According to the principle of "best execution" (art. 5 para. 1 SBA Rules of Conduct for Securities Dealers and commentary to Art. 5 N 15) a broker must, in the absence of instructions to the contrary, in principle execute a security transaction without delay, in its entirety and at best possible market conditions on the broker's local market, on the home market of the security or on any other market with the necessary liquidity.

<sup>229</sup> ROTH, Commentary SESTA, Art. 11 N 101.

<sup>230</sup> SBA Rules of Conduct for Securities Dealers, commentary to Art. 17 N 18.

<sup>231</sup> SBA Rules of Conduct for Securities Dealers, commentary to Art. 7 N 19.

<sup>232</sup> Fees and duties can either be included in such lump sum or charged separately (art. 7 para. 1, 2nd sentence SBA Rules of Conduct for Securities Dealers).

<sup>233</sup> ROTH, Commentary SESTA, Art. 11 N 138 and N 148.

<sup>234</sup> BSK BEHG-HERTIG/SCHUPPISSE, Art. 11 N 93, N 70 and N 99.

<sup>235</sup> ROTH, Commentary SESTA, Art. 11 N 137.

based on the transactional volume during a specific period. The calculation of Soft Commissions also causes difficulties.<sup>236</sup> For these reasons, it is advantageous for the broker to account to customers on a lump-sum basis.

### III. Obligation to Deliver up

Art. 11 SESTA and the SBA Rules of Conduct for Securities Dealers do not address the question whether Commissions must be delivered up, but only deal with the question of transparency, i.e. whether the Commissions must be disclosed.<sup>237</sup>

Art. 400 CO determines whether a broker must deliver up Commissions to the customer if he acts as commissioner or agent (cf. the IAM's obligation to deliver up above in B.V.3).<sup>238</sup>

<sup>236</sup> ROTH, Commentary SESTA, Art. 11 N 148.

<sup>237</sup> ROTH, Commentary SESTA, Art. 11 N 149.

<sup>238</sup> GAUTSCHI, Art. 433 N 1b, submits that it is a breach of fiduciary duty – and even dishonest – not to pass on rebates, reductions, *pots-du-vin* and any other benefits received as a result of the transaction. A failure to declare these in the statement reduces the amount to be delivered up and has the consequence that the agent is not entitled to his fee (art. 433 para. 1 CO).

## D. Commissions and Investment Funds

### I. Fiduciary Duty of the Fund Management

The fund management and its representatives are obliged to act solely in the interest of the investors (cf. art. 12 para. 1 IFA; new: art. 20 para. 1 CISA). Under the CISA, which entered into force on 1 January 2007 and replaced the IFA, the licensees, e.g. the fund management and portfolio managers of Swiss collective investments<sup>239</sup> and their agents may in connection with the acquisition and sale of assets and rights only accept for themselves and third parties the remuneration specified in the relevant documents (e.g. the collective investment agreement<sup>240</sup>). It is explicitly provided that Commissions and other benefits must be credited to the collective investment (art. 21 para. 2 CISA). The provision art. 21 para. 2 CISA was inspired by art. 12 para. 2 IFA and extends the rule to all collective investments governed by the CISA.<sup>241</sup>

The provision (cf. previously art. 12 para 2 IFA) covers Commissions in money and *in natura* (Soft Commissions). The Code of Conduct for the Swiss Fund Industry issued by the Swiss Funds Association ("SFA")<sup>242</sup> has brought some clarification in this respect. The Code is part of the self-regulatory minimum standard recognised by the Swiss Federal Banking Commission.<sup>243</sup> Under its rules the fund management must ensure that Soft Commissions (e.g. financial analysis, market and market-price information systems) and services compensated by such benefits will be passed on directly or indirectly to the fund.<sup>244</sup> The implementation of this principle is not easy in practice, particular where a fund management manages several funds, rendering the individual allocation of the Soft Commissions difficult.

Under the SFA Code of Conduct the fund management is obliged<sup>245</sup> to define a clear policy regarding the use of Soft Commissions on stock exchange transactions conducted on the fund's account, and to set such policy out in writing. The following items must be regulated in internal guidelines:

- i) The permitted remuneration for services of brokers themselves (incl. research) or of third parties (e.g. subscriptions to electronic media such as Bloomberg or Reuters) which can be remunerated with Soft Commissions;

<sup>239</sup> Art. 13 para. 2 CISA.

<sup>240</sup> Art. 15 CISA.

<sup>241</sup> Green paper on the Collective Investments Act of 23 September 2005, BBl 2005, p. 6445. Furthermore, under art. 20 CISA licensees have an explicit fiduciary duty, duty of care and duty to inform, and must ensure transparent reporting with regard to the collective investments under their management.

<sup>242</sup> Swiss Fund Association SFA, Code of Conduct for the Swiss Fund Industry of 30 August 2000 (hereinafter "SFA Code of Conduct").

<sup>243</sup> SFBC Circular 04/2, Self-Regulation as a Minimum Standard [Selbstregulierung als Mindeststandard] of 21 April 2004.

<sup>244</sup> SFA Code of Conduct, no. 10.

<sup>245</sup> SFA Code of Conduct, no. 10.

- ii) The rule that the principle of “best execution” (duty of loyalty to investors) must be observed, and
- iii) The issue of monitoring compliance with existing agreements (including reports on the services provided or paid for by the broker).<sup>246</sup>

Furthermore, the fund management is obliged under the SFA Code of Conduct to draw up appropriate regulations with the portfolio managers entrusted with the management of the fund's assets and to monitor compliance with these regulations.<sup>247</sup> The delegation of the conclusion of Soft Commission agreements to external portfolio managers in accordance with criteria specified by the fund management must be regulated in the portfolio management agreement.<sup>248</sup> The fund management may not enter into any agreements that would restrict its freedom in taking decisions.<sup>249</sup>

The same fiduciary duty applies to the custodian bank (cf. art. 20 IFA; new: art. 13 para. 2 lit. e, 20 para. 1 and art. 21 para. 2 CISA).<sup>250</sup>

## II. SFA Guidelines on Transparency with regard to Management Fees

### 1. The Aim of the Guidelines

As a result of considerable political pressure from the Federal Banking Commission the SFA issued Guidelines on Transparency with regard to Management Fees (“SFA Guidelines on Transparency”).<sup>251</sup> These guidelines were then ratified by the Federal Banking Commission (which had had a considerable say as to the contents) and recognised as a self-regulatory minimum standard.<sup>252</sup>

The SFA Guidelines on Transparency aim to create transparency with regard to Management Fees debited to the fund and to achieve the (relative) equal treatment of the

<sup>246</sup> SFA Code of Conduct, Implementation Guidelines of 9 May 2001, p. 15.

<sup>247</sup> SFA Code of Conduct, no. 10, and SFA Code of Conduct, Implementation Guidelines of 9 May 2001, p. 15.

<sup>248</sup> SFA Code of Conduct, Implementation Guidelines of 9 May 2001, p. 15.

<sup>249</sup> SFA Code of Conduct, no. 9.

<sup>250</sup> This was already the case under IFA although art. 20 para. 2 IFA (unlike art. 12 para. 2 IFA) did not (probably by error) mention commission arrangements. ALFRED BUTTSCHARDT, *Commentary Investments Funds Act*, Art. 12 N 6; DEN OTTER, *Investment Fund Act*, Art. 12 para. 2 N 1. It was a result of the debate in parliament that commission arrangements were mentioned in Art. 12 para. 2 IFA.

<sup>251</sup> SFA Guidelines on Transparency with regard to Management Fees [SFA Richtlinien für Transparenz bei Verwaltungskommissionen] of June 2005, in force since 1 August 2005, but deferred until 1 July 2006 for new domestic and foreign funds (cf. the SFA announcement no. 21/05 of 29 December 2005). In liaison with the Swiss Federal Banking Commission a further deferral of the entry into force of no. 2 of the transparency guidelines for domestic and foreign funds was decided and communicated to members and the media in announcement no. 11/6 on 6 July 2006.

<sup>252</sup> SFBC Circular 04/2, *Self-Regulation as a Minimum Standard [Selbstregulierung als Mindeststandard]* of 21 April 2004.

investors.<sup>253</sup> While the first aim concerns Commissions, the second one relates to the problem of rebates granted to institutional and other large investors, who are thus privileged compared with other investors.

## 2. Trailer Fees and Reimbursements

Trailer Fees (“Bestandespflegekommissionen”) in the meaning of the SFA Guidelines on Transparency are payments made to sales agents and sales partners out of the Management Fee. They are thus a form of Commissions.

By contrast, Reimbursements in the meaning of the SFA Guidelines on Transparency are payments made to unit holders out of the Management Fee. Here the problem is not Commissions, but equal treatment of the investors (fig. 5).

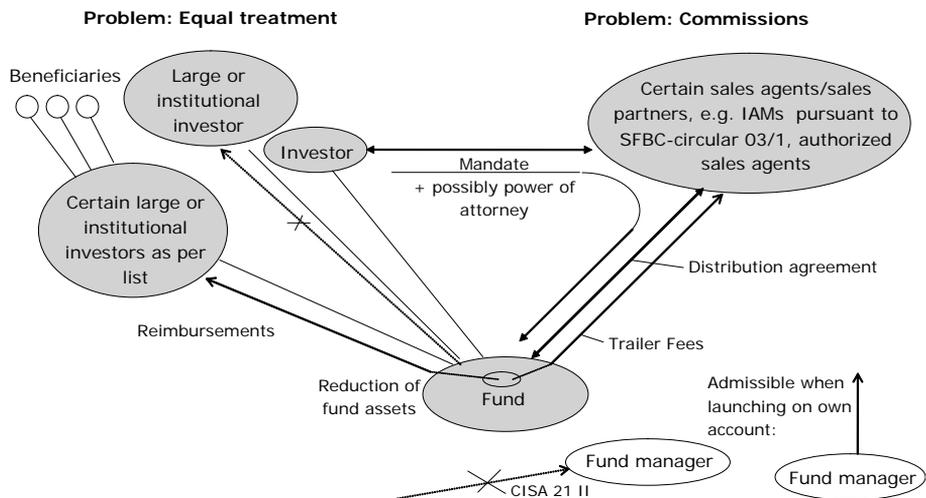


fig. 5

Trailer Fees may in principle be paid only to the sales agents and sales partners specified in the SFA Guidelines on Transparency, namely to:<sup>254</sup>

- i) Authorized sales agents (distributors) in the meaning of art. 22 para. 1 IFA<sup>255</sup>;
- ii) Sales agents (distributors) exempted from the authorization requirement in the meaning of art. 22 para. 4 IFA<sup>256</sup>;

<sup>253</sup> SFA Guidelines on Transparency I.

<sup>254</sup> SFA Guidelines on Transparency II no. 4. SFA Guidelines on Transparency II no. 5 is reserved.

<sup>255</sup> New: art. 19 para. 1 CISA.

<sup>256</sup> New: art. 19 para. 4 CISA.

- iii) Sales partners who place fund units exclusively with institutional investors with professional treasury facilities (*institutionelle Anleger mit professioneller Tresorerie*) in the meaning of sections 12 et seq. of SFBC Circular 03/1;
- iv) Sales partners who place the fund units with their customers exclusively on the bases of a written commission-based asset management agreement in the meaning of section 16 of SFBC Circular 03/1 (i.e. asset management agreement in conformity with the Guidelines of the Swiss Bankers Association for investment management agreements or equivalent standards.<sup>257</sup>

It is not permitted to pay Trailer Fees to other sales agents or sales partners save for a few exceptions.<sup>258</sup> According to SFA, the rationale for this is that the Trailer Fees should, in general, not be remitted to the investors because of the principle of equal treatment of the investors.<sup>259</sup>

The SFA Guidelines on Transparency make no reference to Soft Commissions; only payments are qualified as Trailer Fees.<sup>260</sup> This is surprising in that Soft Commissions involve considerable cost and may be of considerable value. If Soft Commissions are financed by Management Fees they might qualify as Trailer Fees.

The SFA Guidelines on Transparency do not contain any rules regarding commissions paid out of issue or return commissions. In a circular letter to all fund managers and representatives of foreign investment funds the Federal Banking Commission stated that the payment of such Commission to distributors or to investors or groups of investors does not raise problems from the point of view of equality of treatment as long as the arrangement is structured pursuant to objective criteria and disclosed in the fund's prospectus.<sup>261</sup> Currently such return commissions are relatively seldom in practice as far as Swiss investment funds are concerned.

### 3. Disclosure of Commissions in the Fund's Prospectus

Originally the SFA Guidelines on Transparency provided that for Swiss public investment funds<sup>262</sup> the fund regulation must provide for a duty of the fund management to indicate in the prospectus the intended use of Management Fees,<sup>263</sup> broken down

<sup>257</sup> SFBC Circular 03/1 concerning publicity in the meaning of investment fund legislation [Öffentliche Werbung im Sinne der Anlagefondsgesetzgebung] of 28 May 2003, 3.2.1 (most recent amendment: 25/26 January 2006).

<sup>258</sup> SFA Guidelines on Transparency II no. 4.

<sup>259</sup> SFA announcement no. 22/06 of 5 December 2006, p. 4.

<sup>260</sup> SFA Guidelines on Transparency II no. 3.

<sup>261</sup> Cf. Annual Report of the Swiss Federal Banking Commission 2003, pp. 86 et seq.

<sup>262</sup> The transparency guidelines primarily apply to public investment funds, i.e. funds which are not exclusively open to institutional investors in the meaning of art. 2 para. 2 of the ordinance implementing the Investment Fund Act (SFA Guidelines on Transparency II no. 1).

<sup>263</sup> Fund interest categories with diverse Management Fees are permitted if the conditions for participation in a given categories are transparent and based on objective criteria (e.g. institutional investors or investors who have concluded a management agreement with a group company etc.; SFA Guidelines on Transparency II no. 6). In the case of funds for institutional investors with a professional treasurer in the meaning of art. 2 para. 2 of the ordinance

into three elements: (i) administration, (ii) asset management and (iii) distribution. For each of these three cost centres the fund management would have had to indicate the maximum amounts in advance in the prospectus, and the sum of these three maximum amounts would have had to be no more than 150% of the maximum of the total of the Management Fees (fig. 6).<sup>264</sup>

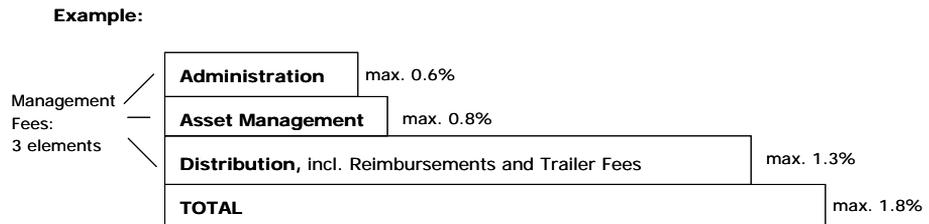


fig. 6

However, after consultation with the Federal Banking Commission the SFA deferred the entry into force of no. 2 of the SFA Guidelines on Transparency, regarding the duty to disclose the three elements of the Management Fees, until the end of 2006.<sup>265</sup> The reason is that the European Commission has submitted an implementing directive<sup>266</sup> to the Directive concerning Markets for Financial Instruments (MiFID)<sup>267</sup> which generally prescribes that the costs be disclosed at the point of sale rather than at the fund management level.<sup>268</sup> According to this concept Trailer Fees would be disclosed by their recipients (e.g. sales agent) and not by those who pay them (i.e. the fund management). The intention was to introduce a solution which is compatible with European law by the end of 2006. However, this did not happen by that time.

implementing the Investment Fund Act, categories without Management Fees are permitted under certain circumstances (SFA Guidelines on Transparency II no. 7).

<sup>264</sup> SFA Guidelines on Transparency II no. 2.

<sup>265</sup> It would only have been possible to pay Trailer Fees (and refunds) from the marketing element. The amount of Trailer Fees is therefore less easy to calculate if the management fees are not broken down into their three elements. Cf. the criticism of abandoning this type of breakdown by MICHAEL RASCH, The fund association peddles back regarding the transparency guideline [Der Fondsverband rudert bei Transparenzrichtlinie zurück], NZZ of 7 July 2006, no. 155, p. 25.

<sup>266</sup> Commission Directive, Implementing Directive 2004/39/EC of the European Parliament and of the Council regarding organisational requirements and operating conditions for investment firms and defined terms for the purpose of that Directive, Draft 30.6.2006.

<sup>267</sup> Directive 2004/39/EC of the European Parliament and Council of 21 April 2004, ABI. L 145 of 30.4.2004.

<sup>268</sup> Cf. art. 26 of the implementing directive, pursuant to which in future "investment firms" and others are obliged to disclose all commissions received from third parties (e.g. fund companies).

#### 4. Indirect Influence on Civil and Penal Law?

Die Federal Banking Commission approved the SFA Guidelines on Transparency and recognised them as self-regulatory minimum standard in its circular 04/2,<sup>269</sup> thereby acknowledging that the payment of Trailer Fees to distributors and distribution partners, including IAMS in the meaning of section 16 of SFBC Circular 03/1, is admissible from a regulatory point of view if they have been adequately disclosed (it being sufficient to indicate maximum amounts) and the other conditions set out in the SFA Guidelines on Transparency have been met. In view of the supervisory role of the Federal Banking Commission such recognition is primarily of regulatory significance, but may nonetheless have a certain indirect effect on civil and penal law practice, since a court will tend to be reticent with regard to disqualifying as illicit a conduct ratified by the Federal Banking Commission, an independent Federal supervisory body,<sup>270</sup> albeit its standpoint is not binding on the courts.

<sup>269</sup> SFBC Circular 04/2, Self-Regulation as a Minimum Standard [Selbstregulierung als Mindeststandard] of 21 April 2004.

<sup>270</sup> Cf. Swiss Federal Banking Commission, The Swiss Federal Banking Commission and its Environment [Die EBK und ihr Umfeld], <http://www.ebk.admin.ch/d/ebk/umfeld/index.html> (last visited: 22 June 2006).

## E. Commissions (Rebates) within Groups of Companies

Within groups of companies Commissions or rebates are paid primarily for fiscal reasons. Often a holding company or an individual is the principal and at the same time also the beneficial owner of the recipient of the payments, so that the problems caused by Commissions as such do not arise, as the following example shows (fig. 7):

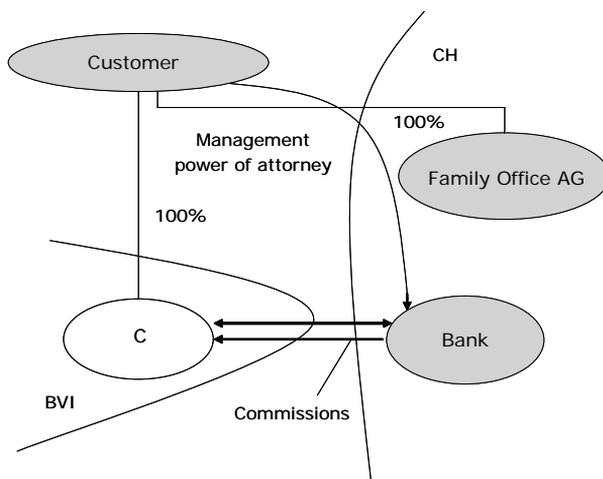


fig. 7

A customer domiciled abroad entrusts his Family Office AG with domicile in Switzerland with the management of his assets. The Family Office AG is wholly owned by the customer. The customer discloses to the custodian bank the management power of attorney which he has given to the Family Office AG, and the Family Office AG instructs the custodian bank to pay Commissions to a Company domiciled in the British Virgin Islands ("BVI Company") which in turn is wholly owned by the customer.

As far as corporate income tax levied by the Confederation and the Cantons is concerned, the bank will be able to book the Commissions (provided these are of reasonable proportion) as operating expenses with the justification that these are payments for the retention of clients and maintenance of client relationships.

The Family Office AG must take care to ensure that the waiver of the Commissions entailed by the instruction that these be paid to the BVI Company not be qualified as a constructive dividend, for this would incur corporate withholding tax and income tax for the Family Office AG. The Family Office AG must therefore be able to show that the payments made to the BVI Company (instead of the Family Office AG) are economically speaking rebates or a "customer retention fee", and not remuneration for

services provided by the Family Office AG. Accordingly, the payments should not be paid in consideration of the fact that the Family Office AG introduced clients. For tax reasons the Family Office AG must be structured at least as a cost-plus company with a modest profit in the region of 5–10% of the costs. The same considerations apply where the customer is not an individual, but the parent company of a group of companies.

It is unclear to what extent Commissions between companies of a group of companies are subjected to the duty to deliver up if customers are involved that are not part of the group, e.g. if a bank receives Commissions in the course of distribution of financial products of other entities of the group. As mentioned above, the motives for intra group payments are often fiscal. Formally they look like Commissions. However, as a rule, the requirement for the duty to deliver up of an intrinsic connection between the payment and the execution of the mandate for the customer under the law of mandate is lacking. This might even be the case if the payments are calculated on the basis of a scale that refers to transaction or fee volumes, although such variables are ultimately a result of the mandate for the customer. In substance, it is a transfer of profits for tax reasons between one entity of a group to another one, both entities having the same beneficial owner. Beyond the transfer of profits for tax reasons, the issue of conflicts of interests in the context of intra group Commission payments may be put into perspective and allows a consolidated view. It should not make an essential difference here whether several departments of the same legal entity or several legal entities under common control of the group (i.e. formally but not in substance third parties) are involved. Furthermore, incentives to sell to the customer financial products of the group exist even if no Commissions are paid intra group. Consequently, a customer of a bank must assume that the bank or the asset manager of the bank, as a rule, favours the group's products or products distributed by the group. Unlike an IAM, an asset manager of a bank will normally also not hold out to make an independent and unbiased choice. This dependency and limitation of the duty of loyalty is an immanent and evident part of the contractual relationship.<sup>271</sup>

<sup>271</sup> Cf. Hsu/Stupp, p. 207.

## F. Commissions in the Insurance Industry

### I. Marketing Forms and Contractual Structures

In the Swiss insurance industry services are still mainly marketed (probably around 70–80%) by insurance agents and representatives (so-called dependent brokers),<sup>272</sup> and around 20–30% by independent brokers.<sup>273</sup>

Independent brokers are not employed by an insurance company, but have a brokerage agreement with their customers and a cooperation agreement with the insurers.<sup>274</sup>

A typical key clause of a brokerage agreement with the customer might read:

“The [insured] mandates and empowers the [broker] to manage his/her existing policies and to procure these from a licensed insurance company at the best possible conditions for a through commission (which is paid by the insurance company).”<sup>275</sup>

The so-called “through commission” paid by the insurance company is the broker fee or commission arrangement.

As a rule, broker and insurer will conclude a cooperation agreement defining their mutual rights and duties. This is usually a framework agreement containing standard administrative rules and details of the broker fees or Commissions for all the insurance contracts acquired and managed by the broker.<sup>276</sup>

Insurance brokers do not work for free.<sup>277</sup> As a rule the customer does not pay a fee for the arranging of the insurance. However, the broker receives a Commission from the insurer. This normally consists of a percentage of the insurance premiums, sav-

<sup>272</sup> Art. 43 para. 2 Insurance Supervision Act. Cf. p. 2 of the letter from the Federal Office for Private Insurance of 13 December 2005 to enterprises in Switzerland operating in insurance brokerage concerning legislative innovations which came into force on 1 January 2006.

<sup>273</sup> Art. 43 para. 1 Insurance Supervision Act. Cf. p. 2 of the letter from the Federal Office for Private Insurance of 13 December 2005 to enterprises in Switzerland operating in insurance brokerage concerning the legislative innovations which came into force on 1 January 2006. According to unofficial information given on the telephone by the Federal Office for Private Insurance on 10 January 2006, there are about 10'000 dependent insurance brokers and 3'000 independent insurance brokers in Switzerland. The Federal Office for Private Insurance has not hitherto kept precise statistics, but the newly introduced registration requirements for independent insurance brokers should provide more data on this in the future.

<sup>274</sup> Swiss Insurance Broker Association (“SIBA”), Professional Profile of Swiss Insurance Broker [“Berufsbild Schweizer Versicherungsbroker”], [http://www.siba.ch/pdf/SIBA\\_Berufsbild\\_D.pdf](http://www.siba.ch/pdf/SIBA_Berufsbild_D.pdf) (last visited: 22 June 2006; “Professional Profile SIBA”), no. 1.

<sup>275</sup> Example taken from a broker agreement of Panorama GmbH ([www.uv panorama.ch:82/PDF/NEUMAND.pdf](http://www.uv panorama.ch:82/PDF/NEUMAND.pdf)) (last visited: 11 February 2006).

<sup>276</sup> Professional Profile SIBA no. 8.

<sup>277</sup> Cf. SFTD 124 III 481 cons. 4a.

ings deposits or insured capital and the amount is usually determined in the cooperation agreement.<sup>278</sup> Sometimes additional annual “super commissions” are paid pursuant to additional agreements and depending on the growth of business.<sup>279</sup> Economically such payments to brokers are a part of the insurance premiums paid by the insured to the insurer,<sup>280</sup> so they constitute Commissions (fig. 8).

Insurance brokers must primarily represent the interests of their customers and act as their agents.<sup>281</sup> However, they are not paid directly by their customers, but by the insurers. This is a classical conflict of interest situation, and the Marsh case referred to in the introduction to this book shows to what excesses such situations may lead.<sup>282</sup>

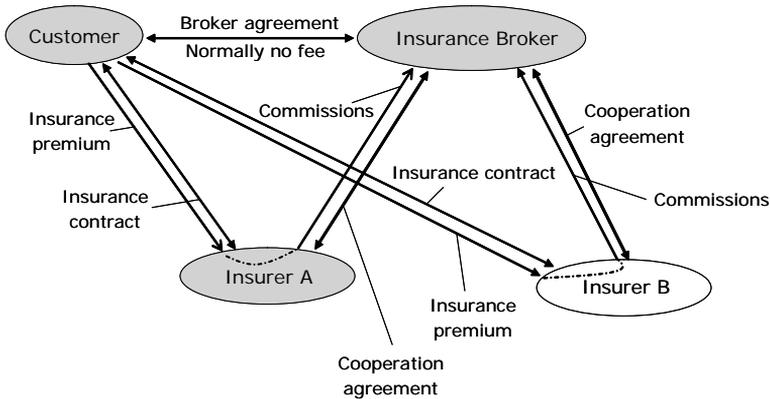


fig. 8

## II. Brokerage Agreement between the Customer and the Broker

### 1. Contents of the Brokerage Agreement

The primary function of a brokerage agreement is to identify optimal coverage of the insured parties’ risks and obtain appropriate insurance. Within the framework of his mandate the broker is obliged to advise the customer as to (i) which risks are to be covered and to what extent, (ii) how optimal coverage can be obtained, (iii) the available choice of insurers and (iv) what would be a reasonable premium for such coverage, taking all factors into consideration.<sup>283</sup> The broker must first conduct a risk anal-

<sup>278</sup> Professional Profile SIBA no. 7. Remarkably, it is also stated there that provided the amount of fees is not explicitly agreed the insurance broker is entitled to the usual or an appropriate fee, which shows that such compensation mechanisms (through commissions) are an established usage. Cf. STUDER, pp. 142 et seq.

<sup>279</sup> MÜLLER-CHEN/UHLMANN, p. 226; Professional Profile SIBA no. 6.4.

<sup>280</sup> Cf. SFTD 124 III 481 cons. 4a.

<sup>281</sup> Professional Profile SIBA no. 2.1; SFTD 124 III 481 cons. 4b.

<sup>282</sup> Cf. above A.

<sup>283</sup> Professional Profile SIBA no. 3.1.

ysis,<sup>284</sup> and then develop with the customer a risk management and insurance policy which he then implements by choosing an insurance company and obtaining the necessary insurance cover.<sup>285</sup> Often the broker will continue to advise the customer by attending to administrative tasks, giving support if damage is suffered and adapting the insurance cover to new legislation or changes in the risk or market situation.<sup>286</sup>

## 2. Legal Qualification

The Swiss Federal Tribunal seems to qualify the agreement as a brokerage agreement in the meaning of art. 412 et seq. CO, but has left the question open.<sup>287</sup> Writers primarily qualify the agreement as an innominate contract containing elements of the contract of mandate, the contract for the provision of a work and the contract of brokerage<sup>288</sup>.

The fact that the contract of brokerage is in principle remunerated is an argument against qualification under art. 412 et seq. CO. An unremunerated contract to arrange for services is not a brokerage contract but a mandate.<sup>289</sup> However, in the case of brokers who arrange insurance cover all the parties will generally assume that the broker is acting professionally and will consequently expect remuneration. They will usually be aware that economically speaking the broker's fee comes from the insurer, and that therefore the broker does not work for nothing but in the expectation of receiving a Commission from the insurer and with the understanding that the customer is in agreement that the broker keeps the Commission.<sup>290</sup>

A further argument against the qualification as a brokerage contract is that double brokerage is not allowed if it is expressly excluded in the agreement or if it leads to conflicts of interest. Although some writers consider that double brokerage for a tip leading to a transaction (*Nachweismäkeler*) is in principle admissible, this is not the case where the broker also concludes the transaction.<sup>291</sup> As a rule the insurance broker is actively involved in the conclusion of the insurance agreement, so the conflict of interest is apparent where he has to reach as reasonable a bargain as possible for the customer on the one hand, while receiving a Commission calculated as a percentage of the premium on the other.<sup>292</sup>

<sup>284</sup> Professional Profile SIBA no. 3.2.

<sup>285</sup> To this extent there are parallels with independent asset management, for an IAM must at the onset also analyse the customer's situation and aims and determine an investment strategy with him which must then be implemented.

<sup>286</sup> Professional Profile SIBA no. 3.3–3.6.

<sup>287</sup> SFTD 124 III 481 cons. 4a; in an earlier judgment the Swiss Federal Tribunal held that the agreement was (only) a mandate in the meaning of art. 394 et seq. (SFTD 84 I 140, particularly cons. 4).

<sup>288</sup> MÜLLER-CHEN/UHLMANN, p. 225; Professional Profile SIBA no. 4; cf. STUDER, pp. 83 et seq., particularly pp. 88 et seq.

<sup>289</sup> BSK OR I-AMMAN, Art. 412 N 2.

<sup>290</sup> SFTD 124 III 481 cons. 4a.

<sup>291</sup> BSK OR I-AMMAN, Art. 415 N 4.

<sup>292</sup> STUDER, p. 72.

To the extent that the law of mandate applies, the broker has a duty to account and deliver up under art. 400 para. 1 CO. This duty must be waived as far as possible. It would be different if the rules of the contract of brokerage were to apply, since here there are no duties to account and deliver up.<sup>293</sup>

Pursuant to Professional Profile SIBA no. 7 the broker is entitled to the usual or appropriate Commission in the absence of an agreement to the contrary. Given that Commissions are traditionally even more common in the insurance industry than in the field of independent asset management, and the rules of conduct qualify them as customary, it is conceivable that also the courts would hold that this is so.<sup>294</sup>

### III. Cooperation between Insurance Broker and the Insurer

Writers qualify the cooperation agreement between insurance brokers and insurance companies as an innominate contract with elements of the contract of mandate and the contract of brokerage.<sup>295</sup> The legal qualification depends on the services stipulated for. For comprehensive agreements to provide insurance brokerage services over a lengthy period the emphasis of the broker's activities is on portfolio management and customer advice, the acquisition element being of a subordinate nature.<sup>296</sup> In STFD 124 III 481 cons. 4d the Swiss Federal Tribunal examined whether from the insurer's point of view the fee should even be qualified as a rebate. The insurer's interest lies in the fact that professional brokers assume the task of advising the customers, thus saving it considerable administrative expense. The Swiss Federal Tribunal accordingly held that the Commissions depend on what the customer and the broker have agreed and that the right to receive Commissions will cease upon termination of the agreement.<sup>297</sup>

### IV. Insurance Supervision Act

The revised Insurance Supervision Act (VAG)<sup>298</sup>, its Implementing Ordinance (AVO)<sup>299</sup> and the Ordinance concerning the Federal Office for Private Insurance<sup>300</sup> have been in force since 1 January 2006.

<sup>293</sup> BSK OR I-AMMAN, Art. 412 N 8.

<sup>294</sup> Cf. SFT judgement of 15 June 2006, 6P.144/2005 E.3.6; cf. judgment of 22 March 2006, 4C.432/2005 cons. 4.3, where the court held that keeping the commission does not constitute a "usual payment" in the meaning of art. 394 para. 3 CO.

<sup>295</sup> Professional Profile SIBA no. 4; MÜLLER-CHEN/UHLMANN, p. 226; STUDER, pp. 182 et seq.

<sup>296</sup> SFTD 124 III 481 cons. 4d.

<sup>297</sup> *ibid.*

<sup>298</sup> Revised Insurance Supervision Act of 17 December 2004, SR 961.01. The green paper was published in BBl 2003, p. 3826. The revision primarily took into account the contents of the European Directive 2002/92/EG of 9 December 2002 on insurance brokerage.

<sup>299</sup> Implementing Ordinance [Aufsichtsverordnung] of 9 November 2005 ("AVO"), SR 961.011.

<sup>300</sup> Ordinance of Federal Office for Private Insurance [Verordnung des BPV über die Beaufsichtigung von privaten Versicherungsunternehmen, Aufsichtsverordnung-BPV; AVO-BPV] of 9 November 2005, SR 961.011.1.

An innovation is that insurance brokers have an obligation to inform under art. 45 VAG. They must disclose their contractual relationship with the insurers for whom they act to their customers, specifying who these insurers are.<sup>301</sup> However, it does not seem to be necessary that commission arrangements be disclosed in detail.

In addition, independent insurance brokers are now obliged to register.<sup>302</sup> The conditions for registration include sufficient professional qualifications.

Apart from this the VAG does not contain any rules concerning brokerage fees. However, the supervisory authority<sup>303</sup> does have the task of protecting the public against misconduct by insurers and brokers,<sup>304</sup> and to intervene where the interests of the insured are at risk<sup>305</sup>. In the fulfilment of this task an intervention by the supervisory authority in the event of abuses in connection with brokerage fees would be conceivable.

Investigations and interventions by the supervisory authority are also conceivable within the framework of insurance supervision.

<sup>301</sup> Art. 45 para. 1 lit. c VAG.

<sup>302</sup> Art. 43 para. 1 VAG. Dependent brokers ("insurance agents") may, but need not, register (art. 43 para. 2 VAG).

<sup>303</sup> The supervisory authority is the Federal Office for Private Insurance (FOPI).

<sup>304</sup> Art. 46 para. 1 lit. f VAG.

<sup>305</sup> Art. 46 para. 1 lit. g VAG.

## **G. Investment Companies and the SWX Additional Rules**

Investment companies (and their shareholders) have an interest in the distribution or placement of the company's shares since this might lead to a higher stock price, thus reducing the capital costs and generating added value to shareholders as well as reducing a potential difference between the stock price and the Net Asset Value. However, distribution costs burden the balance sheet.

The SWX Additional Rules for the Listing of Investment Companies ("SWX Additional Rules") provide that the prospectus must specify the persons and companies responsible for managing the assets. It must also specify the remuneration paid by the company to third parties for distribution, management and other services.<sup>306</sup> Consequently, any commission arrangements must be disclosed in the listing prospectus. However, these rules only apply to the listing prospectus, and there is in principle no duty to inform of subsequent changes regarding such remuneration.

Trailer Fees to shareholders of investment companies raise problems in view of the principle of equal treatment of shareholders. As a rule they are prohibited, unlike Management Fees paid to intermediaries, who are not shareholders and therefore not need to be treated equally.

The SWX Additional Rules make no reference to remuneration paid by third parties to persons or companies managing the investment company's assets.<sup>307</sup> Investment companies listed on the Swiss Stock Exchange and which fulfil the criteria pursuant to art. 2 para. 3 CISA do not fall under that act, so that art. 21 para. 2 CISA, which provides that such Commissions and other benefits must be credited to the company's assets, does not apply.

<sup>306</sup> Art. 10 para. 4 lit. d SWX Additional Rules.

<sup>307</sup> Cf. *ibid.*

## H. Fiduciary Responsibilities in Asset Management under the Professional Pensions Act

There is legislation concerning commission arrangements in asset management for professional pension funds.

The Federal Act on Professional Old Age Pensions, Survivors' Pensions and Invalidation Assistance of 25 June 1982 (BVG) provides in art. 53a<sup>308</sup> that the Federal Council shall edict implementing provisions (a) for the avoidance of conflicts of interest between the beneficiaries and persons responsible for the asset management<sup>309</sup> and (b) regarding the disclosure of monetary benefits which persons involved in the investment and management of pension fund assets have received in connection with these activities.<sup>310</sup> Based on this competence the Federal Council issued implementing provisions in Ordinance "BVV 2"<sup>311</sup>.

Art. 48g BVV 2 provides for a duty to disclose such Commissions. Art. 48f BVV 2 concerning conflicts of interests and benefits does not explicitly refer to Commissions. However, the Federal Council's comments on this provision state that it is generally prohibited to accept non-disclosed benefits or benefits without a valid economic reason to achieve an inappropriate advantage (including so-called kickbacks),<sup>312</sup> and that Commissions received by asset managers belong in principle to the pension fund since the asset managers have already been compensated for their activities.<sup>313</sup>

In addition, art. 48g BVV 2 obliges persons and institutions entrusted with the investment and management of pension fund assets to provide annual statements specifying whether, and if so which personal monetary benefits they have received in connection with their activities for the pension fund. Explicitly excluded are small presents and the usual occasional gifts<sup>314</sup>. Persons and institutions to which the Fed-

<sup>308</sup> Federal Act on Professional Old Age Pensions, Survivors' Pensions and Invalidation Assistance [Bundesgesetz vom 25. Juni 1982 über die berufliche Alters-, Hinterlassenen- und Invalidenvorsorge; BVG] of 25 June 1982, SR 831.40.

<sup>309</sup> Art. 53 lit. a BVG.

<sup>310</sup> Art. 53 lit. c. BVG.

<sup>311</sup> Implementing Ordinance to the Pensions Act [Verordnung über die berufliche Alters-, Hinterlassenen- und Invalidenvorsorge; BVV 2] of 18 April 1984, SR 831.441.1.

<sup>312</sup> Cf. Comments of the Federal Council [Erläuterungen des Bundesrates zu den Änderungen der Verordnung vom 18. April 1984 über die berufliche Alters-, Hinterlassenen- und Invalidenvorsorge (BVV 2)] of 1 January 2005 (<http://www.bsv.admin.ch/aktuell/presse/2004/d/0407020102.pdf>), (last visited: 22 June 2006) commentary ad art. 48f BVV 2.

<sup>313</sup> Comments of the Federal Council to the revision of the Ordinance of 18 April 1984 (BVV 2) of 1 January 2005 ("Erläuterungen BVV 2") ad art. 48f BVV 2. Here it is stated (without further references) that art. 48f BVV 2 corresponds to the rules applicable to the financial markets and asset management (guidelines, directives and other rules of conduct) and therefore these latter rules apply to banks and other institutions subject to banking regulatory law. However, as far as commission arrangements are concerned such rules are sparse (e.g. art. 21 para. 2 CISA, art. 11 SESTA), so it is questionable whether such exception is warranted.

<sup>314</sup> For determining such gifts the test is presumably similar to that applicable in legislation regarding medicines, cf. sub I below.

eral Banking Act applies are exempt from this reporting requirement. The reason given in the Federal Council's comments for the exemption is that such persons and institutions are subject to strict asset management rules which are more far-reaching than those set out in the BVV 2.<sup>315</sup> This is unconvincing. Although banks are of course subject to supervision, it is not apparent what the Federal Council means by stricter provisions on asset management in this regard which are more far-reaching than those set out in the BVV 2.

Finally, it should be mentioned that under art. 48h BVV 2 pension fund assets may only be managed by persons who are capable and organised in such a manner as to be able to comply with the rules concerning conflicts of interest (art. 47f BVV 2) and personal monetary benefits (art. 47g BVV 2).

The possibility to accept Commissions in this field is thus limited.

<sup>315</sup> Commentary BVV 2, ad art. 48g.

## I. Federal Medicine Act

Art. 33 para. 1 FMA<sup>316</sup> explicitly prohibits the offering, granting or accepting of monetary benefits to: “Persons who prescribe or dispense medicines, and organisations which employ such persons may neither be offered, granted nor promised monetary benefits for prescribing or dispensing medicines.” This provision aims at preventing professionals who dispense medicines (e.g. doctors, chemists and pharmacists) from being influenced by monetary benefits which include special bonuses, free travel, invitations, gifts or free samples.<sup>317</sup>

The wording of the law currently in force contains (unlike the draft law) an explicit list of exceptions. Monetary benefits of small value which are of relevance for the practice of medicine or pharmacy are permitted (art. 33 para. 3 lit. a FMA). These are defined as benefits of a value of up to CHF 300 per company, recipient and year.<sup>318</sup> A comparable exception is that contained in the revised art. 4a para. 2 UCA, which provides that small benefits which are socially customary shall not be deemed inappropriate. The exception in the FMA is, however, confined to benefits of relevance for the practice of medicine or pharmacy.

Also admissible are rebates which are usual in the trade and economically justifiable, and which have a direct influence on the price (art. 33 para. 3 lit. b FMA).<sup>319</sup> The latter requirement implies that such rebates must either be directly passed on to the patient who pays for his medicine himself, or indirectly in the form of rebates to health insurers with a subsequent effect on premium rates,<sup>320</sup> which also benefits patients. Under art. 56 para. 3 lit. b of the Illness and Accident Insurance Act<sup>321</sup> service providers such as doctors, pharmacists and hospitals must pass on the direct or indirect benefits received by persons or institutions who deliver medicines to them.

Art. 33 FMA is of considerable practical importance, but the general legal concepts employed therein engender numerous difficulties of interpretation. The Federal Office

<sup>316</sup> Federal Medicine Act [Bundesgesetz über Arzneimittel und Medizinprodukte] of 15 December 2000 (“FMA”), SR 812.21.

<sup>317</sup> Green Paper on the Federal Medicine Act of 1 March 1999, BBl 1999, p. 3518.

<sup>318</sup> Cf. recommendation of 21 December 2000 concerning the promising, accepting and accepting of pecuniary benefits in connection with medicines and the duty to pass on reductions received. The limit of CHF 300 is derived from court practice regarding “petty pecuniary offences” in the meaning of art. 172ter PC (e.g. SFTD 121 IV 264; cf. statement by State Counsellor Beerli of 27 September 2000, Official Parliamentary Bulletin 2000, p. 612; EICHENBERGER/MARTI, p. 208, particularly fn. 399; POLEDNA/BERGER fn. 677).

<sup>319</sup> This exception was mentioned already in the green paper, but not in the draft statute (Green Paper on the Federal Medicine Act, pp. 3519 et seq.).

<sup>320</sup> Green Paper on the Federal Medicine Act, pp. 3519 et seq.

<sup>321</sup> Illness and Accident Insurance Act [Bundesgesetz über die Krankenversicherung; KVG] of 18 March 1994, SR 832.10.

for Social Insurance has issued a number of recommendations.<sup>322</sup> While these do not have the status of laws and are therefore not binding on the courts, there remains a likelihood that the courts will take them into account when interpreting the recommendations.<sup>323</sup>

<sup>322</sup> These are in particular: (i) a recommendation of 21 December 2001 [Empfehlung vom 21. Dezember 2001 betreffend das Versprechen, Annehmen und Anbieten geldwerter Vorteile beim Umgang mit Medikamenten; Pflicht zur Weitergabe erhaltener Vergünstigungen]; (ii) a recommendation of 15 March 2002 [Empfehlung vom 15. März 2002 betreffend die Weitergabe der beim Einkauf verwendungsfertiger Arzneimittel erhaltenen Vergünstigungen im stationären Bereich]; (iii) a recommendation of 11 July 2002 [Empfehlung vom 11. Juli 2002 betreffend die Weitergabe der beim Einkauf verwendungsfertiger Arzneimittel erhaltenen Vergünstigungen im ambulanten Bereich] and (iv) a recommendation of 20 December 2002 [Empfehlung vom 20. Dezember 2002 betreffend den Umgang mit und die Weitergabe von geldwerten Vorteilen, insbesondere im Zusammenhang mit Weiter- und Fortbildung]. cf. <http://www.sozialversicherungen.admin.ch> (last visited: 22. Juni 2006).

<sup>323</sup> EICHENBERGER/MARTI, p. 208.

## J. Further Practical Examples

### I. Auctions

The principal participants in an auction are (i) the seller, (ii) the auctioneer and (iii) the buyer of the auctioned objects. The legal relationship between the seller and the auctioneer is usually qualified as a brokerage contract or a mandate.<sup>324</sup>

Auction firms in the art and antique business tend as a rule to charge the seller a consignment commission of between 10% to 20% of the selling price and a surcharge of between 10 and 25% of the selling price.<sup>325</sup>

There is strong competition between auction firms, in particular for first class works and important collections. In consequence, a firm will often be prepared to charge a reduced consignment fee and offer advance payments, guaranteed minimum prices and other benefits and reductions. In some cases the consignment fee might be waived altogether.

Sometimes the principal does not approach the auction house himself from the onset, but mandates an intermediary agent (e.g. a lawyer, art expert or testamentary executor) to obtain the best possible price for his objects and to choose a suitable auction firm. The agent generally receives a fee for this service and has a fiduciary duty towards the principal under the law of mandate.

Because of this some auction firms grant intermediaries (agents) Commissions as an incentive to choose them. This leads to a typical conflict of interest situation, there being a danger that the agent will keep the Commission without disclosing it to his principal, and choose the auction firm which pays the highest Commission although it might not provide the best service from the customer's point of view. An agent acting in the best interests of the customer will use his bargaining power to secure the best terms for his principal rather than the highest possible Commission for himself (fig. 9).

Here the duties under the law of mandate relating to information, reckoning up and delivery up apply. We examined these in detail above in connection with independent asset management.

<sup>324</sup> HEINRICH HONSELL, *Schweizerisches Obligationenrecht, Besonderer Teil*, 7th ed., Berne 2003, § 17 IV.2; BSK OR I-RUOSS, Art. 229 N 35.

<sup>325</sup> Sometimes degressive scales are used. Cf. e.g. Christie's: [http://www.christies.com/howtobuy/buyers\\_premium.asp](http://www.christies.com/howtobuy/buyers_premium.asp) (last visited: 22 June 2006; buyer's premium); <http://www.christies.com/howtosell/termsofsale.asp> (last visited: 22 June 2006; seller's commission).

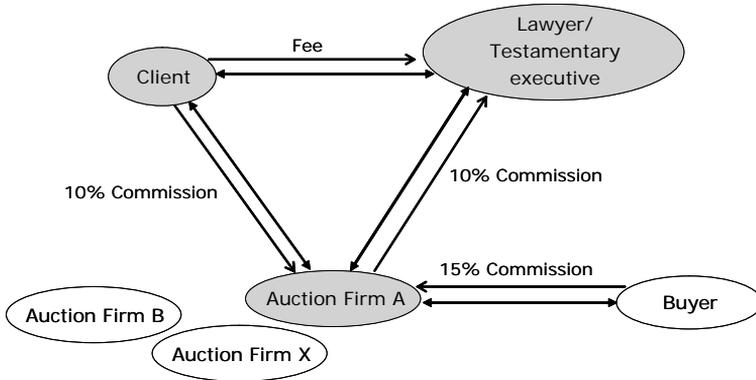


fig. 9

## II. Commissions for Lawyers who Introduce Customers

Sometimes lawyers receive Commissions from banks for having introduced customers, or receive other offers which have certain similarities with Commission arrangements. For instance it is said that some banks make it clear that they will only retain the services of a lawyer provided he introduces clients to them. Lawyers and clients have a fiduciary relationship. Commission arrangements can lead to a classical conflict of interest and impinge on such relationship (fig.10).

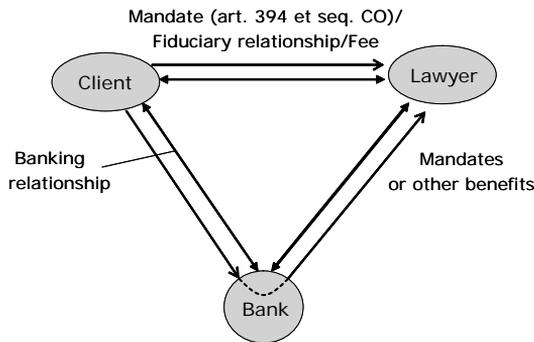


fig. 10

Lawyers must fulfil the obligations resulting from the law of mandate. Furthermore, the Federal Act governing Attorneys-at-law explicitly provides that lawyers must avoid any conflicts between the interests of their clients and persons with whom they have business or private relationships.<sup>326</sup>

<sup>326</sup> Art. 12 lit. c Act governing Attorneys-at-law [Bundesgesetz über die Freizügigkeit der Anwältinnen und Anwälte: Anwaltsgesetz, BGFA] of 23 June 2000, SR 935.61.

Lawyers must therefore at least inform their clients of the situation. They may, however, only inform the client of the other client's customer relationship with the bank with the latter's consent.

Where financial benefits are accepted – to the extent that such are even admissible here – high standards apply to the duty to disclose. In other cases it should suffice that the lawyer explains to the client that he works together with the bank and would therefore like to recommend it, always provided that the client's interests remain completely protected.

## K. Conclusion

In many areas commission arrangements are widespread or even customary. We have only examined a few practical examples here, and these would lend themselves to further analysis.

Characteristic for situations where commission arrangements exist is a three-party relationship between a principal, an agent and a third party who pays Commissions. Such relationships typically cause problems because the Commissions can lead to conflicts of interest. Thus there is a risk that the third party will encroach on the fiduciary relationship between the principal and the agent.

The Swiss Federal Tribunal has held that the duty to deliver up under the law of mandate (art. 400 para. 1 CO) may be waived. This is of significance far beyond the business of independent asset management. The Swiss Federal Tribunal has held that there is no general usage in the business of independent asset management to the effect that the customer waives his right to deliver up and that keeping Commissions is a usual (additional) form of remuneration of the IAM in the sense of art. 394 para. 3 CO. Whether such a general usage exists in other business areas, e.g. in the distribution of insurance services, remains open.

Only with retinence can the customer's tacit waiver of the right to delivery up of Commissions be inferred from the fact that the customer has not intervened and demanded payment. Consequently, if they intend to keep the Commissions, IAMs are, as a rule, well advised to obtain an express waiver from the customer. It seems to be justified to adopt a less stringent approach with regard to the extent of the knowledge which the customer must have in the event of an express waiver than for a tacit one. In our view, it should already be sufficient if the IAM informs the client about the fact that he receives Commissions and expressly offers to the customer to inform him upon request about the composition and the prospective amount of the Commissions even if the customer eventually does not take this expressly offered opportunity to receive information. However, until there is more court practice, IAMs are recommended to inform customers of all the factors necessary for determining the approximate amount of Commissions which they expect to receive. It is submitted that it is sufficient if the IAM informs the client of the maximum amount as a percentage of the assets under management or in some other comprehensible formula. Further, as a rule, an agreement on Commissions implemented in the general terms and conditions should also be effective.

In the light of art. 4a UCA it must be ensured that the customer (principal) explicitly or implicitly ratifies the retention of the Commissions so that they will not be considered as inappropriate benefits. Finally, it must be considered that the payment and acceptance of Commissions can, under certain circumstances, also entail potential rights of penal sanctions, e.g. for disloyal management (art. 158 PC).

The practice of the courts, particularly with regard to the duty to delivery up under the law of mandate and the unfair competition law aspects, will provide more guidelines on the requirements for the admissible granting and keeping of Commissions in the future. This would lead to more legal certainty without additional regulation being necessary. However, it involves high costs for the individual parties. In this regard it is to be hoped that the recent judgment of the Swiss Federal Tribunal will not lead to a flood of litigation.<sup>327</sup> For some time there has been increased awareness of the problems raised by commission arrangements, and this trend might well become even stronger. In some areas specific legislation or regulation is already in place. It is to be expected that more will follow, mainly in the form of self regulation. This could promote transparency and legal certainty. Furthermore, it would allow the introduction of new compensation models with a reduced conflict potential to the entire industry.

<sup>327</sup> Cf. footnote 5 above.

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