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Retrocession fees harder to keep

Retrocession fees designate the commissions paid to a financial intermediary by a third party – a bank, for instance – as an incentive for selecting services or products sponsored by them. Switzerland regulates the admissibility of retrocession fees differently from other jurisdictions, and most requirements have been set by case law. This article outlines certain aspects of the legal Swiss regime surrounding retrocession fees in the light of a recent ruling of the Swiss Federal Supreme Court (SFC), which has put an end to some uncertainty while opening the way to new legal debates.

Wealth managers are bound to their clients by an agency contract, under which the agent agrees to render a service to the principal without guaranteeing a result. The wealth manager is bound by several obligations, including a duty to transfer to the client all items acquired within the performance of the service (see article 400(1) of the Swiss Code of Obligations (CO)). The restitution duty arises from the general duty of loyalty of agents to their principals, and also extends to the benefits indirectly obtained by the agent when rendering the service, including those originating from third parties, such as retrocession fees.

In a landmark decision of March 2006, the SFC ruled that retrocession fees were subject to the obligation to restitution. Furthermore, it confirmed that a client could waive the statutory right to obtain retrocessions, provided that he/she had been fully and truthfully informed thereon (informed waiver requirement). In another decision dated August 2011, the SFC ruled that a waiver could be granted *ex ante*, but that an informed waiver implied, in such case, that the agent disclose the order of magnitude of the expected retrocessions. According to the SFC, such order of magnitude *could* be expressed by way of a percentage of the client's assets managed by the wealth manager.

It was still unclear whether the order of magnitude of retrocession fees could be disclosed in a different manner. This year, however, the SFC eventually clarified this case law. In a ruling dated May 13 2020 (4A_355/2019), it considered insufficient a clause in a wealth management agreement defining the amount of possible retrocessions on the basis of the amount invested in funds and other financial products. In the SFC's view, such information does not enable the client to know the precise parameters on which the calculation is based, nor to compare the expected retrocessions with the fees agreed with the client for the wealth management service.

According to the SFC, the contract must indicate the amount of possible retrocessions within a certain range, as a percentage of the managed assets, so that the information disclosed enables the client to appreciate the composition of the agent's remuneration and identify the conflicts of interest which the asset manager may face and which may encourage him/her to enter into or multiply transactions not serving the client's interests. This ruling, therefore, sheds light on the type of information required from a wealth manager for a court to uphold a client's waiver of the statutory right to obtain retrocessions.

The May 2020 SFC ruling was rendered in application of Swiss contract law in connection with a wealth management matter. One may legitimately wonder how the principles retained in that ruling will apply to other financial services, such as execution-only relationships where the service, while being limited to the receipt and transmission of client orders, is subject to the same limitations on retrocession fees (as confirmed by article 26 of the Swiss Financial Services Act, a new law that came into force on January 1 2020).

To be in line with case law, the information on retrocession fees in respect of such service could state the amount/scale of the expected retrocessions on an individual transaction basis, allowing for a comparison with the corresponding transaction fee. No doubt that adjustments will be necessary inasmuch as the investment decisions for such service (similarly to pure advisory service) lie solely with the client. Nevertheless, it remains unclear how such case law will apply to all-in fee arrangements, which cover a broader range of services than those to which the retrocession fees relate.

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