

Retrocessions: disclosure, waiver and the duty to restitute

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Retrocessions are remuneration received from third parties, long paid in particular by custodian banks to the independent portfolio managers whose clients hold assets with them. Swiss case law and the Financial Services Act (FinSA) now require these payments to be disclosed and, in principle, passed on to the client. This article explains where retrocessions sit in the wealth management business model, which rules govern them and how disputes about them are resolved.

1 Where retrocessions come from

A wealth management bank draws its income from several sources. Management and advisory fees, usually calculated as a percentage of assets under management, come first. Brokerage commissions, custody fees and the interest margin follow. Product-related remuneration completes the picture, including commissions earned on in-house investment funds and retrocessions received from third parties. Because its treatment is governed by the case law on retrocessions and by FinSA, this last category is exposed to regulation and transparency more directly than the others.

The tripartite relationship that characterises much of Geneva's wealth management explains why retrocessions became so widespread. The client entrusts the management of the portfolio to an independent portfolio manager, while a custodian bank holds the assets and executes the orders. For the custodian bank, independent managers are a channel for gathering assets without the direct cost of the client relationship, on which the bank earns custody fees, brokerage and an interest margin. The division of that income between bank and manager is a matter of negotiation, in which retrocessions paid by banks to managers were long common.

2 The rule under the Financial Services Act

FinSA entered into force on 1 January 2020 together with the Financial Institutions Act (FinIA). It draws on European regulation while adapting it to the Swiss context, as the fiduciary firm Bonnefous & Cie observed on 2 May 2022. The deadline for implementing its requirements expired on 31 December 2021, according to PwC Switzerland's overview of the new regime. Article 26 FinSA admits remuneration received from third parties only where the clients have been expressly informed in advance and have waived it, or where it is passed on to them in full. Remuneration from third parties must therefore be disclosed and, unless the client has validly waived it, paid over to the client.

Article 26 sits within a wider set of conduct rules. Article 25 FinSA requires providers to take appropriate organisational measures to avoid conflicts of interest and to inform the client where a disadvantage cannot be excluded. The provider must also inform the client about itself, the services offered, the risks and the costs, as Article 8 prescribes. Under Articles 10 to 12, it must check that an advisory or management service is appropriate or suitable in the light of the client's knowledge, experience, financial situation and objectives. It must also execute orders on the best terms and manage conflicts of interest. Articles 15 and 16 require it to document the services provided and to report to the client on them.

3 Remuneration and conflicts of interest

Retrocessions raise a question of incentives. A relationship manager paid according to the revenue generated may be tempted to favour lucrative products, which is why supervisors have addressed remuneration systems. FINMA circular 2010/1 on remuneration systems, published on 21 October 2009 with an implementation deadline of 1 January 2011, requires that such systems do not create incentives to take inappropriate risks. According to FINMA's release of 19 January 2011, the circular also increased the deferred share of variable pay and placed responsibility on the board of directors. The FinSA rules on conflicts of interest apply to product-related remuneration as well. The more prudent institutions tie part of variable remuneration to quality and compliance criteria and defer its payment.

The combination of case law and statute has changed commercial practice in the tripartite relationship. Alongside the duty of transparency and restitution, models in which the client pays the manager directly, without any retrocession, have developed. Transparency of fees, which regulation imposes and clients demand, has also made comparison easier and pushed

prices down, a pressure that falls hardest on the smaller firms whose fixed compliance costs cannot be spread over sufficient assets.

4 When disputes arise

Disputes between institutions and clients frequently concern losses on investments, unauthorised transactions, execution errors and the termination of relationships. Retrocessions feature among them. FinSA requires providers to join an ombudsman, which offers an amicable route before any court proceedings. Since a revision in force from 1 February 2021, according to the implementation guide published by PwC and the Swiss Association of Asset Managers on 27 August 2021, that affiliation is compulsory only for providers that do not serve institutional or professional clients exclusively.

Client classification therefore matters for the available routes. FinSA divides clients into private, professional and institutional clients. Under Article 5, wealthy private clients may declare that they wish to be treated as professional clients, a person being deemed wealthy if they declare the necessary knowledge together with assets of at least CHF 500,000, or hold assets of at least CHF 2 million.

Litigation before the courts falls to the Geneva civil courts, whose banking case law is abundant, and to the Federal Supreme Court. Among the recurring questions in that case law are the liability of the manager for losses, the scope of client instructions, the consequences of breaches of the conduct rules and the validity of hold-mail and complaint clauses. In judgment 4A_471/2017 of 3 September 2018, commented by the Centre de droit bancaire et financier on 18 October 2018, the Federal Supreme Court held the hold-mail clause valid subject to abuse of rights and distinguished it from the complaint clause, which deems transactions ratified when the client does not object in time. Since the revision of the Civil Procedure Code in force on 1 January 2025, cantons may also give a commercial court jurisdiction over certain international commercial disputes and allow proceedings in English.

5 What to take from it

Disclosure and restitution are the rule. Under Article 26 FinSA, remuneration from third parties may be kept only after express prior information and a waiver by the client. Otherwise it must be passed on in full.

Incentives are supervised as well. FINMA circular 2010/1 requires remuneration systems that do not encourage inappropriate risks. The FinSA rules on conflicts of interest also reach product-related pay.

Classification shapes the forum. Whether an ombudsman must be available depends on whether the provider serves private clients, while litigation runs through the Geneva courts and the Federal Supreme Court.

6 Sources

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