CENTRE DE DROIT
BANCAIRE ET FINANCIER

Retrocessions

What kind of reimbursement is due on investments in a fund of funds ?

Par Nicolas Ollivier le 21 February 2024

In its decision 4A_350/2023 of 21 November 2023, the Swiss Federal Supreme Court upheld a partial ruling by the Zurich Handelsgericht (HG190111-O), ordering an asset manager to account to a BVG/LPP pension fund for retrocessions received in connection with investments in target funds via two funds of funds.

This commentary focuses on the question of the foundation's right to information regarding the retrocessions received by the fund manager (for a description of the facts and the issue of informed approval of investments in funds of funds, see Hirsch, cdbf.ch/1326 and the summary diagram of the facts).

Firstly, the High Court points out that a claim for the rendering of an account can only be accepted if there is a corresponding claim for payment. It is therefore necessary to clarify beforehand the existence of a right to the return of retrocessions, because in the absence of such a right, no right to information can be exercised.

The asset manager maintains that the retrocessions on which it should provide information fall within the scope of art. 21 para. 2 CISA. By virtue of the primacy of the CISA over art. 400 of the Swiss Code of Obligations, the Foundation would not be entitled to repayment of the retrocessions. Consequently, the main claim for payment would fail.

The Federal Court points out that art. 21 para. 2 CISA states that persons who administer, hold or represent collective investment schemes and their agents may only receive the remuneration provided for in the documents and that retrocessions must be credited to the collective investment scheme. Accordingly, the retrocessions paid by the target funds to the fund manager must be credited to the fund of funds' assets. In this respect, the Foundation's argument that it is not claiming the amounts that the manager paid to the two funds of funds, but only those that were not paid or were not paid in full to the funds of funds, is not valid. Consequently, the Foundation has no right to information under the asset management contract with the fund manager. On the other hand, the fund of funds or the fund management company would have a right to information on these retrocessions by virtue of the asset management contract concluded between them and the manager.

The Court did not stop there and went on to hold that if the fund manager had invested directly in the target funds in accordance with its obligations, the foundation would be entitled to

information and the return of retrocessions under the asset management contract between the parties. The fact that the Foundation does not have a right to information results solely from the manager's failure to comply with its obligations. Any target fund retrocessions not paid to the fund of funds therefore constitute an element of the loss resulting from the manager's behaviour in breach of his obligations, for which he could be required to pay damages under the asset management contract between the parties (art. 398 cum 97 CO). In conclusion, the foundation should be granted a right to account for the retrocessions received by the manager from the target funds, as well as for the amounts of these retrocessions that were retransferred to the funds of funds.

Remarkably, the Federal Court ruled in this case that the client who was harmed by an unnecessary layer of structuring of the investments – through funds of funds with no interest other than to increase the manager's income – was entitled not to restitution of the retrocessions, but to damages under art. 97 CO. The client's argument was limited to claiming restitution of only those retrocessions paid by the target funds to the manager that had not been retransferred to the fund of funds. In our view, the foundation may still, in its staged and unquantified action, claim the full amount of the retrocessions on the basis of art. 97 CO, given that the Handelsgericht defines the loss as the difference between the investment in the funds of funds compared with an investment directly in the target funds, and that in this hypothesis the foundation would have been entitled to restitution of the full amount of the retrocessions.

In our opinion, this decision could herald a federal court ruling that retrocessions in an execution-only relationship constitute damages resulting from a breach of the best execution contract. The fund manager was also ordered to pay damages for having purchased overpriced tranches of target funds (for retail clients instead of institutional clients), which enabled it to collect higher retrocessions. A retrocession can be defined as a portion of the commission paid to the fund that is paid back to the manager, thereby increasing the price paid by the client. Only time will tell what the Federal Court's position will be on the restitution of retrocessions in the event of an execution-only relationship. In the meantime, uncertainty persists with contradictory cantonal decisions, even within the Geneva Court of First Instance (see e.g. JTPI/10949/2023 vs JTPI/1076/2024).
