3/2014

Guidelines on Duties regarding the charging and use of Fees and Costs (Transparency Guidelines; TGL) from 22 May 2014

1. Introduction

As part of the revision of the Collective Investment Schemes Act (CISA) and the Collective Investment Schemes Ordinance CISO, the following provisions (amongst others) were issued:

Art. 20 CISA Principles [of the codes of conduct]
1 Licensees (authorised parties) and their agents shall fulfil the following requirements in particular:
(…)
c. Duty to provide information: They ensure the provision of transparent financial statements and provide appropriate information about the collective investment schemes which they manage and distribute and the assets which they hold in safekeeping; they disclose all charges and fees incurred directly or indirectly by the investors and their appropriation; they notify investors of compensation for the distribution of collective investment schemes in the form of commissions, brokerage fees and other soft commissions in a full, truthful and comprehensible manner.

Art. 34 CISO Duty of disclosure
(…)
2bis The duty of disclosure with regard to compensation for distribution encompasses the nature and scale of all fees and other pecuniary benefits through which the activities of the distributor are to be compensated.

Art. 37 CISO Fees and incidental Costs
(…)
5 The fund management company, asset manager of collective investment schemes and custodian bank may pay commissions only as reimbursement for the fund's distribution activities and only if this is specifically provided for in the fund contract.

Based upon this, the SFAMA has issued the Transparency Guidelines, which the Federal Financial Market Supervisory Authority FINMA has declared to be a minimum standard. Five aspects are of particular interest: (i) the scope of application, (ii) the duty to provide information, (iii) the regulations concerning retrocessions, (iv) the regulations concerning rebates and (v) the transitional period.

2. Scope of Application (N. 2–4 TGL)

The Transparency Guidelines are directed towards all licensees and their agents and thus towards (i) fund management companies, (ii) custodial banks, (iii) SICAVs, (iv) asset managers of collective investment schemes, (v) representatives of foreign collective investment schemes, (vi) distributors and (vii) foreign collective investment schemes, inasmuch as these are distributed to qualified and non-qualified investors.
Three limitations are to be noted:

(i) in geographical terms, only the activities in and from Switzerland are covered;
(ii) in substantive terms, only the actual fund business is covered (but not for example the administration of individual portfolios by an asset manager);
(iii) with regard to foreign collective investment schemes, the TGL only applies if and as far as stricter foreign regulations reach. Should stricter foreign regulations exist, these are to be laid out in the prospectus, so that investors in Switzerland also benefit from them. This applies for example to the so-called RDR (Retail Distribution Review) share classes as per UK Law, according to which no retrocessions may be paid (thus upon distribution in Switzerland too).

The distribution to qualified investors falls without limitation in the area of application of the TGL.

3. The Duty to provide information as per Transparency Guidelines (N. 9–15 TGL)

The licensees are, as previously, required to transparently disclose in the fund documentation the manner and level of fees which are charged to the fund's assets. These costs can differ per share class as long as arranged according to objective criteria.
Newly, it is to be disclosed whether such fees may flow to third parties for the provision of services incurred in the exercise of the fund business, and what type of service it is. On the other hand, it is not required to reveal the identity of the recipient nor the size of the amounts. The duty to provide information may have the result that the general statement thus far used in model prospectus of Swiss funds, *„This [commission] is applied for the administration, the asset management and the distribution of investment funds, as well as the covering of ensuing costs"* may no longer suffice. Rather, it may be required to specifically list the delegated activities (e.g. asset management, distribution, sub-custody etc.), and explain from which raised fees (generally from the management fee) the compensation takes place.
Alongside this general duty to provide information, there are in addition specific duties to provide information. They are based on art. 84 CISA (right of information) and the accountability of the agents as per art. 400 CO and applies – upon request – to all parties to the fund contract (i.e. the fund management company and custodian bank) or the SICAV and the SICAF and their agents. For the agents, this however applies only as far as a direct contractual relationship with the investor exists (which in practice should be the case with distributors who have an asset management or investment advisory contract with the client).
This duty to inform is limited in that (i) the investor must raise a "justified" interest, (ii) the duty of disclosure is limited only to a concrete investment of the investor and its investment period is limited and (iii) the regulations concerning statute of limitation and appropriateness must be taken into account.
It is to be noted that the wording of the TGL is not in line with that of the Law: according to Art. 84 Abs. 1 CISA, the investor shall have the right to receive information on the basis for the calculation of the net asset value per unit without exercise of a justified interest, and according to Art. 84 Abs. 2 CISA on information "on specific business transactions such as the exercising of membership and creditors' rights or on risk management", as

far as he can assert a valid (not necessarily a "justified") interest. As the TGL cannot alter valid civil law, a civil court judge may judge the demand for information exclusively supported by Art. 84 CISA.

4. Requirements for the legal Applicability of Retrocessions (N. 16–22 TGL)

Retrocessions are payments from fund management companies, SICAVs, SICAFs and their agents for distribution activities in respect of fund units. They are as a rule paid from the management fee and/or distribution fee (the latter is usually part of the management fee), in practice often also from the subscription fee. They are thus not intended for the final investor (even though they may to be released based on the disclosure and publication duty according to art. 400 CO in certain cases to the final investor).

The Transparency Guideline explicitly defines that retrocessions are permitted, irrespective of the contractual relationship which the investor has with the recipient of the retrocessions and irrespective of whether the payment occurs as a part of the distribution to non-qualified investors, to qualified investors or in the course of non-distribution (also known as private placement). It is however required that it is disclosed in the fund contract (not in the prospectus) that retrocessions are paid (art. 37 para. 5 CISO).

Additionally there is the duty of the recipient of the retrocession to disclose voluntarily and without charge the extent or the parameters of the retrocessions, which as a rule should occur in the asset management or investment advisory agreement. Upon request, he is obliged to disclose the amounts received.

With regard to the retrocession payments, the inherent potential conflict of interest, that the asset manager does not buy those investments that are most suitable for the client but those from which he receives the highest retrocessions, is to be disclosed to the investor in appropriate manner. This disclosure should as a rule occur in the asset management or investment advisory agreement.

5. Requirements for the legal Applicability of Rebates (N. 23–28 TGL)

Rebates are "payments by fund management companies, SICAVs, SICAFs and their agents directly to investors from a fee or cost charged to the fund with the purpose of reducing the said fee or cost to a contractually agreed amount."

As with retrocessions, rebates are also permitted, however only if the following requirements are cumulatively fulfilled:

(i) The rebates must be paid out of the fees, which are due to the paying financial intermediary. They may not be additionally charged to the fund assets.

(ii) The rebates are granted on the basis of objective criteria, e.g. due to the investment volume in a fund or a product range, the amount of the fees generated by the investor, the expected length of investment or the willingness of support upon launch.

(iii) The rebates must be granted to all investors that fulfil the objective criteria.

(iv) The objective criteria to be fulfilled for the payment of rebates must be presented transparently in the prospectus.

In addition to this duty of disclosure of the criteria in the prospectus, the amount of the rebate is to be disclosed to the investor upon request. However, the identity of those investors who have already received rebates may not be revealed.

6. Transitional period (N. 30 / 31 TGL)

The Transparency Guidelines came into force on 1 July 2014. The documents of Swiss collective investment schemes, which take the regulations of the TGL into account, are to be submitted for approval to the FINMA by 1 March 2015. The documents concerning foreign funds are to be submitted for approval to the FINMA by 1 June 2015.

The documents concerning funds which are only distributed to qualified investors (and which are not to be approved by the FINMA - art. 120 para. 4 CISA), are similarly to by adjusted to the TGL by 1 June 2015.

7. Final notes

The topic of retrocession payments and rebates remains a hot potato, as it is not only regulated by the Transparency Guidelines, but also by civil law, in particular art. 400 CO. In this, the view of the Swiss Federal Supreme Court may be valid even after the issuing of this new TGL, that the TGL does not take precedence over the art. 400 CO (BGE 138 III 175 Erw. 5.8.2; N. 3 TGL) and consequently an obligation to disclose and release can exist, even if the requirements regarding payment of retrocessions as per TGL are fulfilled.

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