Liability of an independent asset manager in Switzerland

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1. Overview

In cases of losses clients usually seek relief by suing their asset managers. This essay outlines the requirements regarding the prerequisites to establish an independent asset manager's liability in such cases. In principle, the client has to prove his loss, a breach of contract committed by the asset manager as well as causation between such breach and the loss. The asset manager may defend himself by showing that he was not at fault.

2. Legal framework of independent asset management agreements

In Switzerland the law does not provide for special provisions that are applicable to independent asset managers. Therefore, the general provisions of the Swiss Commercial Code, the Code of Obligations (hereinafter 'CO') and especially its provision on mandate agreements are applicable. Notably, independent asset managers (as opposed to banks) are not subject to supervision by the government. However, several organisations have issued self regulatory rules, eg. the Swiss Bankers Association for banks or the Swiss Association of Independent Asset Managers for their members.

3. Asset manager's liability

The following lines deal with the asset manager's liability under private law only and excludes aspects as anti money laundering and similar issues. It follows the four requirements to establish liability outlined above.

3.1 Loss

The client's loss is hypothetically calculated by comparing the amount of the actual assets with the amount that would have resulted if the asset manager had correctly performed his duties. According to this calculation, damage is the difference between the total amount of assets after the faulty management and the hypothetical amount of assets that would have resulted if the asset manager had acted in accordance with the aims and instructions of the client. The relevant factors to judge the asset manager's actions are the necessary knowledge and the market expectations at the time the contract was concluded. These two elements determine how a correctly composed portfolio would have developed according to general expectation. Relevant for comparison are ordinary portfolios, not the results of the most successful asset managers.

If a different and dutiful composition of the portfolio had equally led to a negative result, eg in case of a general decline in stock values, the client does not suffer a loss in a legal sense.

3.2 Breach of contract

The second requirement to establish an asset manager's liability is the proof of a breach of contract. Most cases are based on a breach of the asset manager's due diligence and, to a certain extent, breaches of his duty to inform. Less frequent are breaches of his duty of trust. Other obligations are stipulated by the law of the mandate agreement, especially art. 398 CO.

Generally, the standard of an asset manager's diligence exceeds that of an employee. Such standard is again governed by the required knowledge and a generally prevailing market expectation. However, liability might also be established where an asset manager accepts a mandate in spite of his unsatisfactory professional qualifications.

Because no set of principles specifies the requested duties, the Swiss Bankers Association has published guidelines for asset management mandates. Such guidelines are generally considered as a specification of the relevant duties and, therefore, attain a special legal status.

To 'know his customer' is one of the principal duties of the asset manager. He has to establish a full picture of the client's assets and income situation (the 'know your customer-rule'). Such requirement is best observed by filling in a respective client profile. After having determined the client's means and needs, the asset manager then assesses the client's ability to bear risks. Once the risk capacity has been established, the asset manager has further to investigate the client's willingness to take risks. Based on such client preferences, the asset manager implements a fitting strategy. Consequently, one of the main tasks of the asset manager is to learn the client's interests. The documentation put in place has to be renewed constantly.

With respect to the duty to inform there is an ongoing practise identifiable in the decisions rendered by the Swiss Federal Supreme Court so that professional asset managers have to observe special duties to verify, to advise and to warn the client in accordance with the respective situations. Consequently, the asset manager has to advise the clients regarding all possible risk situations if the latter is not already aware of them. Such information must be provided with due care but it does not have to be correct. Therefore, a piece of information given by the asset manager may turn out to be wrong after a certain time in spite of the fact that such information has to be qualified as diligently made at the relevant time.

There are even some further duties: According to

the guidelines, the asset manager is not allowed to raise a credit in the name of his client. As an exception to this, it is widely accepted that the account may be overdrawn for a short period of time if incoming gains in the necessary amount are expected within a short time.

The asset manager is obliged to choose his investments with diligence. In addition, he has to supervise the portfolio's development on a regular basis. On the other hand, it is up to the client to prove that an investment violates market principles, is prohibited by the agreement or should not have been chosen due to its currency, industry sector etc.

If an investment is not covered by the principles of customary asset management the client can only approve it after having been duly informed. Such information has to cover the envisaged risks and the characteristics of the financial instruments applied. However, there is no need that the client understands the financial transaction in detail.

3.3 Causation

As already mentioned above, the asset manager is only liable if there is causation between the alleged breach of contract and the loss suffered. The first test is whether the loss would not have occurred but for the breach of contract (natural causation). However, this broad principle is narrowed down to the so called 'adequate causation' which leads to the second question: According to the general experience and pursuant to the ordinary course of things, does a loss usually occur under these circumstances or does the breach enhance the occurrence of such loss? Consequently, the client has to show natural and adequate causation with respect to each breach of contract and arising loss. It is not sufficient to establish loss and breach of contract independently.

3.4. Fault

The asset manager is not liable if he can prove that he was not at fault. Pursuant to the latest doctrine, the diligence inherent in a mandate agreement is considered as part of the contract. Consequently, it is unclear whether the observance of the required diligence is to be examined as breach of contract or as an indication of fault.

4. Summary

A client may establish his asset manager's liability if he proves his loss, a breach of contract committed by the asset manager as well as causation between such breach and the loss. The asset manager may defend himself by showing that he was not at fault. There are quite a few proceedings in Switzerland most dating back to losses after the turn of the millennium. ■