Jane Campbell and John Wakim, NSW

Referring clients for financial advice: *Is it worth the trouble?*

In the increasingly complex world in which we live, it is impossible for any one professional to be expert in all the areas that might impact upon a client's overall position. The need for lawyers to work in association with other professionals such as financial planners or accountants to advance their clients' interests is obvious and common practice in commercial legal practice. But what of plaintiff lawyers? Should plaintiff lawyers recommend their clients obtain financial advice, and if so, should the recommendation simply comprise the bald statement, 'You need to get financial advice', or can a lawyer go one step further and recommend a particular financial adviser?

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PART I: LAWYERS' DUTY TO RECOMMEND FINANCIAL ADVICE

Part I of this article is written by Jane Campbell, a lawyer working as a structured settlement consultant for ipac securities ltd, specialising in the financial planning implications of personal injury compensation.

This article was researched by the author in response to the number of queries arising around the issue of plaintiff lawyers' responsibilities in the area of financial advice. The article expresses the author's personal view on this issue generally and does not constitute legal advice.

Introduction

A person making a claim for compensation, settling a matrimonial property dispute or dealing with the administration of an estate usually knows they need legal advice. However, the need for financial advice in those same situations is frequently overlooked.

Lawyers are in a good position to point out to their clients the benefits of ▶

financial advice and even to recommend a financial adviser. The bonds of trust between lawyer and client mean that such advice is likely to be heeded.

Referring clients for financial advice is not only a means by which lawyers can help clients maximise the proceeds from litigation or litigation resolution, it may also be a legal obligation. A review of case law makes it clear that in certain circumstances the duty of care that lawyers owe their clients requires they advise their clients to obtain financial advice.

Duty beyond the scope of the retainer?

In *Hawkins v Clayton*[1], Deane J advanced the proposition that the solicitor's duty of care in tort may require the taking of positive steps beyond the specifically agreed professional task or function, to avoid a real and foreseeable risk of the client sustaining economic loss.[2]

This reasoning was relied upon by a majority of the New South Wales Court of Appeal in *Waimond Pty Ltd v Byrne*[3] and was also applied by a majority of the Full Court of the Supreme Court of South Australia in *Micarone v Perpetual Trustees*[4].

In *Astley v Austrust Ltd*[5] and *Perre v Apand Pty Ltd*[6] a view emerged that where contract law can regulate the rights and duties of client and solicitor, the courts should be slow to impose tortious duties upon solicitors.

However, where there are 'gaps' in the retainer, and the client is 'vulnerable' in the sense of his or her rights being affected by the control or conduct of the solicitor, tort law may continue to play an important role.[7]

A duty to provide financial advice?

Certain cases decided during the 1980s held that the duty of care owed by lawyers to their clients would require the provision of financial advice in some circumstances.

In *McNamara v Commonwealth Trading Bank*[8], King CJ expressed the view that, in the absence of instructions to the contrary, a solicitor's retainer should be regarded as including that the solicitor should themself offer advice on the financial wisdom of the proposed transaction.

This issue was considered in some detail by Bryson J in *O'Brien v Hooker Homes Pty Limited and Ors*[9]. He stated:

'A decision about what tasks are required of a solicitor by a particular contract of retainer could not, in my opinion, be confined in all cases to the bounds of the express terms of the retainer... It is necessary to consider the circumstances in which each particular retainer was given, the nature of the task which the solicitor was retained to carry out, and what it would be necessary to do to carry it out in an effectual manner.... Performance of a retainer with reasonable care and skill may sometimes require that financial advice be given.'

"It would be a brave lawyer who assumes that a duty to advise a client to obtain financial advice has not survived *Astley*."

Such decisions are best understood in the context of the history of the rules regarding lawyers and financial advice. Prior to, and during, the 1980s the line between legal and financial advice was not clearly drawn. It was considered quite acceptable for lawyers to give financial advice so long as they were mindful of their fiduciary duty to their client and otherwise complied with legal practice and conduct rules. Up until at least the mid-1980s, lawyers were involved in giving financial advice to a significant degree. This was perhaps evidenced by the significant amounts of money being invested in solicitors' mortgage funds.

During the latter part of the 1980s, information started to filter through to the legal community about licensing rules relating to the provision of financial advice. Articles in the *New South Wales Law Society Journal* in 1988 and the *Victorian Law Institute Journal* in 1989, for example, referenced the licensing rules.[10] However, the licensing regime was generally considered to only affect those lawyers acting specifically as financial planners and did not impact on the way that most lawyers went about their business.

In an article on O'Brien's case published in the *New South Wales Law Society Journal* it was noted that:

'The judgement does not clearly distinguish between a solicitor's duty to give legal advice on the one hand and financial advice on the other hand. It can be argued that, upon reading the totality of his Honour's reasons, these two duties overlap and are so interdependent that there is not need or purpose to be served in seeking to distinguish between them. Or it may be that there is always a duty to advise on the legal aspects of a transaction, and there may sometimes be a duty to advise on the financial aspects according to the facts and circumstances of the particular transaction. In any case, many solicitors who, until now, believe that their functions included the giving of only legal advice, as opposed to financial advice, may wish to reassess their position.'[11]

Lawyers not to give financial advice

Attitudes changed as the financial boom times of the 1980s gave way to the recession of the early 1990s. There was a recognition that lawyers lacked the professional training and skills required to give financial advice and that they should instead refer their clients to financial advisers.

This shift in attitude was evident when the New South Wales Court of Appeal handed down its decision in

Citicorp Australia Ltd v O'Brien[12]. The court reversed the abovementioned decision of Bryson J. In his judgement, Sheller JA looked in detail at the issue of whether a solicitor's duty extended to giving financial advice. He said:

'Stated bluntly, such a duty would require solicitors, retained to act on a purchase or mortgage for their skill in the law, to inform every client for whom they acted of their views about the financial prospects of the purchase or mortgage where they felt, or reasonably ought to have felt, that there was a risk of loss. One consequence of this would be to require solicitors to give opinions, which they were not qualified to give, with the obvious consequence that if they were wrong and the client had acted on the basis of those views, they would be liable in negligence. For good reasons, such a proposition is contrary to authority. The solicitor's duty is found on the terms of the retainer and the ambit of any additional assumed responsibility relied upon.'

"How is a lawyer to assess whether a client's financial and investment 'strategy' presents 'a real and foreseeable risk of economic loss'?"

The *Financial Services Reform Act* 2001 (Cth), amending the Corporations Act, reinforces that lawyers are unable to give personal financial advice unless they are licensed under the Act. However, although lawyers must not give financial advice, they equally should not simply ignore their clients' needs for financial advice.

A duty to recommend financial advice?

In *Tarzia v National Australia Bank*[13], the Full Court of the Federal Court of Australia noted that it was generally not the task of solicitors to explain the financial result or prudence of transactions involved in documents they are merely instructed to explain, but added the qualification:

'In certain situations it may be negligent of a solicitor not to ensure that his client has good financial advice, particularly when the client is at a disadvantage with respect to the other parties to the transaction, and where the results are potentially disastrous to the client.'

In *Janesland Holdings Pty Ltd v Simon*[14], the court held that there was ▶

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no general principle requiring solicitors to provide financial advice. Crispin J said, 'To hold otherwise could impose intolerable burdens on solicitors'.

His Honour noted the decision in *Tarzia*, but concluded on the facts that the solicitor was not required to take the initiative of advising the plaintiff to engage independent financial adviser.

A few months later in *State Bank of NSW v Sullivan*[15], the New South Wales Supreme Court held that the solicitor had breached his duty of care by not recommending that his client obtain financial advice. James J looked specifically at the issue of the obligation to recommend financial advice, stating:

'There remains the question whether [the solicitor] was under an obligation to advise [the client] to obtain independent financial advice, even though it was not within his retainer to give such advice and even though there was no assumption of responsibility by [the solicitor] to give such advice. I have already held that I consider that I should apply what Dean J said in *Hawkins*, that the relationship of solicitor and client may give rise to a duty on the part of the solicitor which requires the taking of affirmative steps beyond the specifically agreed task or function to avoid a real and foreseeable risk of economic loss being sustained by the client. Priestly JA observed in *Cousins* that Dean J was contemplating that some cases would, and some cases would not, require a solicitor to do more than he was specifically retained to do.

'In *Tarzia* the Full Court of the Federal Court, after stating the passage I have already quoted it is not generally the task of a solicitor to give financial advice to a client about a proposed transaction, added: - "In certain situations it may be negligent of a solicitor not to ensure that his client has good financial advice, particularly when the client is at a disadvantage with respect to the other parties to the transaction, and whether the results are potentially disastrous for the client…".

'I do not, with respect, consider that a solicitor can be obliged to "ensure" that his client has "good" financial advice. However, this passage in the judgement of the forecourt does support the proposition that in some cases a solicitor may be obliged to advise his client to obtain financial advice, although the giving of such advice by the solicitor is not required in order to preform his retainer.'

"It is common practice in the world of commercial law for lawyers to recommend financial advisers."

Personal injury plaintiffs and financial advice

The majority of plaintiffs (together with the majority of the population) are ill equipped to achieve the optimum result from a lump sum without expert advice. The complexity of financial planning issues affecting plaintiffs should not be underestimated. Good financial advice means that plaintiffs will have the best prospect of meeting their future financial and lifestyle needs from that hard fought lump sum.

In addition to benefiting the client, the obtaining of financial advice also affords protection to the lawyer.

In the text *Professional Liability in Australia*[16], the authors Walmsley, Abadee and Zipser state:

'…in light of the uncertainty concerning the scope of the duty of care generated by *Astley*, a prudent solicitor would be wise to presume that an independent tortious obligation to advise a client about a matter might arise independently of (but not inconsistently with express or implied terms of) the retainer, in circumstances where it is foreseeable that a failure to exercise reasonable care will cause the client economic loss.'[17]

It would be a brave lawyer who assumes that a duty to advise a client to obtain financial advice, such as that found to exist in *Sullivan*, has not survived *Astley*.

Forseeability of financial loss may arise when the client informs the lawyer what he or she intends to do with the lump sum. Based upon the approach in *Sullivan* it would appear obvious that if the lawyer knows that what the client intends to do with the funds would result in 'a real and foreseeable risk of economic loss', the lawyer would have a duty to advise the client to seek financial advice.

The issue is then a practical one – how is a lawyer to assess whether a client's financial and investment 'strategy' presents 'a real and foreseeable risk of economic loss'? There may be clear-cut cases, such as a client who informs the lawyer he intends to take up day-trading or to invest in alpacas, but what of the client who informs the lawyer he intends to buy an investment property in Melbourne? To invest the money in her brother-in-law's building company? To invest in hardwood plantations? What degree of knowledge of investment, tax, the property market, Centrelink entitlements and so forth will a lawyer be deemed to have when making the assessment?

Further, it is arguable that plaintiff lawyers have a duty to advise a client to seek financial advice where the lawyer has concerns about the client's ability to manage a lump sum, for almost inevitably the relationship between plaintiff lawyer and client will result in the lawyer gaining a good understanding of the client's ability, or inability, to manage a lump sum.

In light of the uncertainty as to the circumstances in which a duty to advise a client to obtain financial advice arises, it would be prudent for a plaintiff lawyer to advise most plaintiffs who have (or will) receive a damages sum to

obtain financial advice. This would particularly be the case where the amount received is large, the client's earning capacity has been affected, the lawyer is aware the client may be subject to pressure from family or friends to 'share' or 'loan' the money, the client has ongoing treatment needs which must be funded from the lump sum, there is a lengthy Centrelink preclusion period, the lawyer has concerns about what the client proposes to do with the funds, and/or where the client is ill equipped to manage the funds due to poor education, ill health, below average intelligence, emotional state or the effects of medication. It is important, however, to bear in mind that regardless of intelligence or education there are few people, including lawyers, who would not benefit from professional financial advice.

Of course, the advice that the client needs to obtain financial advice should be in writing and signed by the client. Any refusal to obtain the advice should also be documented and signed by the client.

Lawyer's liability for referral to financial adviser

Many plaintiff lawyers refuse to recommend a financial adviser, even if asked by the client, for fear that they may be held liable should the adviser give negligent advice or abscond with client funds.

This unwillingness to provide a recommendation is almost unique to plaintiff lawyers. It is common practice in the world of commercial law for lawyers to recommend financial advisers, accountants, tax agents, valuers and other professionals to their clients. Indeed, commercial lawyers see such recommendations as an important part of the service that they provide to their clients.

What is a recommendation? At its highest, a recommendation simply amounts to a statement by the lawyer that in their view the adviser is competent and will act in the client's best interests. Provided the lawyer has a basis upon which to make such a recommendation, it is difficult to envisage a scenario whereby the lawyer could be held liable for any action or inaction of the adviser. Part II of this article by John Wakim sets out a framework for determining whether a financial adviser is competent and will act in the client's best interests.

There are two further ways of minimising any risk arising from a recommendation:

1. Ensuring the adviser has sufficient professional indemnity cover.
2. Being very cautious about accepting commissions, referral fees and/or rewards from the adviser.

In respect of rule 38 of the Revised Professional Conduct and Practise Rules (NSW), which deals with referral fees, Virginia Shirvington, the senior ethics solicitor at the Law Society, states:

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'The effect of the rule is basically that is not necessarily wrong to receive a commission for referring the work or business of a client to a third party as long as the referral is free from any undue influence and the arrangement does not involve conflict between the clients interests on the one hand and yours/the third parties on the other hand... The client might be quite happy for you to receive a commission and the deal might be quite commercially sound for the client, but is it truly informed consent unless the client also understands the risk that you might be potentially, either with or without intent, preferring your own interest in carrying out the legal aspects of the transaction to the detriment of the client?'[18]

Conclusion

The law is clear that lawyers have an obligation to advise their clients to obtain financial advice in certain circumstances. What is unclear for plaintiff lawyers is when those 'certain circumstances' exist. A policy of advising all clients to obtain financial advice provides protection to lawyers by removing the need to identify whether a particular case is a 'certain circumstance'. The question becomes where does the client get the advice from? Recommendation of a specific adviser is not the risky exercise that many plaintiff lawyers fear, provided you have selected this adviser using a due-diligence approach that puts your clients interests first.

PART II: RECOMMENDING A FINANCIAL ADVISER: A (LAWYER TURNED) FINANCIAL ADVISER'S PERSPECTIVE

Part II of this article is by John Wakim, a Certified Financial Planner with ipac securities ltd. A lawyer by training, he has 16 years experience in providing financial planning advice.

Introduction

I have quizzed numerous plaintiff lawyers from around Australia about whether they make specific recommendations of financial advisers. From this 'straw poll' the following emerged:

Lawyers are scared to make a recommendation for fear it may expose them to liability should the client suffer damage due to the action (or inaction) of the financial adviser.

Upon hearing the recommendation as to the need for financial advice, clients almost inevitably ask their lawyer for a recommendation.

The majority of lawyers felt they were letting their clients down in not giving a recommendation, feeling their clients were ill equipped to choose their own financial adviser.

If you are one of those lawyers who feels that you would better serve your client by making a specific recommendation of a source of financial advice, and having read Part I of this article feel reassured you can make a recommendation, how do you ensure that you are making an appropriate recommendation?

> "Specific experience in giving financial advice to plaintiffs is of critical importance."

The prudent lawyer will carry out some due diligence before recommending someone. This process will give you comfort that you are meeting your obligation to your clients, and protecting yourself.

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What due diligence is required?

Due diligence need not be a time consuming process. Ideally, the financial advisers that you will deal with will make the process easy for you by providing documentation addressing the questions you have. This documentation can then be kept on file as a record of the due diligence undertaken. The best way, however, of making an assessment is to supplement the documentation with a face-to-face meeting.

The Australian Securities and Investments Commission (ASIC), together with the Financial Planners Association (FPA), have published a brochure entitled 'Don't kiss your money goodbye', which is a guide to assisting consumers in choosing a financial adviser. The 10 questions below are based upon the guide, but adapted for the particular needs of plaintiffs as consumers.

1. Is the adviser licensed?

Companies or people who provide financial advice must be licensed by ASIC. ASIC enables free checks on whether a particular company or person is properly licensed through their consumer website: www.fido.asic.gov.au.

Look beyond the mere holding of a licence and check whether the company or person has a history of problems relating to compliance. ASIC provides two further checks on their website. At the fido website you can enter the surname of an adviser to see that they have not be banned or disqualified. On the ASIC website - www.asic.gov.au - you can type in a company name in the 'search this site' facility and you will be able to access media releases on topics such as enforceable undertakings, fines, and so on.

2. What qualifications and experience?

There are many ways to become a financial adviser. Qualifications may be tertiary, professional and/or industry based. The best combination, as in the law, is qualifications plus experience.

Look for an adviser who is a Certified Financial Planner (CFP). This is the highest professional designation that can be given to a financial planner. To achieve this level a financial planner must have an Advanced Diploma of Financial Services (Financial Planning) or relevant tertiary qualifications and have completed the CFP professional education program. It is also important that the adviser receives ongoing professional development to ensure they remain leaders in their field.

Financial advisers and their companies may be members of the FPA which is the peak professional body representing financial planners in Australia. The FPA is a helpful source of information about the financial planning industry, particularly if you have any questions relating to education and qualifications. See: www.fpa.asn.au

3. What experience in advising plaintiffs?

Specific experience in advising plaintiffs is of critical importance as plaintiffs have particular characteristics and needs that must be understood by the adviser and addressed by the advice and investment strategy. Plaintiffs are usually in physical and emotional distress and under financial pressure. Many are unsophisticated and have been subjected to well meaning but distracting advice. These factors may impact upon their ability to comprehend advice and make decisions. Some plaintiffs are too conservative and run the risk of running out of money. Others have some knowledge of the risk/return concept and intend to do something 'hair raising'. Frequently plaintiffs wish to spend their lump sum in large lump sums rather than investing to generate an income stream.

A good 'plaintiff' financial adviser must have genuine understanding and empathy, patience to educate the uninitiated (as people will only do what they understand), modelling tools to demonstrate outcomes and the ability to assist the client in considering their particular financial and lifestyle needs.

4. What philosophy?

Will they put the client first and help them to achieve their individual ▶

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objectives? Plaintiffs require financial advice that involves a holistic approach. The process should be one of working with the client to identify their short-, medium- and long-term lifestyle goals and developing a financial strategy to address those goals, rather than simply implementing an investment strategy.

Is the focus on advice and not products? Will they make sure that the client understands the choices available to them and has a framework for prioritising and making decisions? Will there be an ongoing relationship? Plaintiffs will usually benefit from ongoing financial advice as life plans and needs (and the financial market) invariably change over time.

What is the adviser's attitude to risk? This is somewhat of a trick question as the issue is really what is the client's attitude to risk and how the adviser will accommodate it? Usually it is a matter of educating the client.

5. Who owns the business and who are the directors?

Ownership provides an indication of financial strength and thereby financial security. It also enables assessment of whether there is an association between the company and any of the products recommended by its advisers. A link between the adviser and the products is not of itself a problem, so long as a recommended solution is in the best interests of the client and there is a sufficient range of solutions to address differing consumer needs.

It is useful to know the identity of the directors so an assessment can be made on their reputation and management experience within the industry.

6. What is their reputation?

Independent third party endorsement is a sound way of assessing an adviser. This may come from individuals who have dealt with the adviser or from mystery shopper surveys, such as that undertaken by ASIC and the Australian Consumers Association.

7. How will they 'fit' with your clients?

This one is a bit 'warm and fuzzy', but very important. Will the adviser relate to your clients? Does the adviser speak in a way your clients will understand?

8. How are they paid?

There is no standard method of charging clients within the industry, which makes it difficult to assess the appropriateness of any fee charged. Fees may be charged as a proportion of funds invested, on an hourly rate or as a flat fee. Alternatively, or in addition, the adviser may receive commissions including trial commission.

The issue of whether commissions impact on the impartiality of advice remains vigorously debated and unresolved within the industry. But the most important issue is understanding the 'cost' of the advice and the value the client receives. Good financial advice, like good legal advice, is not cheap. Developing a comprehensive understanding of a client's lifestyle goals takes numerous hours, as does formulating a plan to achieve those goals and walking the plaintiff (and their family) through the plan.

The cost of a financial plan can vary significantly, however the variation is usually attributable to the difference between comprehensive financial advice and 'advice' which merely recommends a particular product. The former takes a holistic approach to advice and may or may not be related to any particular investment product. The latter 'advice' may be no more than compliance advice in respect of a specific transaction or product and may be 'free', the adviser being remunerated through commission. Hybrids of comprehensive financial advice together with recommendations as to particular products are also commonplace.

If a client has received a smallish sum by way of damages and has no loss of earning capacity then it is possible that only limited advice on investment products is needed. However, in most serious personal injury cases where the sums are material to the client and/or the client's earning capacity has been affected, then comprehensive financial advice is critical. Issues such as cashflow, tax planning, investment and estate planning are important to the client's future wellbeing and usually cannot be dealt with in isolation.

> "Obtaining preliminary advice about what can be achieved with a lump sum can reassure the client and facilitate appropriate compromise of a claim."

Anecdotally, the writer is aware that many plaintiff lawyers feel more comfortable with the concept of fee-based charges while the clients want it both ways – they are distrustful of commissions but would prefer not to pay for advice! What is essential is that costs are known and the client recognises the value received, given the extent and complexity of the advice required.

9. What resources are available to the adviser?

The resources available to an adviser translate directly into client service and are a strong indication of

professionalism. Get a feel for the resources available, such as investment research and analysis, access to products, adviser training and assessment, technical support including modelling tools, client follow-up processes, client service monitoring and compliance support. Resources should include an ability to work with those trusts established for plaintiffs with a legal disability.

Recognise the importance of ensuring clients stay on course as their life and markets change, so have resources that support ongoing advice.

10. Do they have professional indemnity insurance?

Obviously there is no need to explain to lawyers why this is important! The adviser should be prepared to provide details as to the nature and amount of their cover.

One more practical issue... At what stage should financial advice be obtained?

We recommend a client obtain advice prior to receipt of any monies. The advantage of this is that the client will receive the cheque with a clear picture in their mind as to what can be achieved with the money through proper advice, making it less likely it will burn a hole in their pocket. In respect of large claims, it may be useful to obtain preliminary advice as to what can be achieved through investment prior to engaging in settlement negotiations. This can be reassuring to the client and can facilitate appropriate compromise of the claim.

Conclusion

A lawyer's decision to refer a client to a financial adviser may spring from a desire to provide a more holistic client service or from the terms of a retainer. Whatever the motivation, a specific recommendation as to a financial planner will mean a client need not navigate their own way through the maze of choosing a financial adviser. With minimal time and effort, a lawyer can carry out due diligence, thereby ensuring that the recommendation is in their clients' best interests. PL

Endnotes: **1** (1988) 164 CLR 539. **2** at 579. **3** (1989) 18 NSWLR 642. **4** (1999) 75 SASR 1 at 140. **5** (1999) 197 CLR 1. **6** (1999) 198 CLR 180. **7** see *Hill v Van Erp* (1997) 188 CLR 159 at 231 and *Perre v Apand* (1999) 198 CLR 180 at 222 and 229. **8** (1984) 37 SASR 232. **9** NSW Supreme Court in Equity 4679 of 1988 – unreported. **10** See 'Guidelines for solicitors who act as financial planners' by the Society's Professional Development Committee and 'Licensing requirements for solicitor financial planners' by John Wakim and 'Solicitors as financial advisers' by Ian Hankin Law Institute Journal. **11** Jim Anderson, 'Duties of Care in Conveyancing: Dangers of Acting for Several Parties Exemplified: *O'Brien's Case*', *New South Wales Law Society Journal* (November 1993) p. 54. **12** (1996) 40 NSWLR 398. **13** [1996] ANZ ConvR 380. **14** (1999) ACTSC 35. **15** (1999) NSWSC 596. **16** 2002, Law Book Co. **17** at p 281. **18** *Ethics: Commercial Dealings and Fiduciary Duties* (2002) 40 (1) LSJ44.

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