

# A duty of care

25 June 2007 | by Elysia Decelis

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>Introduction

Recent decisions of the Administrative Appeals Tribunal, the [Financial Industry Complaints Service](#) (FICS) and other Courts have highlighted the standard of conduct expected of financial planners by stakeholders.

This has included an examination of the fiduciary nature of the relationship financial planners have with their clients and the duties and obligations that arise as a result.

This article will consider in summary:

- > The legal standard of care being applied by Australian Courts and other stakeholders to financial planners; and
- > the elements of a fiduciary relationship in a financial services context.

After reading this article participants should be able to:

- > Discuss the key features of the current legal standard of care for financial planners;
- > Describe some of the core principles that underpin a fiduciary relationship; and
- > Apply these standards in the provision of advice to clients.

>The legal standard of care

The current legal standard of care to which financial planners are accountable has many elements including:

- > Statutory obligations pursuant to the Corporations Act 2001 (Cth) ('the Act');
- > Other statutory obligations pursuant to Commonwealth and State Law such as the Privacy Act, Trade Practices and Fair Trading Laws;
- > Contractual Duties, usually arising from the nature of the retainer between the Australian Financial Services Licensee, financial planner and the client;
- > A duty of care in tort, usually articulated as a negligence action; and
- > Fiduciary obligations.

In determining financial planning complaints, FICS usually describes the standard of care it expects of financial planners as follows<sup>1</sup>:

“The legal nature of the adviser – investor relationship, as in financial planning, is fiduciary unless the scope is limited by the scope of the engagement... but the relationship also founds rights of action in contract law, the tort of negligence and under statutory law. Accordingly, liability for loss or damages may arise from common law, out of breach of contract, duty of care, fiduciary duty or from the breach of statutory duty such as under the Corporations Law.”

The contractual relationships referred to, for example, are usually derived from the retainer between the licensee, financial planner and client. Recently, courts have held that the nature of this retainer may impliedly change over the years. For example, in dealing with elderly clients who have been clients of the adviser for many years, a court is likely to imply a higher duty on the adviser to understand the changing nature of the professional relationship, particularly as the client’s mental and physical faculties diminish<sup>2</sup>.

Common law duties include the duty to use due care, skill and diligence in the relationship and in the preparation of advice. Litigation proceedings for a breach of this duty are usually framed in negligence.

Accordingly, breaches of the Act are only one element of the legal standard taken into account by FICS and other Courts when determining the legal and professional conduct expected of a financial planner.

>Recent judicial decisions – The impact of the decision in Hayes

A recent decision of the Administrative Appeals Tribunal<sup>3</sup> upholding an ASIC banning order against a financial adviser, has focused on the professional standards an adviser will be held accountable to in the provision of financial advice and the requisite duty of care required when providing advice to family and friends.

Hayes was banned by ASIC for three years in February 2006<sup>4</sup>. He had been the subject of an ASIC review on superannuation switching advice. In all, the review examined nine client files related to advice given to family friends and staff of the licensee.

ASIC found numerous breaches of the Act had occurred. Table 1 (see page 24, June 2007) outlines the main legal breaches and links them to concurrent ethical breaches of the FPA Code of Ethics.

The Administrative Appeals Tribunal (AAT) held the adviser accountable to a particular professional standard as well as a legislative one. Interestingly, it was the condition of the client files and that the adviser “lacked a sense of responsibility” that led the AAT to ultimately uphold the ASIC banning order, albeit reducing it from three years to one year. The AAT believed the adviser’s dereliction of responsibilities was largely attributable to an absence of “due care and professional consideration” and it was this that had led to the legal contraventions.

In terms of the duty of care the adviser owed to his clients, the AAT said that the fact that the advice was given to family and friends did not lower his obligation to provide appropriate advice, as a similar duty of care applies to every client, irrespective of their personal relationship to the adviser.

Rod Purvis QC, AAT Deputy President found that Hayes had not complied with the “fundamentals of financial planning”, which ASIC had argued are now enshrined in the Act. He further found in addition to findings that Hayes had breached specific legal requirements, in sections 954A, 947D and 946C of the Act, that Hayes lacked a basic understanding of his professional obligations to his clients.

Further, Purvis agreed with the submission made on behalf of ASIC that:

“When a person is licensed as an authorised representative, ASIC effectively endorses that person to the public as reliable and a person in whom consumers can place trust and confidence. ASIC reviews this public aspect of the role as a serious matter relevant to the confidence of the market and consumers generally. Being an authorised representative is a privilege not a right involving dealing with other people’s money. The obligations are personal ones under the Act.”

This statement clearly implies that financial advisers will be held individually accountable for breaches of their statutory law duties. That accountability will include the ability of consumers to trust the advice and conduct of the adviser and ASIC's notion of reliability.

>The nature of fiduciary relationships

There is significant evidence to suggest that the current common law duties of a financial planner also include fiduciary obligations.

ASIC already holds financial planners to this standard<sup>5</sup> and has done for some time, as does FICS. Indeed, the FICS standard articulated previously in this article and by which FICS members are currently judged, is a very high one and includes reference to industry standards.

A fiduciary can be defined as a person who owes a duty of good faith and loyalty to another person. The fiduciary occupies a position of trust and confidence to that person and undertakes to act on behalf of their behalf. A person will be in a fiduciary relationship with another when that other is entitled to expect the fiduciary will act in that other's interests to the exclusion of the fiduciary's interests. The service of that other's interests is the key to the fiduciary relationship.

A fiduciary cannot misuse their position, knowledge or the opportunities resulting from it, to their own or a third party's possible advantage (see Deane J in *Chan v Zacharia* (1984) CLR178). They can also not, in any manner within scope of the service, have a personal interest or an inconsistent engagement with a third party, unless the beneficiary, fully informed, consents, or it is authorised by the law.

So the key elements of this relationship are that the fiduciary:

- > Occupies a position of trust and confidence;
- > Has an obligation or gives an undertaking given to act in the interests of another;
- > Alternatively, that the other person has a reasonable expectation the fiduciary will act in their interests in and for the purposes of the relationship;
- > Has the power to affect the other's interests in a legal or practical sense;
- > Must understand there is a potential for inequality of bargaining power in the relationship; and
- > Must ensure they do not abuse the reliance placed on them by the other.

The relationship requires a very high standard of conduct in the interests of the client in relation to:

- > Loyalty;
- > Discretion;
- > Confidentiality; and
- > Good faith

A fiduciary relationship will therefore give rise to a higher standard of care and duty than one based simply in statute or contract. These elements are not specifically articulated in the Act, for example, as a minimum legal requirement.

>How it affects financial planners

There are effectively two types of fiduciary relationship. One type is established by law or based in status, such as a trustee/beneficiary; lawyer/client; director/shareholder. The other type is usually established on the facts of each case. In these circumstances the plaintiff must prove the defendant is a fiduciary for the purposes of the relationship<sup>6</sup>.

Courts have formulated no single test for determining whether a given relationship is fiduciary in character, but will regard a fiduciary relationship as arising where a reasonable expectation exists that a person will act in the interests of another in and for the purposes of the relationship. It is arguable that in the context of the financial planner/client relationship that this expectation does arise.

There is significant evidence to suggest that financial planners as 'investment advisers' will be held to be in a fiduciary relationship with clients, in the provision of financial advice to clients<sup>7</sup>.

In the case of *Daley v Sydney Stockbroking Limited* (1986) 160 CLR 371, a stockbroking firm that provided investment advice to a client was held to owe fiduciary duties to that client.

In that case, a potential investor sought advice from the firm about share investment opportunities. An employee of the firm advised the investor to deposit his funds with the firm until an opportune time arose to buy shares. The investor did so, unaware that the firm was in a precarious financial position. The firm became insolvent some months later. The investor's funds were lost.

The High Court of Australia, particularly Justice Brennan, noted that in respect of a function commonly performed by stockbrokers, that is the buying and selling of shares, a fiduciary relationship had arisen between the firm and the client.

His Honour said:

"Whenever a stockbroker or other person who holds himself out as having expertise in advising on investments is approached for advice on investments and undertakes to give it, in giving that advice the adviser stands in a fiduciary relationship to the person he advises.

"The adviser cannot assume the position where his self interest might conflict with the honest and impartial giving of advice. His duty is to furnish the client with all the relevant knowledge which the adviser possesses, concealing nothing that might be reasonably regarded as relevant to the making of the investment decision including the identity of the buyer or seller of the investment when that identity is relevant, to give the best advice which the adviser could give if he did not have, but a third party did have, a financial interest in the investment to be offered, to reveal fully the adviser's financial interest and to obtain for the client the best terms which the client would obtain from a third party if the adviser were to exercise due diligence on behalf of his client in such a transaction."

The Chief Justice, Mr Justice Gibbs, also found that it was material that the firm had held itself out as an adviser on matters of investment and had undertaken to advise the client who, in turn, had relied on the advice given to him.

Similarly, in *Commonwealth Bank of Australia v Smith* – 42 FCR 390, 102 ALR 453, [1991], the branch manager of a bank advised long-standing customers on their purchase of a hotel business in a small country town. The Full Federal Court found that a fiduciary relationship arose even though the bank had a manifest personal interest in the transaction by acting as a financier for it.

The basis of the existence of that fiduciary relationship was the expectation the bank had created in the customer that, despite its own interests, it would advise in the customer's interests as to the wisdom of a proposed investment. In this way the bank had become a fiduciary and occupied the position of "an investment adviser".

Further, the business inexperience of the customer and the reliance placed on the bank's advice inter alia gave rise to a fiduciary duty.

In that case the bank failed to fulfil the fiduciary duty, for although the customer was informed of its relationship to the vendor and the existence of a conflict, the customer was dissuaded from seeking skilled independent advice.

Another example is *Adams v Perpetual Trustees & ors* [2006] SADC 62A, where the District Court of South Australia held that Perpetual Trustees, which had provided investment advice to an elderly client for many years, had breached its fiduciary duty to her by not advising or counselling her to discontinue loans to her nephew; in not counselling or advising her to seek independent advice about the loans and in not ensuring that commercial loan arrangements were in place. Its defence that it had acted on her instructions and felt she was competent to make these decisions was discounted by the Court.

These are just a few examples of court cases which suggest that a financial planner who gives financial advice to a client will be defined as an "investment adviser" and held accountable to a fiduciary standard of care in the performance of financial planning advice.

It is apparent from the cases, even though they did not explain the meaning of the words "investment", "financial" or "corporate" advice, that advice on the merits or other aspects of

> raising funds (either privately or publicly, by either debt or equity interest),

> investing or spending funds,

> entering into a particular investment and its alternatives,

> financing and timing considerations; and to

> documenting and implementing the investment transaction

will, at a minimum, constitute investment advice for this purpose.

The reliance by a client on the adviser is also required for a fiduciary relationship to arise. However, the client may not need to be financially unsophisticated for this to occur and reliance will not be hard to prove in a financial planning relationship.

The fiduciary obligation will be imposed on financial planners to the extent of the advice; that is the giving of advice or more specifically to the undertaking to give advice and will apply in respect of those advisory services for which the parties have contracted.

However, even if a fiduciary relationship is found to exist, it may be a Court will confine the obligations to a number of specific duties – for example, in the absence of fully informed consent, to avoid both conflicts of interests and profits arising out of fiduciary relationship.

>Conclusion

The current legal standard of care to which financial planners are accountable has many elements including statutory obligations, contractual duties, a duty of care in tort and fiduciary obligations.

Breaches of the Act are therefore only one element of the legal standard taken into account by FICS and other Courts when determining the legal and professional conduct expected of a financial planner.

There is significant evidence to suggest that the common law duties of a financial planner in the provision of financial planning advice, has included fiduciary obligations for some time, probably since 1986 and the decision of the High Court in *Daly*. ASIC and FICS already hold financial planners to this standard. Indeed, the FICS standard articulated previously in this paper and by which FICS members are currently judged, is a very high one and includes reference to industry standards.

Financial planners should be aware of these standards and ensure their conduct in the provision of advice to clients meets them in order to ensure the ongoing confidence of stakeholders.

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