BRESSLER, AMERY & ROSS

A PROFESSIONAL CORPORATION

SECURITIES LAW ALERT

AUGUST 22, 2013

Client Bequests to Financial Advisors

We recently tried a case involving a $1 million client bequest to a financial advisor. The case reminded us of the issues presented when a firm is notified that one of its customers has made a bequest to his or her financial advisor. There are no FINRA rules that specifically address this situation, nor any specific FINRA guidance. Thus, there is no absolute, clear-cut prohibition preventing a financial advisor from accepting a client's bequest. Nonetheless, such bequests present the risk that family members or other interested parties dissatisfied with the client's testamentary disposition could file a claim for breach of fiduciary duty, violation of FINRA Rule 2110 (Standards of Commerical Honor and Principles of Trace) or violation of elder abuse state statues. Thus, firms should find it useful to have policies and procedures in place to address these situations.

At first blush, it might seem simplest for a firm to adopt a policy that forbids its advisors from accepting bequests from non-family members. However, such a policy presents its own problems. For example,

- the financial advisor may choose to leave the firm, rather than renounce the bequest. In this scenario, the firm may lose a valuable employee, and may still be caught up in a lawsuit filed by disappointed heirs;

- the financial advisor may decide to file a claim against the firm, claiming constructive or wrongful termination, or interference with an expectancy. The merits of such claims would be determined under state law, and, as a general rule, the employee should have difficulty prevailing on such claims. Nevertheless, there would be litigation costs associated with defending the claims; or,

- the client may move his or her accounts, feeling the firm has no right to interfere with his or her testamentary dispositions.

Thus, an inflexible policy forbidding the acceptance of all non-family bequests may bring undesirable results.

Alternatively, firms may choose to consider policies that evaluate client bequests on a case-by-case basis. If a firm chooses this path, the firm could begin by requiring its financial advisors to notify the firm promptly if they become aware of a client bequest. Upon being notified of a bequest by a financial advisor, an investigation should ensue, in which the primary considerations for the firm would be: 1) whether the client had testamentary capacity, and 2) whether there is any evidence of undue influence. "Testamentary capacity" is defined generally as the testator's ability to know their assets, their heirs (the "objects of their bounty"), and the effect of their dispositions. "Undue influence" is defined as influence or persuasion that overcomes the testators' free will or judgment. In some jurisdictions, undue influence is presumed when there is a confidential relationship.

The firm's investigation of the bequest should begin with an interview of the employee to explore the circumstances surrounding the bequest. Possible areas of inquiry include:

- Did the financial advisor request the bequest or discuss the bequest with the client?

- Is the client elderly, and if so, is there any indication of diminished capacity?

- Have other family members been excluded in the client's testamentary documents?

- Have other family members consented to the bequest?
- Are there any non-lineal descendants who could bring a claim?
- What is the length and nature of the financial advisor's relationship with the client?
- How large is the bequest in relation to the total estate?
- Does the client have estate planning attorneys? If so, does the financial advisor have any relationship to these attorneys or was the financial advisor involved in the selection or retention of the client's estate planning attorneys?
- Has the financial advisor spoken to the client's estate planning attorneys?
- Has the financial advisor been named as a beneficiary by other clients?

If the firm learns of the bequest while the client is still alive, the firm should also consider contacting the client to assess the client's capacity, to confirm the client's desire to make the bequest to the financial advisor, to explore the relationship between the client and the financial advisor and to inquire whether the financial advisor requested the bequest.

Finally, the firm should consider contacting the client's estate planning attorneys, or other advisors, and asking for an opinion as to testamentary capacity, lack of undue influence, the absence of heirs, or consent by the heirs to the bequest to the financial advisor.

Importantly, all parts of the investigation should be documented.

Assuming a thorough, documented investigation, the firm should be in a good position to decide whether the financial advisor engaged in any conduct that may appear improper. If any conduct giving the appearance of impropriety exists, the financial advisor should be directed to renounce the bequest immediately, in writing. If there is no such conduct, the firm can determine not to interfere with the bequest. In that event, the firm should consider seeking an indemnification agreement from the financial advisor to protect the firm should his or her acceptance of the bequest give rise to any litigation. ■

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