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The Embedded Risk in Financial Planning — Fiduciary Liability

by William E. Mahoney Jr. and Brandon Riley

On Sept. 15, the Pennsylvania Superior Court ruled that a financial planner/insurance agent who sold a life insurance policy may have unwittingly created a fiduciary relationship with the purchasers, solely because the sale of the policy came on the heels of a financial analysis undertaken by the planner. Pennsylvania courts have long recognized that a fiduciary relationship may arise between a securities broker and a customer, depending on the circumstances. However, this newest decision upends the long-standing general rule in Pennsylvania that purchasing an insurance policy is an arm's-length transaction for which the insurer and selling agent owe no independent fiduciary duty, apart from any that may be defined in the policy itself. In the wake of this decision, securities and insurance brokers who recommend or sell insurance products to clients as part of an overall financial plan now face an added layer of potential liability that did not exist previously.

In *Yenchi v. Ameriprise Financial, Inc.*,[1] a financial planner from American Express reached out to the plaintiffs, identified himself as a financial planner, and offered to perform a financial analysis on their behalf. The plaintiffs met with the financial planner and agreed to purchase a financial analysis for $350. The plaintiffs provided the financial planner with information about their finances, including their employment, savings levels and insurance coverage. The financial planner then presented the plaintiffs with a detailed financial management proposal, which included several recommendations to help them better prepare for retirement.

One of the recommendations was to consolidate the plaintiffs' several existing life insurance policies into one policy, which the financial planner represented could be purchased using the cash value of their pre-existing policies. The financial planner also told the plaintiffs that under this new single policy, the premiums would never increase and would cease after 11 years. Moreover, the financial planner recommended the purchase of a variable annuity that would mature when the plaintiffs turned 65. The plaintiffs followed these recommendations.

Several years later, the plaintiffs had the life insurance policy and annuity independently reviewed. They learned that the policy was in fact underfunded and that the premiums would never cease, but instead would increase. They also learned that the annuity they purchased would not mature until they turned 84, and that early withdrawals would incur penalty charges. The plaintiffs filed suit, claiming, among other things, breach of fiduciary duty by the financial planner in connection with the sale of the life insurance policy and variable annuity.

The defendants moved for summary judgment on the breach of fiduciary duty count, arguing that the plaintiffs could not establish a fiduciary relationship as a matter of Pennsylvania law with respect to the sale of an insurance policy. The trial court granted the motion, holding that a fiduciary relationship "does not arise in the context of an insurance transaction, absent evidence that the insured had ceded decision-making authority to the insurer."

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On appeal, the Superior Court reversed the trial court. The Superior Court acknowledged the long-standing presumption that "the purchase of insurance is considered an arm's-length transaction, in which the insurer incurs no fiduciary duty" other than what may be set forth in the policy itself. However, the court found that a blanket application of this rule was too rigid. Instead, the court noted that whether a fiduciary relationship exists is a question of fact. The court concluded that a fiduciary relationship may be found where there is evidence of either (i) an "over-mastering influence" by the broker over the client, or (ii) the client's "weakness, dependence or trust, justifiably reposed" in the broker.

Turning to the case before it, the court held that plaintiffs had presented sufficient evidence to support the finding of a fiduciary relationship. This "evidence," however, consisted entirely of the plaintiffs' contention that they purchased "what they believed was independent, financial planning advice" before they decided to purchase the recommended insurance products.

The court found it significant that the financial planner cultivated a relationship with the plaintiffs "first as a financial advisor,[2] not as an insurance salesperson . . . ." The court concluded:

> [H]ere, the Yenchis contend their dependence upon Mr. Holland arose because he promoted his services as a financial advisor and they paid him to develop a comprehensive, objective, financial plan. Thus, according to the Yenchis, their trust was justifiably reposed.

In other words, if a financial plan is prepared, a customer need only *contend* that he or she purchased a financial product in reliance on the plan in order to assert a fiduciary relationship. This decision ensures that such a claim will survive summary judgment and go to a jury.

In a dissenting opinion, Judge Lazerus makes this very point, noting that the plaintiffs' fiduciary duty claim was based on the "bare assertion" that their planner had greater knowledge than they did in financial planning. Judge Lazerus noted that this assertion was undercut by the fact that the plaintiffs followed some, but not all, of the planner's recommendations. While acknowledging that the record showed that the plaintiffs had relied on the planner's advice and superior knowledge, Judge Lazerus found the evidence woefully inadequate to establish a fiduciary relationship between the parties.

Given the egregious allegations of this case, it is tempting to relegate this decision to the "bad facts make bad law" category. That would be a mistake. Despite the court's effort to minimize its scope and reach, this decision has broad implications for financial advisors and insurance brokers alike. Financial planning is an increasingly common first step for any relationship between advisors and clients, particularly as baby boomers and Gen Xers seek advice with an eye toward retirement. What used to be perceived as two distinct functions – financial planning, on the one hand, and decisions to implement all or portions of the plan, on the other – are increasingly being viewed as points on a single continuum, for which the financial planner (and his or her firm) are exposed to ever greater liability.

As this decision makes clear, Pennsylvania courts are now prepared to recognize a fiduciary duty where none existed before. In any case in which a supposedly independent financial plan is prepared, the financial planner is now open to a breach of fiduciary duty claim, together with its potential for punitive damages. What makes this decision even more troubling is the thin evidentiary reed upon which the court based its holding. Purchasers of investments and insurance products need only allege that they justifiably relied on a plan in order to survive summary judgment. Based on nothing more than their say-so, plaintiffs can now take these claims straight to a jury. It does not take much imagination to envision the many scenarios under which the plaintiffs' bar will seek to invoke this decision, even where a written financial plan does not exist.

The Superior Court opinion in *Yenchi* demonstrates that the law can expand or contract at any moment, and that sellers of financial products must be ever vigilant with respect to their relationships with customers. When recommending or selling insurance and other financial products, it is important that financial planners have in-depth knowledge of the products being sold, a solid understanding of the customer's financial situation and needs, and an honest discussion about how the financial plan will be implemented. This includes being candid and explicit about

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potential conflicts and stressing the nonfiduciary nature of the relationship. Equally important is creating and maintaining a contemporaneous record of discussions and interactions with the customer, in order to blunt and discredit any revisionist history that a customer may employ to assert a breach of fiduciary duty claim.

Securities and insurance brokers alike should take these and other steps to manage customer expectations and more clearly define their respective roles. In so doing, they and their employers can better manage and minimize their liability risk. ■

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[1] — A.3d —, No. 753 WDA 2014, 2015 WL 5430353 (Pa. Super. Ct., Sept. 15, 2015).

[2] It appears that the court used the phrase "financial advisor" in a colloquial, rather than a technical, sense. There is nothing in the decision to suggest that the financial planner was a registered financial advisor, who would otherwise be subject to the fiduciary duties under the Investment Advisors Act of 1940. Indeed, the court made clear that "we do not hold that evidence of [defendants'] position as financial advisors is sufficient by itself to establish a confidential relationship."

Attorneys at Work

Partner and Securities Enforcement Chair **Gregory D. DiMeglio** participated in the panel discussion, "Foreign Corrupt Practices Act and Other International Anti-Corruption Statutes (Ethics)," at the What's Hot in International Business Transactions seminar hosted by the Pennsylvania Bar Institute. The seminar provided an overview and practical tips for attracting foreign investors and tackling issues in ever-changing international business law. Greg's panel focused on recent developments and potential next steps in FCPA enforcement.

Partner and Insurance Practice Group Chair **Steven B. Davis** moderated the panel discussion "The Board and Risk Oversight" during the 2015 Executive Roundtable held by the Pennsylvania Association of Mutual Insurance Companies in Leola, Pennsylvania. The panel, which included Pennsylvania Deputy Insurance Commissioner Stephen Johnson, Vincent Burke of WeiserMazars and Damon Bendesky of Aon, provided an overview and practical tips for directors on risk management and internal controls.

Counsel **Jana M. Landon** served as the instructor for an expert witness courtroom testimony course held by the International Association of Arson Investigators, an association of more than 8,000 fire investigation professionals from across the world united by a commitment to suppress the crime of arson. Jana worked with fire investigators from the U.S. and Canada to prepare them for expert witness testimony, instructed the group on various legal issues including best practices for preserving electronically stored information, and examined the investigators during a mock trial exercise.

Steve Davis and **Jana Landon** spoke at the Association of Insurance Compliance Professional's Education Day in Philadelphia. Steve served as a panelist for "Property & Casualty Market Conduct Update," which provided an overview and practical tips for market conduct examinations. Jana served as a panelist on "Cyber Threats – The Compliance Implications of Not Protecting Your Customers Data."

Partner **Patrick R. Kingsley** spoke at the 40th Annual Meeting & Seminar program hosted by Surety Claims Institute in Santa Ana Pueblo, New Mexico. Patrick and co-panelist William Pearce of Arch Insurance Company presented "Inter-creditor and Forbearance Agreements," which featured a discussion on harmonizing the conflicting interests of creditors, sureties, lenders, banks and owners before bankruptcy.

Patrick also presented "Key Bond and Contract Provisions" to surety professionals at a CLE program hosted by Stradley Ronon. The presentation discussed Pennsylvania law addressing the obligations of sureties and their principals. Topics included the Pennsylvania Bond Law, the Commonwealth Procurement Code, and the Contractor and Subcontractor Payment Act, among several other matters.

Twenty-three Stradley Ronon attorneys were named to the recently released 2016 edition of *The Best Lawyers in America,* regarded as a definitive guide to legal excellence in the region. The chosen lawyers received high ratings from their peers in the publication's annual survey for their "abilities, professionalism and integrity." The full list of Stradley's selected Best Lawyers is here. ■

Real Client Successes

Stradley Ronon recently secured a significant trial victory for AIG's Private Client Group, defending a $29 million claim for intentional interference with contractual relations. The U.S. District Court for the Eastern District of Pennsylvania. U.S. District Judge William H. Yohn Jr. presiding, ordered a complete defense verdict in AIG's favor. The case relates to a 2012 fire at a historic Villanova, Pennsylvania, mansion known as Bloomfield. Partners **Jeffrey D. Grossman** and **Daniel T. Fitch** and Associate **Benjamin E. Gordon** represented AIG at trial.

Partner and Insurance Practice Group Chair **Steven B. Davis** and Counsel **Karl S. Myers** represented Reliance Insurance Co. (In Liquidation) in a case regarding a claim filed by the Alabama Insurance Guaranty Association (AIGA). The Pennsylvania Supreme Court upheld a 2014 precedential ruling by the state Commonwealth Court that the liquidating trustee for Reliance was not bound by an Alabama high court ruling when determining the priority fo AIGA's claim in the estate. ■