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FINANCIAL ADVISING BY ATTORNEYS

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A. Introduction

As Ohio attorneys seek to broaden and diversify the services they provide to clients, they must keep in mind the Ohio laws that govern their financial planning and investment advisory services. These laws consist primarily of certain provisions of the Ohio Securities Act ("Securities Act")[1], the Ohio Code of Professional Responsibility and related disciplinary rules, and a trilogy of recent opinions issued by the Ohio Supreme Court's Board of Commissioners on Grievances and Discipline ("Board"). This article: describes the three types of persons in the advisory field who are subject to regulation under the Securities Act; notes the circumstances under which attorneys are excluded from Securities Act regulation; discusses the recent Board opinions and the disciplinary rules that underlie those opinions; provides guidance for attorneys serving as trustees; and comments on the prohibition on assisting non-attorneys in the unauthorized practice of law.

B. The Definition of "Investment Adviser"

"Investment adviser" is the legal name for a person who is in the business of providing advice regarding securities. Specifically, Ohio law defines investment adviser as a person who: (1) for compensation; (2) is engaged in the business of; (3) providing advice regarding securities.[2] A person must satisfy all three of these elements in order to be an investment adviser. However, it is not necessary that a person's activities consist solely of investment advisory services. Rather, the test is whether any part of the person's activities meets the three elements.

The Securities Act imposes a number of regulatory requirements on investments advisers. In general, investment advisers: must be licensed by the Ohio Division of Securities or registered with the federal Securities and Exchange Commission; are subject to certain business responsibilities (such as record-keeping requirements and document delivery obligations); and are subject to certain business conduct and anti-fraud standards (such as disclosure obligations and requirements for custody of client funds and securities).[3]

1. Exclusions from the Definition of "Investment Adviser" for Attorneys

Certain persons are excluded from the statutory definition of "investment adviser." In particular, attorneys are excluded from the definition if the performance of advisory services is "solely incidental" to the practice of law.[4] Whether advisory services are solely incidental is dependent on all the relevant facts and circumstances. Three factors are especially relevant: (1) whether the attorney holds himself or herself out to the public as an investment adviser, financial planner, or other provider of advisory services; (2) whether the advisory services are rendered in

[1] R.C. Ch. 1707.

[2] R.C. §1707.01(X).

[3] *See generally* Ohio Investment Adviser Manual (LexisNexis Publishing 2002) Chapters 5 to 14.

[4] R.C. §1707.01(X)(2)(a).

connection with and reasonably related to legal services; (3) whether the fee charged for advisory services is based on the same factors as those used to determine the fee for legal services.[5]

In addition to this "solely incidental" exclusion, attorneys may rely on the exclusion from the definition of investment adviser for persons who privately advise a small number of sophisticated, trust or family entities.[6] In general, this "private adviser" exclusion is available for a person who has fifteen or fewer clients, does not hold himself or herself out to the public as an investment adviser, and has clients consisting solely of specified sophisticated, trust or family clients.

To summarize, an attorney may provide investment advice in a manner that is solely incidental to the practice of law and not meet the definition of investment adviser under the Securities Act. In the alternative, an attorney may privately provide investment advice to fifteen or fewer specified sophisticated, trust or family clients, and not meet the definition of investment adviser under the Securities Act.

However, if an attorney, for compensation, engages in the business of providing advice regarding securities outside the scope of the "solely incidental" or "private adviser" exclusions, the attorney is an investment adviser subject to the filing, conduct and other regulatory requirements of the Securities Act.

Whether operating within the definition of "investment adviser," or outside the definition, an attorney is subject to the Securities Act's prohibition on false representations and omissions of material facts by persons who provide advice regarding securities for compensation.[7]

2. Board Opinion 2000-4: Financial Services through a Law Firm

Board Opinion 2000-4[8] stated that the Ohio Code of Professional Responsibility does not prohibit an attorney from providing financial planning services through a law firm to business and estate planning clients of the law firm when the law-related services are provided in connection with and related to the provision of legal services. However, the Board concluded that "an attorney who wants to provide financial services through a law firm should do so only when the services are provided 'solely incidental' to the practice of law." The Board noted that operating outside the solely incidental exclusion would cause the attorney to be subject to regulation under the Securities Act, which among other things, provides for the regulatory examination of records. Such regulatory examination would breach the attorney's obligation to preserve client confidences and secrets pursuant to Disciplinary Rule ("DR") 4-101.

[5] *See, e.g.*, Milton O. Brown, P.C., SEC No-Action Letter, 1983 WL 28750 (Sept. 27, 1983); *see also* Ohio Investment Adviser Manual (LexisNexis Publishing 2002) § 1.8.

[6] O.A.C. § 1301:6-3-01(K)(1).

[7] R.C. § 1707.44(B)(5).

[8] 2000 WL 1872570 (December 1, 2000).

The Board also noted that charging a fee for financial planning services based on a percentage of assets under management would tend to indicate that the attorney is operating outside the solely incidental exclusion. Thus, the Board suggested the use of a fixed fee (flat or hourly) and gave a reminder of the prohibition on excessive fees set out in DR 2-106.

Finally, the Board stated that an attorney providing financial planning services to law firm clients should avoid the conflict of interests prohibition contained in DR 5-101(A)(1) by informing a legal client who needs financial services that the client may obtain financial services elsewhere. The Board also recommended that the attorney inform the client of the fee, if any, for providing the financial planning services.

3. Board Opinion 2001-4: Prohibition on Sale of Annuities

Although Board Opinion 2000-4 allowed attorneys to provide financial planning services to law clients under certain conditions, Board Opinion 2001-4[9] stated that it is improper for an attorney to sell annuities through a law firm to the attorney's estate planning clients. The Board began its analysis by recognizing that an attorney's interest in selling annuities, and a client's interest in receiving independent legal advice, represent differing interests. Next, the Board noted that DR 5-104(A) prohibits an attorney from entering into a business transaction with a client if they have differing interests, unless the client has consented after full disclosure. The Board then questioned "whether full disclosure and meaningful consent ever could be achieved" when an attorney sells annuities to a law client. Further, the Board stated that "even if full disclosure and meaningful consent may be obtained, there exists the appearance of impropriety." Ultimately the Board advised that it is improper for an attorney to sell annuities through the law firm to estate planning clients of the attorney. The Board noted that this conclusion was contrary to holdings in other states that permit attorneys to sell insurance to legal clients subject to various conditions such as disclosure, consent, confidentiality and fairness.[10]

4. Ohio Supreme Court Disciplinary Actions

The Ohio Supreme Court has upheld disciplinary actions against attorneys who have engaged in improprieties when providing investment advice to clients. For example, in *Toledo Bar Association v. Miller*[11] the Court upheld an indefinite suspension against an attorney who misrepresented his interest in an investment he recommended to clients. More recently, in *Stark County Bar Association v. Buttacavoli*[12] the court upheld discipline against an attorney/financial planner who failed to disclose fully that he would receive commissions from securities transactions he recommended to law clients. Buttacavoli was licensed as a securities salesperson and an investment adviser representative at the time of the transactions. The Court stated: "Although our Disciplinary Rules do not prohibit an attorney from engaging in the dual

[9] 2001 WL 964112 (August 10, 2001).

[10] Those states include Arizona, Illinois, Kansas, Michigan, New Hampshire, North Carolina, North Dakota and Utah.

[11] 22 Ohio St. 2d 7 (1970).

[12] 96 Ohio St. 3d 424 (2002).

professions of law and financial planning, the rules do require that an attorney providing both legal and financial advice must carefully separate these services and provide full disclosure as to his financial interest in the investment advice he provides."[13]

C. The Definition of "Solicitor"

The second type of person in the advisory field defined by the Securities Act is a "solicitor." A solicitor is "any person who, directly or indirectly, solicits any client for, or refers any client to, an investment adviser or investment adviser representative."[14] There are no exclusions from this definition.

1. Board Opinion 2000-1: Prohibition on Receipt of Referral Fee

The primary, if not sole, reason a person acts as a solicitor is to receive payments for referrals made. However, Board Opinion 2000-1[15] stated that it is ethically improper for an attorney to accept a fee from a financial services group for referring clients in need of financial services. In reaching this conclusion, the Board recognized two ethical concerns: (1) improper business relationships with clients and other non-attorneys; and (2) interference with the professional judgment of an attorney.

With respect to the former concern, the Board noted that DR 3-103(A) prohibits a partnership with a non-lawyer if partnership activities consist of the practice of law, and that DR 5-104(A) generally prohibits an attorney from entering a business transaction with a client if they have differing interest therein. The Board found that the proposed referral fee arrangement would run afoul of both of these rules.

Regarding the latter concern, the Board noted DR 5-101(A)(1)'s general prohibition on an attorney's acceptance of employment when the attorney has an interest that will (or reasonably may) affect the attorney's professional judgment on behalf of the client, and DR 5-107(A)'s general prohibition on accepting compensation for legal services from one other than the client. The Board concluded that even full disclosure and client consent would not resolve the conflict between these rules and the proposed referral fee arrangement, and concluded that the proposed arrangement was ethically improper.

Consequently, attorneys may not serve as solicitors or otherwise receive payments for referring clients to an individual or firm that provides financial planning or investment advisory services.

D. The Definition of "Investment Adviser Representative"

The third type of person in the investment advisory field defined by the Securities Act is an "investment adviser representative." In general, an investment adviser representative is a natural person who gives specific advice on behalf of an investment adviser firm to a certain minimum

[13] *Id.* at 427.

[14] O.A.C. §1301:6-3-44(C)(4)(c).

[15] 2000 WL 202051 (February 11, 2000).

number of natural person clients through regular meetings or communications.[16] An investment adviser representative is subject to many of the conduct and anti-fraud standards applicable to investment advisers.

In order to meet the definition of investment adviser representative, a person (among other things) must be a "supervised person." A supervised person is a natural person who is an employee, partner, officer, or director (or other person occupying a similar status) of an investment adviser firm, or a person who provides investment advisory services on behalf of an investment adviser firm subject to the supervision and control of the firm.[17] This definition requires a high degree of interaction between a person and an investment adviser firm. Consequently, it would seem that Board Opinions 2000-1, 2000-4 and 2001-4 (and the disciplinary rules cited therein) prohibit an attorney from serving as an investment adviser representative with respect to the attorney's law clients.

E. Attorneys Serving as Trustees

When serving as trustee, an attorney may have occasion to provide investment advice. As previously discussed, Board Opinion 2000-4 requires that attorneys provide investment advice to law clients in a manner that is "solely incidental" to the practice of law. Board Opinion 2000-4 also notes that charging a fixed fee for advisory services aids in keeping the services "solely incidental" in nature. Such a fixed fee is in contrast to a fee based upon the value of the assets in a trust or advisory account.

In the case of testamentary trusts, Ohio county courts of common pleas have schedules for the compensation of trustees.[18] These schedules generally provide for compensation based on either the value of the principal of the trust, or the income generated by the trust. At first glance, it would appear that this type of compensation threatens to move an attorney/trustee outside the "solely incidental" exclusion as interpreted in Board Opinion 2000-4. But, the better reasoning seems to be that such scheduled compensation should be considered to be within the "solely incidental" exclusion since it is paid pursuant to a schedule established and monitored by a probate court.

In contrast, there are no court schedules for the payment of a trustee of an inter vivos trust. An attorney/trustee accepting compensation based on the assets under management of an inter vivos trust may be operating outside the "solely incidental" exclusion as interpreted in Board Opinion 2000-4. Note, however, that without regard to how an attorney/trustee is compensated, and without regard to whether an attorney/trustee is operating inside or outside the "solely incidental" exclusion, an attorney/trustee may be able to rely on the "private adviser" exclusion previously discussed.

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[16] R.C. §1707.01(CC).

[17] R.C. §1707.01(DD).

[18] *See, e.g.*, Franklin County Court of Common Pleas Probate Division Local Rule 74.1; Cuyahoga County Court of Common Pleas Probate Division Rule 74.1; Hamilton County Court of Common Pleas Probate Division Rules 71.1(H) and 74.1.

An attorney/trustee operating within the "solely incidental" or "private adviser" exclusion remains subject to Board Opinion 2001-4's prohibition on selling annuities to law clients, and Board Opinion 2000-1's prohibition on receipt of referral fees from financial service providers.

F. Aiding a Non-Attorney in the Unauthorized Practice of Law

An attorney seeking to broaden the range of services he or she provides must keep in mind the prohibition on assisting in the unauthorized practice of law. Specifically, DR 3-101(A) states that a "lawyer shall not aid a non-lawyer in the unauthorized practice of law." Relatedly, DR 3-102(A) generally prohibits an attorney from sharing fees with non-attorneys, and DR 5-107(B) prohibits an attorney from allowing one who pays for the attorney to render legal services for another to direct or regulate the attorney's professional judgment in rendering such services. Attorneys must keep in mind these prohibitions regardless of whether they are operating within an exclusion from the definition of investment adviser, or are operating outside an exclusion.

For example, in *Cincinnati Bar Association v. Kathman*,[19] an attorney's participation in a non-law firm's program that sold "living trusts" consisted of gathering certain information from clients and then returning to clients trust documents prepared by non-attorneys. The Ohio Supreme Court found that the attorney's conduct violated the aforementioned three disciplinary rules, and specifically held that an attorney violates DR 3-101(A) when the attorney assists a non-attorney in the marketing and selling of living trusts.[20]

G. Conclusion

In general, an attorney who wishes to provide financial planning or investment advisory services to a law client, whether in a trustee capacity or not, must ensure that the services are "solely incidental" to the practice of law. In the alternative, an attorney may rely on the "private adviser" exemption to privately provide investment advice to fifteen or fewer specified sophisticated, trust or family clients. However, an attorney may not serve as a solicitor or investment adviser representative with respect to a law client. Further, an attorney may not sell annuities to law clients, and may not receive a fee for referring law clients to a financial services provider.

In general, an attorney may serve as an investment adviser, investment adviser representative, or solicitor with respect to non-law clients, provided the attorney complies with the Securities Act. But in all cases, an attorney must be cautious not to assist a non-attorney in the unauthorized practice of law.

[19] 92 Ohio St. 3d 92 (2001).

[20] *Id*. at 96. *See also* Wayne County Bar Association v. Naumoff, 74 Ohio St. 3d 637 (1996) (holding that an attorney aided a non-attorney tax specialist in the unauthorized practice of law where the attorney prepared legal documents, sometimes without client contact, and shared fees with the tax specialist).

Whether operating within the definition of "investment adviser," or outside the definition, an attorney is subject to the Securities Act's prohibition on false representations and omissions of material facts by persons who provide advice regarding securities for compensation.[21]

[21] R.C. § 1707.44(B)(5).