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Liability For Damage Caused At The Pursuit Of Financial Advisory

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Abstract

The Act No 186/2009 Coll. on financial intermediation and financial advisory and on amendments and supplements to certain laws is reflecting on the topic of liability. It is incorporating provisions about the liability for damage at the pursuit of financial advisory. The attention is being paid to the liability for damage caused to the professional or non-professional client at the pursuit of financial advisory. In accordance with the element of the liability legal relationship, the subjective aspect, the liability for damage caused at the pursuit of financial advisory represents a subjective liability, where fault is necessary. Our proposal de lege ferenda is the introduction of strict liability for damage caused at the pursuit of financial advisory.

Key words

Financial advisory, client, liability for damage, the liability legal relationship

JEL Classification: K12, K15, K23

Introduction

It is undisputed that damages have existed and they will exist. Every person is obliged to act in such manner that no damage to health, property, nature and the environment occurs. This is a so-called general preventive obligation (Veterníková, 2015). But the prevention set by regulation is not sufficient to preserve the full and consistent protection of legal relations; legislation must assure reparation, forcing the responsible person to compensate the damage as quickly and completely as possible (Holub et al., 2003).

Liability is a secondary obligation which establishment presumes the existence of a primary obligation and its breach (Luby, 1958). It is a special form of a law relation. It originates on the grounds of a breach of an obligation and the new law relation has a character of a sanction (Luby, 1958). The elements of the liability legal relationship consist of: Object, objective aspect, subject and subjective aspect (Mitterpachová, 2015). The object is a legal obligation that had been damaged, in comparison with criminal or administrative law it is not sufficient to cause a threat, it is necessary that there is an infringement (Mitterpachová, 2015). The objective aspect incorporates three elements - procedure leading to a breach of obligation, resulting in infringement of an obligation, causal link between the conduct and consequences (Večeřa et al., 2013). The subject represents a person whose act, omission or passivity led to the breach. It must be a person capable of being a subject of liability. The subjective aspect is a category

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according to which liability can be divided into strict and subjective. In strict liability culpability is absenting and in subjective it must be present (Mitterpachová, 2015).

Liability has several functions - reparation, satisfaction and prevention, in which the elimination of other potential offenders is included (Csach, 2011). Liability for damage at the pursuit of financial advisory has the same functions.

Liability can be divided into certain types - contractual liability and torts, depending under what title the breach of legal obligation arose (Knappová, 2003). The general regulation of liability caused by infringement of a legal obligation is representing a liability caused by deliberate breach of duty, whereby the culpableness is being presumed, meaning the person infringing the obligation or another duty arising from law is bearing the burden of proof and is obliged to demonstrate that he/she did not cause the damage (Štenglová et al., 2010).

1 Methodology

Financial advisors, whether they are natural or legal persons, are subject to rules that determine the beginning and the subsequent performance of financial advisory. These rules are affecting especially their interaction with clients. The aim of the paper is to analyze the current legal frame regulating the liability for damage caused at the pursuit of financial counseling by the financial advisor to the client. The goal is to provide a proposal *de lege ferenda,* improving the currently valid regulation. The method of analysis and synthesis will be used for the specified aim.

2 Results and Discussion

The essential and currently valid legislation - the Act No 186/2009 Coll. on financial intermediation and financial advisory and on amendments and supplements to certain laws as amended (hereinafter "Act on Advisory") is reflecting on the topic of liability. It is incorporating provision about the liability for damage at the pursuit of financial advisory. The attention is being paid to the liability for damage caused to the professional or non-professional client at the pursuit of financial advisory. According to the Act on Advisory a non-professional client means a client being a natural person who is provided with financial advisory for his/her individual needs or for his/her family member's needs. A professional client is a client that is not a non-professional client.

2.1 The legal relationship between the financial advisor and the client

In the pursuit of financial advisory, there exists a legal relationship between the financial advisor and his/her client. Legal relations represent a sort of social relations regulated by legal rules, in which people posture as the bearers of subjective rights and obligations defined by the relevant rules (Lazar, 2004). For the law implementation in

legal relations, conditions set by law and regulations must be fulfilled; legal circumstances, subject and object build the premises of a legal relationship, the existence of its elements (subject, object, content) are also needed (Prusák, 1995). Since the premises and elements partially overlap, we will pay attention to them together. A legal circumstance as a premise of a legal relationship is the fact that must occur according to law, so that the entity becomes the bearer of rights and obligations established for a factual situation foreseen in general in the law (Knapp, 1995). Into the group of legal circumstances belongs volitional human behaviour, which may be in accordance with law (legal acts) or it may be a violation of law (unlawful acts) (Prusák, 1995). When performing financial advisory, clients and financial advisors fulfil premises of a legal relationship. The legal circumstances are the legal acts of the client and financial advisor. Legal acts can be defined as acts of volition leading in creation, alteration or dissolution of rights or obligations associated with such act of volition under the law. Subjects of legal relations are natural and legal persons. This premise element of the legal relationship is fulfilled at the pursuit of financial advisory. The object of the legal relationship can be defined as the reason for which entities enter to legal relations (Prusák, 1995). Rights and obligations build the content of the legal relationship.

The existence of premises and elements of the legal relationship when performing financial advisory had been clarified. The analyse issues of liability, the kind of legal relationship that is between the client and the financial advisor should be specified. There exists a variety of sorts of legal relations. One of them is the contractual relationship. A contractual relationship is a social relationship, in which individually defined subjects are the bearers of correlating rights and obligations (Lazar et al., 1994). In accordance with theory of law, contractual relations rise from named, unnamed contracts, from liability or unjust enrichment, from liability for defects and from the liability for delay (Lazar et al., 1994). The elements of a contractual relationship are: subject, object and content (Lazar et al., 1994). A subject of the contractual relationship can be a natural or a legal person, whereby the regulation is demanding that the subject - financial advisor is operating on the grounds of a license to pursuit the activity of a financial advisor. When performing financial advisory, the object of the legal relationship is the legitimate interest of a natural or legal person (the client) in the advice concerning the contract for the provision of a financial service through which the client is for example, covering insurance risk or assuring supplementary income in old age. The content of the contractual relationship is built by rights and obligations. As already mentioned an individual right corresponds to an individual obligation.

The client´s right to obtain an objective analysis of a sufficient number of available financial services. This right is corresponding with the financial advisor´s duty. Mainly it is also the client´s duty to pay the financial advisor for his/her advice, which is corresponding with the advisor´s right to be paid. The existence of elements of a contractual relationship has been proved.

The contractual relationship between the client and the financial advisor arises from a written contract for the provision of financial advisory concluded with the client. It represents a type of contract introduced by the Act on Advisory, for which a mandatory written form has been established (Sidak et al., 2014). The contract´s creation, as a bilateral legal act, is requiring two unilateral legal acts of two different parties addressed to each other and with an identical content (Svoboda et al., 2005). From this contractual relation the financial advisor has the status of a debtor regarding the advice, individual

financial plan concerning the financial service. At the same time the financial advisor is the creditor regarding the client´s fulfilment. It is a mutual relationship meaning that the rights and obligations of a financial advisor are corresponding with rights and obligations of the client (Svoboda et al., 2005).

2.2 The liability legal relationship

Contractual liability and torts can be distinguished (Knappová, 2003). The core of contractual liability lies in the breach of a contractual obligation and is therefore directly dependent on a contractual relationship (Mitterpachová, 2015). When breaching the written contract for the provision of financial advisory concluded with the client, a contractual liability has been established. Torts arise when a duty set directly by law has been breached or an obligation set by an individual legal act has been infringed (Holub et al., 2016). This leads to the conclusion that a breach of a duty set by the Act on Advisory is a tort. Further it is necessary to focus principally on the contractual liability. Mainly because in practice the written contract for the provision of financial advisory concluded with the client may duplicate articles of the Act on Advisory. Meaning the contract repeats the provisions of the Act on Advisory. Logically this leads to the conclusion that an obligation arising from law becomes an obligation arising from contract. Subsequently its breach raises contractual liability instead of torts. Elements which fulfilment is necessary to establish the liability relationship are: unlawful act, fault, injury or damage and the causal link between the fault and the damage (Lazar et al., 2006).

Further, we will focus on each of these elements.

Unlawful act – Unlawfulness can be characterized as a result of human activity, a conflict with the objective law, with the legal order, which represents a consistent category (Holub et al., 2003).

Fault – represents an element that is necessary for the creation of a liability relationship. Fault is the psychological relationship to the unlawful conduct and the damage; it must cover all the features of the respective subject matter - an unlawful act, damage and causal link between them (Holub et al., 2003). There exist two categories of liability – subjective and objective (Mitterpachová, 2015). The liability for damage in the pursuit of financial advisory is subjective, based on fault.

Types of fault are represented by an intentional acting (in the form of a direct or indirect intention) and negligence (in the form of conscious and unconscious negligence) (Večeřa et al., 2013). When the financial advisor acts with a direct intention to cause damage: he/she knows that the acting is unlawful and that a harmful result may be caused and he/she wants to cause it. When acting with an indirect intention the financial advisor knows that he/she is committing a misdemeanour and in case that it happens, he/she understands the consequence. When acting with conscious negligence the financial advisor knows, that he/she is committing a misdemeanour and without reasonable grounds he/she relies on the fact that the result does not occur; when the financial advisor is acting with unconscious negligence he/she does not know that he/she is committing a misdemeanour, although he/she should and could know. Based on theory of

law and judicial practice in civil offenses, we can conclude that the fault, namely negligence is being presumed (Fekete, 2011). If the client of the financial advisor sets up his/her claim on intentional acting, he/she is obliged to prove it (Fekete, 2011).

Damage – there is no legal definition of this term, but its definition is found in judicial decisions, specifying that it is an injury manifested in the sphere of property of the aggrieved person that can be objectively expressed in money.[2] Property damage can take the form of actual damage, which may consist in the reduction of the aggrieved person´s property, including the costs which are connected with the occurrence and detection of the damage, as in vain expended costs and the impossibility to exercise rights (Bejček et al., 2003). Damage may manifest as loss of profit. This is based on the failure to reach what would have been achieved by the aggrieved person normally in case of the absence of the harmful event (Bejček et al., 2003).

The causal link between the fault and the damage – Causality is the relationship between cause and effect, whereby the cause is the unlawful act (ie. causa) and the result is the damage (ie. nexus), as well as their mutual interrelations and conditionality (Mitterpachová, 2015). A cause of the damage can be only a circumstance, the absence of which would avoid the damaging result, but not necessarily the sole cause, but the one that contributes significantly to the negative consequences (Suchoža et al., 2007). The influence of interrelated causes is not equal, there are some that have a key importance and there are those which are minor, but necessary for a result and those which are secondary, insignificant (Fekete, 2011). The understanding of the causal nexus requires not only the time aspect, but also the substantial aspect. The relation between the conduct and consequences must be substantive (Jakubovič, 2005). The functions of the causal link are: prediction – the possibility to anticipate future consequences of actions, retrospective – valuation of temporal and substantive circumstances, attributability - possibility to assign actions and results in the entity (Suchoža et al., 2013). In law as a social science, the causal link is reflecting the patterns of links between actions and reactions which characterize natural sciences. Since life and the diversity of events bring the need to reflect on this fact.

The complete information to provide there is important to note, that the subject causing the damage must have a capacity to incur liability in delict, meaning the ability to bear the consequences for the unlawful act. The first necessary assumption for this capacity is the capacity to have rights and obligations that arises at birth and ends with death. It lasts through the whole life of a natural person, who cannot be limited in it or deprived of it, this capacity expresses the guaranty anchored in law to acquire rights and obligations without a legal act (Vojčík, 2008). A category connected with it is the capacity to enter legal acts. It is defined as the capacity based on grounds of own legal acts, which are in line with legal standards, to creation, alteration dissolution of a legal relationship; requiring the achievement of legally relevant degree of volitional and intellectual maturity of a person to take legal action (Vojčík, 2008). Capacity to incur liability in delict represents the ability of creation of a new obligation arising from liability; this liability is the consequence of an unlawful act (Knappová, 2003). For legal persons, it is necessary to build on the provisions of Article 3 Section 1 in conjunction with Article 2 of the Act No 513/1991 Coll. Commercial Code as amended (hereinafter "Commercial Code"), which are speaking about the validity of legal acts performed beyond business

[2] Judgement of the Supreme Court of the Czech Republic, 21 Cdo 1214/98.

as well as the capability to unlawful acts that has not only an individual entrepreneur, but also a legal person and persons performing such activities in their name and on their behalf.

2.3 The Applicable Law

The following sequence of application of the rules governing liability can be set out: regulation of compensation of damage in accordance with special regulations, regulation of compensation of damage in accordance with specific subject matters of the Act No 40/1964 Coll. Civil Code as amended (hereinafter "Civil Code"), the general scheme of compensation of damage in accordance with the Commercial Code, the general scheme of compensation of damage in accordance with the Civil Code (Pelikánová, 1996). A breach of an obligation set by other legislation than the Commercial Code, must be regulated by the Civil Code (Article 420 and following), provided that this legislation does not contain a specific regulation of compensation of damages, respectively does not expressly refer to the rules of the Commercial Code (Ovečková et al., 2005). The Act on Advisory, does not contain specific provisions regulating the compensation of damages at the pursuit of financial advisory, it also does not refer to the provisions of the Commercial Code. The provisions of the Civil Code are applicable, when compensating a damage that was caused by the financial advisor at the pursuit of financial advisory.

2.4 The Aspect of Exoneration

It also must be focused on the aspect of exoneration. As mentioned above, in terms of fault is the liability for damage at the pursuit of financial advisory a subjective liability based on the principle of a culpable causing of damage (Fekete, 2011). The legislator foresees the possibility of exonerating from this liability, when the offender proves that the damage was not caused by his/her fault. The financial advisor´s client who suffered damage is obliged to prove the unlawfulness, the damage and the amount of damage and the causal link. The fault (in form of unconscious negligence), will be presumed and it constitutes a disprovable presumption (Lazar et al., 2004). Meaning the financial advisor is bearing the burden of proof relating to the absence of fault.

2.5 The General Knowledge of Financial Advisors

Just as in other professions, financial advisors are required to meet professional qualifications[3] and have a legal obligation of professional care.[4] Professional care can be defined as the sum of knowledge needed for the performance of the profession (Mitterpachová, 2015). Certain common elements of the performance of two businesses,

[3] Article 18 and Article 21 Act on Advisory.
[4] Article 28 Act on Advisory.

advocacy and financial advisory), can be seen particularly in the requirement of identifying, monitoring and addressing the needs of the client. The Article 26 of Act No. 586/2003 Coll. about advocacy as amended regulates the liability for damages at the pursuit of advocacy as strict liability with the possibility of liberation. Strict liability is also required by regulation for auditors and tax advisors.

In terms of maintaining the client's interests the activity of a financial advisor can be compared to a barrister. We believe that in the process of definition of general knowledge of financial advisors, the knowledge on the level of so-called average diligent and prudent legal expert can be applied adequately. The average diligent and prudent legal expert has through electronic media access to a wide diapason of information sources, maintaining a relatively high level of knowledge through regular study and is capable to update and adapt this knowledge to a specific situation (Tichý et al., 2013). The general knowledge of financial advisors must also include information about the financial market, economics and mathematics. Common elements should lead to a common standard of liability.

Conclusion

The provided analysis, leads to the conclusion that in accordance with the element of the liability legal relationship, the subjective aspect, the liability for damage caused at the pursuit of financial advisory represents subjective liability, where fault is necessary.

Our proposal *de lege ferenda* is the introduction of strict liability for damage caused at the pursuit of financial advisory. Strict liability is designed as a liability for the unlawful situation. It is a liability set in an objective way in law. A support for strict liability, assessed irrespective of fault, can be seen in the fact that financial advisors are experts in their field. According to the currently valid regulation, financial advisors need to achieve the highest level of professional qualifications. A change of legislation regulating liability for damage caused at the pursuit of financial advisory designed as a strict liability would provide a higher level of protection for clients. Among the group of clients especially financial consumers should be protected. Protection of financial consumers is part of the policy of Slovakia as a state with a functioning market economy. The state creates proper legislative environment containing both private means of protecting financial consumers, as well as public sanctions for misconduct.

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