Legal Profession Amendment (Mortgage Practices) Bill 2000

Explanatory note

This explanatory note relates to this Bill as introduced into Parliament.

Overview of Bill

The object of this Bill is to amend the *Legal Profession Act 1987* for the following purposes:

(a) to make further provision for the regulation of certain mortgage work carried out by solicitors, in light of changes to the *Corporations Law* and to the policies of the Australian Securities and Investment Commission (***ASIC***) with regard to managed investment schemes,

(b) to provide that a solicitor is not required to obtain his or her client's authority before transferring money received by the solicitor on account of costs in a workers compensation matter to an office account.

The Bill repeals and replaces the *Legal Profession Amendment (Solicitors' Mortgage Practices) Act 1998*, which is uncommenced.

Outline of provisions

Clause 1 sets out the name (also called the short title) of the proposed Act.

Clause 2 provides for the commencement of the proposed Act on a day or days to be appointed by proclamation.

Clause 3 is a formal provision giving effect to the amendments to the *Legal Profession Act 1987* set out in Schedule 1.

Clause 4 repeals the *Legal Profession Amendment (Solicitors' Mortgage Practices) Act 1998*.

Schedule 1 Amendments

Amendments relating to mortgage practices and managed investment schemes

Background

The *Legal Profession Amendment (Solicitors' Mortgage Practices) Act 1998* made amendments to the *Legal Profession Act 1987* (***the principal Act***) for the purpose of providing for the stricter regulation of certain mortgage work carried out by solicitors. Among other things, that Act required a solicitor to notify the Law Society if the solicitor carried out certain mortgage work and to obtain separate fidelity insurance in respect of that work.

Since that Act was passed, there have been some significant changes to the *Corporations Law*. The changes have an impact on mortgage work carried out by solicitors.

Chapter 5C of the *Corporations Law* (which commenced on 1 July 1998) introduced a new regime for the regulation of managed investments. Among other things, Chapter 5C requires a managed investment scheme to be operated by a "responsible entity" registered under the *Corporations Law*. A responsible entity must be a public company and hold a dealers licence that authorises it to operate a managed investment scheme.

It is possible that mortgage investment schemes conducted by solicitors will fall within the requirements relating to managed investment schemes.

Under an exemption granted by ASIC, smaller investment schemes conducted by solicitors under the supervision of the Law Society will not be required to comply with the *Corporations*

Law provisions. That is, solicitors will be able to continue to operate them, under the supervision of the Law Society. The provisions of this Bill relating to mortgage practices and managed investment schemes complement the ASIC exemption. Most of those provisions are set out in **Schedule 1 [7]**.

Amendments relating to "regulated mortgages"

The amendments set out in **Schedule 1 [7]** introduce a number of requirements affecting solicitors who conduct mortgage practices. A contravention by a solicitor of any of those requirements will be professional misconduct.

The new provisions will apply to any solicitor who, in the solicitor's capacity as solicitor for a lender or contributor, negotiates the making of or acts in respect of a "regulated mortgage".

A regulated mortgage is any mortgage affecting real property, excluding the following:

(a) a mortgage in which the lender is a financial institution,
(b) a mortgage in which the lender or contributors nominate the borrower, but only if the borrower has not been introduced to the lender or contributors by the solicitor or by another person who is connected with the solicitor,
(c) a mortgage or class of mortgage that the regulations prescribe as not being a regulated mortgage.

Under the new provisions, a solicitor must not, in the solicitor's capacity as solicitor for a lender or contributor, negotiate the making of or act in respect of a regulated mortgage unless the mortgage is:

(a) a State regulated mortgage, or
(b) a run-out mortgage, or
(c) a mortgage that forms part of a managed investment scheme that is operated by a responsible entity (in accordance with the requirements of the *Corporations Law*).

State regulated mortgages are regulated mortgages that will be supervised by the Law Society.

A regulated mortgage is a State regulated mortgage only if:

(a) the mortgage does not form part of a managed investment scheme that is required to be operated by a responsible entity, and
(b) the solicitor has, by notice to the Law Society Council, nominated his or her practice as a State regulated mortgage practice.

A solicitor who, in the solicitor's capacity as solicitor for a lender or contributor, negotiates the making of or acts in respect of any State regulated mortgage will be required to notify the Law Society Council of that fact in accordance with the regulations or solicitors rules.

A run-out mortgage is a mortgage entered into before the commencement of the new provisions that is neither a State regulated mortgage nor a *Corporations Law* regulated mortgage. Transitional arrangements apply to run-out mortgages. These are explained further below.

Requirement to comply with relevant legislation

A solicitor who, in the solicitor's capacity as solicitor for a lender or contributor, negotiates the making of or acts in respect of a regulated mortgage will be required to comply with the requirements of the *Corporations Law* (as modified by any exemption given by ASIC or conferred by the regulations under the *Corporations Law*), the principal Act, the regulations and the solicitors rules.

A solicitor will also be required to comply with the terms of any exemption given by ASIC to managed investment schemes that have more than 20 members, and are supervised by the Law Society, even if the managed investment scheme that the solicitor is acting in respect of has fewer than 20 members.

Insurance requirements

A solicitor will be required to have separate fidelity insurance cover in respect of regulated

mortgages. There will be a bar on the making of claims against the Fidelity Fund in respect of regulated mortgages, but that bar will not operate when the solicitor fails to comply with the requirement to obtain separate fidelity insurance. A solicitor will be required to notify affected clients of the insurance arrangements for regulated mortgages.

The Law Society Council must not issue a practising certificate to an applicant who fails to obtain such a policy of fidelity insurance in accordance with the requirements.

The insurance requirements do not apply in respect of a regulated mortgage that forms part of a managed investment scheme that is operated by a responsible entity.

Amendments relating to managed investment schemes that are operated by responsible entities

The general purpose of the amendments relating to managed investment schemes that are operated by responsible entities is to separate the operation of such managed investment schemes from the conduct of a solicitor's legal practice.

The amendments make it clear that a solicitor may do legal work in connection with a managed investment scheme that is operated by a responsible entity and may have an interest in the scheme. However, if a solicitor accepts money from a client to be invested in a managed investment scheme operated by a responsible entity, and the solicitor has a particular kind of interest in the scheme (eg, the solicitor is a director of the responsible entity), the solicitor will be required to notify the client:

(a) that the solicitor has an interest in the scheme, and
(b) that the operation of the managed investment scheme does not form part of the solicitor's practice, and
(c) that no claim can be made against the Fidelity Fund for a pecuniary loss arising from an investment in the managed investment scheme.

The client will be barred from making any claims against the Fidelity Fund in respect of a pecuniary loss arising from the investment in the managed investment scheme. That bar will not operate if the client has not been given the required notice.

The regulations and solicitors rules may make further provision for the purpose of:

(a) ensuring that the operation of the managed investment scheme is kept separate from the solicitor's practice, and
(b) ensuring that clients of the solicitor are aware that the operation of the managed investment scheme does not form part of the solicitor's practice.

Transitional arrangements

The amendments extend generally to regulated mortgages that were entered into before the new provisions commence. However, the transitional provisions make it clear that the Fidelity Fund continues to be available for the benefit of lenders or contributors under mortgages that were entered into before the commencement of the new provisions, except in relation to any further advances made after that commencement.

In respect of regulated mortgages entered into before the commencement of the new provisions, a solicitor has the following options:

(a) the solicitor can nominate his or her practice as a State regulated mortgage practice, in which case any such pre-existing mortgage will be treated as a State regulated mortgage (but only if it does not form part of a managed investment scheme that is required to be operated by a responsible entity under the *Corporations Law*), and the solicitor will be able to continue to act in respect of the mortgage, subject to the requirements as to State regulated mortgages set out above,
(b) the solicitor can transfer responsibility for the mortgage to a responsible entity for a managed investment scheme, but only if the solicitor obtains the consent of the lenders or contributors under the mortgage,

(c) the solicitor can treat the mortgage as a "run-out mortgage".

A run-out mortgage is a mortgage entered into before the commencement of the new provisions that is neither a State regulated mortgage nor a *Corporations Law* regulated mortgage. Under the amendments, a solicitor will not be able to make any further advances under a run-out mortgage or extend the term of a run-out mortgage. However, a solicitor may substitute a lender or contributor under a run-out mortgage. Such a substitute lender or contributor will be barred from making any claims against the Fidelity Fund in respect of any pecuniary loss relating to the mortgage.

Other provisions

Other provisions set out in **Schedule 1 [7]** allow:

(a) the Law Society to require further information about mortgage practices from solicitors, and

(b) the regulations and solicitors rules to make further provision in respect of regulated mortgages and the involvement of solicitors in managed investment schemes.

The Law Society will have the function of disseminating information to increase public awareness of the requirements of the principal Act and the *Corporations Law* relating to solicitors' mortgage practices. The cost of exercising this function may be recovered from the Fidelity Fund. (See **Schedule 1 [2]** and **[5]**)

Persons who exercise functions under the principal Act will be able to disclose to ASIC particulars concerning the conduct of any solicitor in respect of a regulated mortgage. (See **Schedule 1 [3]**)

Schedule 1 [1] and **[6]** make minor consequential amendments.

Amendments relating to payment of costs in workers compensation matters

At present, section 61 of the principal Act requires a solicitor who, in the course of practising as a solicitor, receives money on behalf of another person (***the client***) to hold the money exclusively for the client and to pay that money into a general trust account or in accordance with the directions of the client, and to disburse the money in accordance with the directions of the client.

The amendment set out in **Schedule 1 [4]** provides that the requirement does not apply in respect of money received by a solicitor on account of costs in a workers compensation matter, where those costs have been awarded by the Compensation Court of NSW. That is, a solicitor will be able to transfer the payment directly into his or her office account without obtaining the client's authority to do so. (Note that under the *Workplace Injury Management and Workers Compensation Act 1998* a legal representative of a person claiming compensation under that Act is not entitled to recover any costs in respect of the claim unless those costs have been awarded by the Compensation Court.)

Other amendments

Schedule 1 [9] inserts savings and transitional provisions. **Schedule 1 [8]** allows further savings and transitional provisions to be made by regulation.