New restrictions for lawyers involved in **Managed Investment Schemes**

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Snapshot

- New laws restricting lawyers' involvement in managed investment schemes and mortgage practices are expected to commence on 1 July 2018.
- The Legal Services Council is making Rules for the implementation of the new laws following a public inquiry conducted in 2017.
- Breach of the new laws can carry serious consequences for law practices.

This July, the final piece of the puzzle restricting lawyers' involvement in investing clients' money will fall into place following the passage of the Justice Legislation Amendment (Access to Justice) Bill (2018) and the subsequent commencement of section 258 of the *Legal Profession Uniform Law NSW* (***'Uniform Law'***). These changes will be accompanied by a number of new *Legal Profession Uniform General Rules 2015* (***'Uniform Rules'***). At the time of writing, the Bill has been passed by the Victorian Parliament but the changes to the *Uniform Rules* are still in consultation. The new provisions are expected to commence in Victoria and New South Wales on 1 July 2018.

The legislation is not limited to mortgage schemes and should be on the radar for all practitioners. It covers the:

- promotion or operation of a Managed Investment Scheme ('**MIS**') by law practices or their related entities;
- provision by law practices of legal services in relation to MIS in which an associate of the law practice has an interest; and
- provision by law practices of certain mortgage-related services to private lenders in circumstances where the law practice (or its agent or associate) has introduced the borrower to the lender.

Since 2004, incorporated legal practices have been prohibited from operating a MIS. There have also been longstanding restrictions on solicitors acting for lenders (or contributory lenders) on mortgages where they introduced the borrower, or in respect of a MIS in which they had an interest. Since 2014, r 41.1 of the *Australian Solicitors' Conduct Rules* has specifically prohibited a solicitor from conducting a MIS or engaging in mortgage financing as part of their law practice. Section 258 extends these existing restrictions.

The legislation provides for much of the detail to be filled in by Rules made by the Legal Services Council ('**LSC**'). In 2017 the LSC commissioned an inquiry into the likely impact of the new requirements, to help guide the exercise of its rulemaking powers. The inquiry report, available on the LSC website, made seven recommendations following consultation with affected firms and professional bodies in Victoria and New South Wales. Those recommendations go to the scope and implementation of the new requirements and are intended to balance client protection objectives with the legitimate business interests of law practices and are reflected in the proposed amendments to the *Uniform Rules*.

The first restriction

Promoting or operating a Managed Investment Scheme

The first of the restrictions is contained in s 258(1)(a), which is qualified by the proposed s 258(1A) and s 258(2). It applies when a law practice or related entity promotes or operates a MIS.

Like the predecessor Acts, the new law adopts the definition of 'managed investment scheme' used in the *Corporations Act 2001* (Cth) (***'Corporations Act'***). This is very broad, and (subject to statutory exceptions) captures any program or plan of action where people contribute money or money's worth to be pooled or used in a common enterprise for the purpose of producing benefits for the contributors or their assignees, where they do not have day-to-day control of the operation of the scheme. This includes a range of non-corporate collective investment arrangements, such as property syndicates or investment pools, and other arrangements falling within the statutory language, even if at first blush they may not look like collective investments (see e.g. *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* [2009] 180 FCR 11; [2009] FCAFC 147).

It is not restricted to arrangements that are registrable with the Australian Securities and Investments Commission ('**ASIC**') under Chapter 5 of the *Corporations Act*, or would be registrable but for ASIC relief. The LSC has taken the view that, despite the drafting of s 258(3) referring to 'the responsible entity for the scheme', s 258(1) is not restricted to registered schemes.

'Law practice' is defined in s 6 of the *Uniform Law* to include sole practitioners, law firms, community legal services, incorporated legal practices, and unincorporated legal practices. If the law practice is a company, its related bodies corporate are related entities. For other practices, the definition of related entity is contained in r 6A of the draft *Uniform Rules*, which adopts a similar approach. The key concept is whether the law practice is controlled by or controls the other corporate entity or shares a common corporate controller. The new law is broader than the old, because it covers both the 'promotion' and the 'operation' of a MIS. These words are not defined in the *Uniform Law* however they have been the subject of judicial interpretation in the context of Chapter 5C of the *Corporations Act 2001* (Cth). A person promotes a scheme if they formulate and establish the scheme and solicit participants for it, or play a significant role in doing so. It is not the same as marketing a scheme; the concept is more akin to that of a company promoter.

A person operates a scheme if they do 'acts which constitute the management of or the carrying out of the activities which constitute the managed investment scheme' (*Australian Securities and Investments Commission v Pegasus Leveraged Options Group Pty Ltd* (2002) 41 ACSR 561; [2002] NSWSC 310 at [55] (Davies AJ)).

The fact that a lawyer is a director of a responsible entity or the operator of a wholesale MIS does not necessarily mean that his or her law practice is promoting or operating the MIS. It is, of course, a question of fact. Lawyers' earlier extensive involvement in mortgage financing means that many firms have commercial and business connections with ASIC registered mortgage schemes. In these cases, care must be taken to ensure that the law practice itself is not operating or promoting the scheme, for example in conjunction with the responsible entity. A law practice can act for the responsible entity of a scheme in the ordinary course, without crossing the line.

The first restriction operates subject to two exceptions. The first is in the new s 258(1A), which is expected to be enacted on the recommendation of the Council and to carve out schemes connected with or related to the business structure or ownership of the law practice; and schemes connected with the operation of the law practice in which only associates of the law practice participate. The second is in s 258(2), which covers law practices whose work involves them in the insolvency or administration of MIS.

The second restriction

Providing legal services in relation to a Managed Investment Scheme

The second restriction is contained in s 258(3). It prohibits a law practice providing legal services in relation to a MIS if any associate of the law practice has an interest in the scheme or the responsible entity for the scheme, except as permitted by the *Uniform Rules* or as approved by the designated local regulatory authority. 'Associate' includes the principals, partners, directors, officers, employees and agents of the legal practice (whether lawyers or not), and consultants if they are lawyers. However, under r 91A of the draft *Uniform Rules*, the prohibition does not apply where the law practice is acting for the responsible entity or MIS operator.

Where the law practice is acting in relation to a MIS for another client, the prohibition only applies if the law practice knows or ought to know that the associate has a substantial interest in the scheme or its operator. 'Substantial interest' mirrors the concept used in r 8.2 of the *Legal Profession Uniform Legal Practice (Solicitors) Rules 2015*; it includes where the associate is entitled to an interest in the assets of the MIS or responsible entity which is significant or of relatively substantial value, or exercises any material control over the conduct and operation of the MIS or responsible entity, or has an entitlement to a share of the income of the MIS or responsible entity which is substantial, having regard to the total income which is derived from it.

The third restriction

Negotiating or acting on mortgages arranged by the law practice

The third restriction is in s 258(5). Its effect is that a law practice or its related entity must not negotiate or act in respect of certain mortgages as the legal representative of a lender that is not a financial institution. 'Financial institution' is broadly defined in s 258(5) and r 91B of the draft *Uniform Rules*; it includes a bank or other authorised deposit-taking institution, an entity that is a professional investor for the purposes of the *Corporations Act* or that holds an Australian credit licence, and a body corporate with gross assets exceeding $10 million whose ordinary business includes the lending of money.

Where the client is not a financial institution, the restriction applies where the borrower is introduced to the lender or contributors by the law practice, or by its associate or agent or a person engaged by the law practice for that purpose.

Consequences

A law practice that contravenes a restriction in s 258 can face a civil penalty of 250 penalty units, or $27,500. It can also be grounds for disqualifying an entity that is or was a law practice from providing legal services, under s 120 of the *Uniform Law*.

More broadly, the commencement of s 258 provides an opportunity for law practices to reflect on the nature of the services they currently provide to clients in relation to investments. There is a renewed focus on the role of intermediaries in the financial system, including those who receive a fee for referring clients or arranging for the sale of financial products and services. Section 258 operates against the backdrop of general professional obligation, including for the management of conflicts of interest and in connection with business activities carried on by lawyers outside of legal practice. It is timely for law practices engaged in assisting clients in financial matters to check carefully the requirements of Chapters 5C and 7 of the *Corporations Act*, along with the changes to the *Uniform Law* and *Uniform Rules*. **LSJ**

*** Professor Hanrahan** is the author of the 'Report of an inquiry for the Legal Services Council into Section 258 of the *Legal Profession Uniform Law*' (October 2017). See: www.legalservicescouncil.org.au/Documents/news/lsc-misinquiry-final-report.pdf