



Lawyers Nominee Companies and Contributory Mortgages

Notes for the guidance of lawyers

1. Introduction

New rules for lawyers nominee companies (the Lawyers and Conveyancers Act (Lawyers: Nominee Company) Rules 2008, SR 2008/213 – available on the Law Society’s website www.lawsociety.org.nz and referred to here as the LNCR) came into force on 1 August 2008, corresponding with the date on which the Lawyers and Conveyancers Act 2006 (LCA) took effect.

2. Changes

The new rules differ in some respects from the previous rules and all lawyers who operate lawyers nominee companies need to familiarise themselves with them. Some of the important changes are highlighted below.

- A new form of constitution is prescribed in Schedule 1 of the rules and firms operating lawyers nominee companies need to adopt it immediately.
- The name of each nominee company must contain the words “Lawyers Nominee Company Limited” or “Solicitors Nominee Company Limited” – Rule 5.2. If the name of a nominee company does not comply with this requirement, immediate steps must be taken to change its name. New Zealand Law Society (NZLS) approval of the new name must be obtained first – Rule 5.1.
- A new form of specific authority for investment, in Schedule 3 of the rules, needs to be adopted immediately.
- The information to be given to investors has been changed and amplified – Schedule 4. The changes result from the position taken by the Securities Commission and by Ministry of Justice officials. In particular, it is necessary to provide information about the basis on which the lawyer’s fee will be charged – clause 13(a). Lawyers will need to ensure that these requirements are complied with in respect of all new advances.

3. Lawyers’ Fidelity Fund

Under s322 of the Lawyers and Conveyancers Act 2006, the Lawyers’ Fidelity Fund will not be available to reimburse losses relating to money that a lawyer has been instructed to invest. Most advances by way of lawyers nominee company securities and contributory securities will be excluded from cover by this section.

There are various circumstances where s322 does not apply and lawyers need to be familiar with its precise provisions.

In the case of investments where s322 does apply, an acknowledgment that the Fidelity Fund will not reimburse losses must be included on the specific authority (see Schedule 3 of the LNCR). The acknowledgment is also required in the case of other types of investment pursuant to Regulation 39 of the Lawyers and Conveyancers Act (Trust Account) Regulations 2008.

4. Conflict of interest

Various provisions of the Lawyers and Conveyancers Act (Conduct and Client Care) Rules 2008 (RCCC) have particular reference to nominee company securities and contributory securities. The rules relating to conflict of interest are of great relevance in this area. Lawyers must always be mindful of their responsibilities to borrowers, contributors, guarantors and any other clients or people to whom the lawyers have a professional responsibility.

Attention is drawn particularly to the following provisions in the RCCC:

- 5.4 Lawyer's interests conflicting with those of his or her client.
- 5.9 Disclosure to clients of commissions receivable.

- 6.1 Acting for more than one party – need for prior informed consent.
- 6.1 Action in the event of a conflict or likely conflict of interest among clients.
- 8.7 Acting against a former client.

5. Advantages of a lawyers nominee company

The practice of taking a contributory mortgage or other contributory securities in the name of a nominee has obvious advantages of convenience. It avoids some of the difficulties of enforcement associated with the security in the names of a number of contributors. It also avoids the inconvenience and difficulty of obtaining execution of a release or a variation of a security held by a number of people. It obviates the necessity for a transfer when one contributor replaces another.

A lawyers nominee company formed and operated under the LNCR provides a suitable and convenient nominee. However, the operation of a nominee company carries obligations imposed by the LNCR, the Trust Account Regulations and the general law.

The entitlement of lawyers to operate lawyers nominee companies depends on an exemption from the Securities Act (Contributory Mortgage) Regulations 1988 granted by the Securities Commission. Lawyers who operate a lawyers nominee company should familiarise themselves with the terms of the

6. Function exemption. and scope of the lawyers nominee company

The procedure requires the formation of a nominee company that will act as a bare trustee holding the security for each loan in its own name, but on behalf of the contributors to the loan who are the beneficial owners of the security.

The company is to function only as a nominee. It is to be the custodian of security documents for contributors.

The powers of the nominee company are very restricted and are set out in Rule 6.2. The powers do not enable the company to carry on any business or to handle moneys or enter into covenants on behalf of the contributors.

The company does not have the power to accept moneys on deposit for investment; nor can it seek to do so. It may not advertise for funds. Lawyers should be careful to avoid giving any suggestion that the company itself is any more than a bare trustee or that it engages in any activity in its own right.

7. Forming the company

NZLS consent to the company's formation, proposed name and proposed registered office is required. The form of application is set out in the rules, as is the form of the constitution. No change to any of these documents is permitted without the written consent or direction of the NZLS. Neither the name of the company nor its registered office may be changed without NZLS consent.

The name must have a recognisable connection with the practice proposing to operate the nominee company and must contain the words "Lawyers Nominee Company Limited" or "Solicitors Nominee Company Limited".

8. Administration of the company

- (a) The directors must all be the partners of a partnership or all the directors of an incorporated law firm. In the case of a lawyer in sole practice, he or she must be the sole director of the company.
- (b) A majority of the directors, or the sole director where applicable, is normally adequate to pass resolutions.
- (c) A majority of the partners/directors in a firm is required to be shareholders or, in the case of a lawyer in sole practice, the lawyer concerned.
- (d) The company must file an annual return with the Registrar of Companies and also file a "nil" tax return. There needs to be an annual resolution, if applicable, that no auditor be appointed.

Lawyers should be aware of the need to make consequential changes to the shareholding and directorship of the nominee company upon the introduction of new partners or directors/shareholders or the death or retirement of existing partners or directors/shareholders.

9. Costs of formation and operation

Lawyers forming or operating lawyers nominee companies will need to meet the associated costs including the annual return and any statutory or regulatory fees.

10. Contributory securities taken in the name of all contributors

Contributory securities may be taken in the names of all the contributors in their respective shares. These may include the lawyer himself or herself, either in his or her own right or (if authorised by the trust instrument) as a trustee.

However, lawyers should keep in mind that the provisions of Regulation 39 of the Trust Account Regulations extend the operation of various provisions in the LNCR to apply to contributory securities. The provisions that apply are:

- (a) The authorities to be given by investors.
- (b) The information to be given to investors.
- (c) The registration of mortgages.
- (d) The prohibition against the taking or holding of a security from an “associated person” (see LNCR, Rule 3) and the disclosure required before an associated person can be a guarantor or indemnifier.
- (e) Default procedures.
- (f) The restrictions relating to advancing moneys on the security of development mortgages.

The above requirements do not apply in the circumstances set out in Trust Account Regulation 39(2).

11. Accounting procedures

The accounting instructions previously provided in relation to nominee companies are set out as a schedule to these guidance notes. There are also specimens of the cards designed for use by firms adopting the scheme. They were devised primarily to assist smaller firms keeping their books manually. Most trust accounting software packages on the market offer an electronic version.

The control feature prescribed is similar to the control account that has been a feature of the procedure used for interest bearing deposit of clients' funds. This control account is to balance at all times with the total of the contributory advances and with the total of the various clients' investments.

The system provides for the entries required when there is a change in contributors. No action at all is needed in respect of the security documents themselves when such a change takes place.

12. Lending policy

All partners in a firm (and all directors and shareholders in the case of an incorporated firm) are individually responsible to ensure that the lawyers nominee company is operated in a manner which complies with all statutory provisions, the LNCR and the Trust Account Regulations, as well as in accordance with the duties owed by the lawyers to investor clients.

Partners or directors should therefore regularly review the philosophy for operating a nominee company. This extends to the viability (including the resources required and the profitability) of the nominee company operation, adherence to the LNCR and possible exposure to liability for contributors' losses.

Lawyers in sole practice should also review as above, given that they make decisions without the benefit of partner advice and peer support, particularly when advances are made and renewed, and when and how to enforce a mortgage in default.

Policy decisions should include:

- (a) Who is responsible for:
 - (i) reviewing the cost effectiveness of the nominee company operation and of contributor lending generally;
 - (ii) ensuring that all of the conditions of the firm's professional indemnity insurance policy are met.
- (b) Who is responsible for deciding which investments are to be made and that they comply with the LNCR and other lending criteria. Partner participation in decision making is essential and can involve one partner or a committee of partners. If it is to be one partner (or even two partners)

his/her/their involvement in property work should not be so great as to inhibit an objective view of loan applications.

- (c) Who is responsible for reaching decisions as to enforcement following default. It is essential that the partner(s) delegated to make decisions are able to take an objective view. The responsibility for exercising enforcement procedures following default rests with the nominee company directors.
- (d) Who is responsible for exercising overall jurisdiction in respect of contributory mortgage lending. A large number of contributors, whether to a contributory security or a security held in the name of the nominee company, will cause added complications and significantly increase administration costs. The appropriateness of a large contributory mortgage advance with many contributors can be open to question.

13. Loans management

The person appointed to manage the operation must have procedures to ensure that:

- (a) Signed specific authorities are obtained on or before the date of the advance or extension of a loan.
- (b) Valuation, and other, information is sent to investors.
- (c) Appropriate reminders for interest payments are sent to borrowers, either just before due date and/or immediately after any missed payments.
- (e) Borrowers are reminded of principal falling due, well before maturity dates.

14. Internal controls

Procedures should be in place for:

- (a) Regular reporting to partners/directors of defaults.
- (b) Reporting to investors of any loans in default for 30 days.
- (c) Regular reports to investors of action taken on defaults.
- (d) Reports to all partners/directors of loans advanced, repaid, or in default.
- (e) Where valuations are required,
 - (i) ensuring that only competent valuers are instructed;
 - (ii) ensuring that valuers receive instructions in sufficient time to enable availability of the valuation, and proper consideration by the appropriate partners or committee, before making an advance;
 - (iii) ensuring that the valuers supply the requisite information; that their comments or qualifications are taken into account and that the valuers' recommendations are appropriate and are acted upon.

SCHEDULE 1

LAWYERS NOMINEE COMPANY ACCOUNTING PROCEDURE

1. Company name mortgages

In this appendix, "company name mortgages" means securities for money lent in the name of a lawyers nominee company.

2. All transactions through trust account

All transactions, both principal and interest, relating to company name mortgages are to be recorded in the lawyer's trust books of account and, together with the relative documents of security and other records, be subject in all matters to the LCA and to the Trust Account Regulations. However, in the case of any mortgage where there is a single mortgagee only, that mortgagee may collect interest direct from the mortgagor.

3. Accounting records

The accounting records to be maintained for company name mortgages are:

- (a) Mortgage cards, of a distinctive size or colour, in the name of the mortgagor recording clearly:
 - (i) particulars of the mortgage, including date of maturity, rate of interest, dates interest payable, number of mortgage and title reference;
 - (ii) principal advanced to the mortgagor and repaid by the mortgagor;
 - (iii) interest due by the mortgagor and interest paid;
 - (iv) names of contributors and amounts contributed by each;
 - (v) changes in contributors showing dates, names and amounts;
 - (vi) interest credited to contributors.
- (b) A register of clients' investments in company name mortgages recording the investments of each client in each mortgage. (This register may consist of a set of cards.)
- (c) A company name mortgages control account in the trust ledger.

4. Separate trust journal

All trust moneys invested on behalf of clients in company name mortgages and all repayments to clients of those moneys should be recorded by journal entry, as indicated below in a separate trust journal, which should be subdivided in sections for:

- (a) Advances from clients.
- (b) Repayments to clients (and transfers of interest).
- (c) Changes in contributors.

(Sectionalising eliminates the need for narrations and facilitates postings to the control account and to mortgage cards and Register of clients' investments.)

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Section 1: Advances

	Authority		
1.11.10 Client A	25.10.10	1,200.00	
Client B	28.10.10	500.00	
Client C	14.10.10	300.00	
to Client Z			
(mortgagor)	-		2,000.00
30.11.10	Client D	10.11.10	800.00
Client E	10.11.10	1,500.00	
Client F	10.11.10	700.00	
to Client Y			
(mortgagor)			3,000.00
		5,000.00	5,000.00

Section 2: Repayments (and transfer of interest)

	Prin.	Int.	Prin.	Int.
31.10.10		Client Z (mortgagor)	2,000.00	60.00
to Client A			1,200.00	36.00
Client B			500.00	15.00
Client C			300.00	9.00
Total	2,000.00		2,000.00	

Section 3: Changes in contributors

	Authority		
30.6.10 Client G	25.6.10	800.00	
to Client D	-	800.00	

5. Company name mortgage control account

In addition to postings each day from the journal (para.4) to the client's trust ledger accounts, at the end of each month the total advances for the month (para 4, Section 1) must be posted to the debit of a company name mortgages control account and the total repayments of principal for the month (para 4, Section 2) must be posted to credit of this account.

6. Payment by mortgagors

- (1) On receipt of interest, amounts due to the various contributors should, wherever practicable, be shown on the first copy of the relative trust receipt (or, where appropriate, on an attachment) and be posted to credit of the trust ledger accounts of the contributors concerned.
- (2) Where payments include principal, the amount received should be credited to the mortgagor's account in the trust ledger and the necessary journal entries completed as in para 4, section 2.

7. Monthly reconciliation

- (1) The balance of the company name mortgages control account should be agreed monthly with:
 - (a) The total mortgage advances outstanding as per company name mortgage cards (para.3 (a)).
 - (b) The total amount of trust moneys invested in company name mortgages according to the register of clients' investments (para.3(b)).
- (2) A clear record of action in accordance with the foregoing should be perused and signed each month by a principal and be suitably filed so as to be readily available for inspection.

8. Computerised accounting

To the extent necessary to integrate with computerised accounting procedures, the procedure outlined may be modified as regards (a) the use of a separate trust journal, (b) the form of mortgage card and of register of clients' investments and (c) posting procedures.

The NZLS Board approved these guidelines on 12 December 2008.