



PRACTICE BRIEFING:

FINANCIAL ADVISERS LEGISLATION - IMPLICATIONS FOR LAWYERS

INTRODUCTION

All New Zealand lawyers will need a clear understanding of the 2008 Financial Advisers legislation in their daily practice.

The intention of this Practice Briefing is to assist lawyers with their understanding of the practical application of the legislation. It is strongly recommended that lawyers seek professional advice where they are not certain whether an exemption applies to a service that they provide. A safe approach for lawyers to adopt to ensure they are not deemed to be giving financial advice is by meeting the exclusions as defined in section 10(3) Financial Advisers Act 2008.

Before assisting clients in relation to financial products and financial advice, lawyers should ensure their own competency in this area. This is required to fulfil their fundamental obligations as lawyers under section 4(c) Lawyers and Conveyancers Act 2006 and to comply with Rule 3 of the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008.

BACKGROUND

In 2008 both the Financial Advisers Act 2008 (“FAA”) and the Financial Services Providers (Registration and Dispute Resolution) Act 2008 (“FSPA”) were enacted. The legislation was accompanied by a Code of Conduct developed for those advisers wishing to be Authorised Financial Advisers under the FAA. The FSPA and the FAA were fully in force from 1 December 2010 and 1 July 2011 respectively.

From 1 December 2010 the FSPA required any person who is a financial service provider, either as an individual or employed by an entity that is a registered person, to be publicly registered.

The FAA legislation regulates the following business activities:

- The giving of financial advice – to make a recommendation, or give an opinion to a client in relation to the acquiring or disposing of a financial product;
- The provision of an investment planning service – to design (or offer to design) for a client a plan that is based on (or purports to be based on) an analysis of an individual’s current and future overall financial situation (including investment needs), identifies their investment goals and gives a recommendation or opinion on how to realise some or all of those goals; and
- The provision of a discretionary investment management service – to decide which financial products to acquire or dispose of on behalf of a client, while acting under an authority granted to the adviser (or the adviser’s employer or principal) to manage some or all of the client’s holdings of financial products.
- In addition, the FAA defined:
 - Category 1 and category 2 financial products;
 - The types of financial adviser – authorised financial adviser (AFA), an individual who is registered but not authorised, a qualifying financial entity (QFE) and a QFE adviser; and
 - Relevant services.

Authorised Financial Advisers (“AFAs”) must be registered, qualified and licensed. Other financial advisers may register as individuals or be employed by an entity that is a registered person. This category is neither qualified nor licensed.

Under section 14(3) FAA relevant service means a service, except for the exemptions offered in section 14(1), that would be classed as a financial adviser service.

EXCLUSIONS

Section 10(3) FAA – When person gives financial advice

“However, a person does not give financial advice for the purposes of this Act merely by –

- (a) providing information (e.g. the cost or terms and conditions of a financial product); or
- (b) making a recommendation or giving an opinion relating to a class of financial products; or
- (c) making a recommendation or giving an opinion about the procedure for acquiring or disposing of a financial product; or
- (d) transmitting the financial advice of another person (unless A gives A’s own financial advice in doing so or holds out the transmitted financial advice as A’s own financial advice); or
- (e) recommending that a person consult a financial adviser.”

Lawyers will not be considered to be providing financial advice if they engage in any of the activities listed above.

EXEMPTIONS

Section 13(1) FAA – Exemption for incidental service:

“A service is not a financial adviser service for the purposes of the Act if the service is provided only as an incidental part of another business that is not otherwise a financial service or does not have, as its principal activity, the provision of another financial service”.

Lawyers will not be considered to be providing financial adviser services when providing services incidental to their principal course of business, provided the principal business in which they are engaged does not include the provision of financial services as a principal activity.

Section 14(1)(d) FAA - Other exemptions:

“A lawyer, incorporated law firm or registered legal executive providing a relevant service in the ordinary course of business of that kind”.

The FAA defines when a person gives financial advice, and conversely when excluded from doing so, together with two potential exemptions that may be available for lawyers.

Under this section lawyers are exempted as a result of their professional occupation. Lawyers will not be considered to be providing financial adviser services when providing services in the ordinary course of business of being a lawyer. This exemption reflects the Law Society submissions prior to the legislation being enacted.

As the giving of financial advice is only one of the three financial adviser services regulated under the FAA, as referred to earlier, these exemptions are potentially available to be used by lawyers for all three regulated financial services.

Consequently lawyers can give financially related advice only if:

- The advice is not deemed financial advice (as defined under section 10(3) FAA); or
- If the activity is covered by an exemption; or
- If they are appropriately qualified under the FAA regime to undertake the activity.

FINANCIAL ADVICE SCENARIOS

The Law Society has developed some financial advice scenarios to assist lawyers with the application of the legislation. In general, lawyers who practise in the following areas of law are more likely to be impacted:

- Company/commercial;
- Property (wills/conveyancing);
- Trusts/estates;
- Family (relationship property); and

- Nominee company lending.

In the scenarios that follow the activities discussed are designed to raise the question of whether financial advice is in fact being given, and if so, consequently whether an exemption may apply.

SCENARIO 1: Property lawyer practising on own account undertaking conveyancing work. On completion of the sale of a property the client seeks advice from the lawyer as to what should be done with the sale proceeds pending distribution to various family interests. The lawyer advises that the funds be deposited on call with a New Zealand trading bank.

Is a financial adviser service or relevant service being provided?

Yes, the activity is not excluded under section 10(3) FAA. The lawyer is providing financial advice to a client on a financial product (category 2 as defined).

If yes, is the lawyer excluded from the application of the FAA under exemptions provided by sections 13 and 14?

Yes, almost certainly under both.

The section 13(1) FAA exemption for incidental service is likely to be available as the principal activity being undertaken is the provision of conveyancing and other land sale related services. The incidental financial adviser service arises as a result of the completion of the conveyancing work and as a stop gap measure required until further work finalises how the distribution is to be made to various family interests.

The section 14(1)(d) FAA ordinary course of business exemption is also probably available as the undertaking of conveyancing work is a core legal service offering for a property lawyer, and the advice given in the course of that service offering.

There is no need for the lawyer to become qualified or to register the practice as a financial service provider under the FSPA, as the lawyer is able to rely upon either of the section 13(1) or section 14(1)(d) FAA exemptions available.

SCENARIO 2: Family lawyer practising on own account holds numerous longstanding significant client balances in the firm's trust account on interest bearing deposit with a New Zealand trading bank pending agreement and distribution of the relationship property. The lawyer has been instructed by respective clients to keep their investments with the bank, in some cases for some quite considerable period of time.

Is a financial adviser service or relevant service being provided?

Yes, the activity is not excluded under section 10(3) FAA. The lawyer is providing a financial adviser service for the lawyer's clients by placing the funds with a chosen financial institution (bank), based on a recommendation and as an alternative to other potential investment opportunities.

If yes, is the lawyer excluded from the application of the FAA under exemptions provided by sections 13 and 14?

Yes, almost certainly under both.

The section 13(1) FAA exemption for incidental service is likely to be available as the principal activity being undertaken is the provision of relationship property advice (concerning family interests), possibly including the settlement of funds into trust. The incidental financial adviser service arises as a result of the necessity to hold funds until further adviser work with family interests determines how any distribution, investment or settlement of the funds is to be made.

The section 14(1)(d) FAA ordinary course of business exemption is potentially available as the provision of advice and subsequent distribution of funds through a trust account, relating to family and relationship property matters, would be a customary part of the range of services a family lawyer would normally provide. However, the nature of the recommendations made may place the advice outside of this exemption, depending on the circumstances.

If there was no recommendation, the deposit was purely a short term holding solution and not considered as a favourable alternative to other investments, then under section 10(3) FAA, the activity is probably not considered to be giving financial advice as defined.

There is no need for the lawyer to become qualified nor does the lawyer need to register the practice as a financial service provider under the FSPA, as the lawyer is able to rely upon either of the section 13(1) or section 14(1)(d) FAA exemptions available.

SCENARIO 3: Company lawyer practising on own account providing financial planning services (to a corporate client base) including advice on a full range of financial products. This work generates the majority of the practice's fee income.

Is a financial adviser service or relevant service being provided?

Yes, the activity is not excluded under section 10(3) FAA. The lawyer is providing financial advice and/or investment planning services to clients with respect to financial products (presumably both categories 1 and 2 as defined).

If yes, is the lawyer excluded from the application of the FAA under exemptions provided by sections 13 and 14?

No, neither exemption is likely to be available.

The section 13(1) FAA exemption for incidental service is not available as the principal activity being undertaken is the provision of a financial service. Even if the financial adviser services offered generated less than half the practice income and occupied less than half of the total time recorded by the practice, it is likely that the financial planning services offered would be regarded as a separate line of business, as it is not carried out to facilitate the legal practice, and may be too far removed from the legal practice to be properly regarded as ancillary to that practice.

The section 14(1)(d) FAA ordinary course of business exemption probably is not available, as the giving of

financial advice or investment planning services is unlikely to be considered in the ordinary course of business of the type of work that a lawyer would carry out.

So there is both a need for the lawyer's practice to be registered under the FSPA and for the lawyer to become AFA qualified unless the financial adviser services provided fall short of an investment planning service and are limited to category 2 products.

SCENARIO 4: Property lawyer practising on own account operating a lawyer's nominee company with a contributory mortgage scheme funded by clients' lending based on the lawyer's specific recommendations.

Is a financial adviser service or relevant service being provided?

Yes, most likely and so there is no need to consider exclusion under section 10(3) FAA. The lawyer is providing financial advice to clients through recommending specific lending investments (category 2 products as defined) within the lawyer's nominee company (LNC) framework.

Given that the LNC is effectively a shell and is owned by the lawyer there is considered to be no degree of legal separation and so the lawyer is deemed to be providing financial advice. The determination about the degree of separation and incidental activity would be made by reference to the size of the loan book and the time spent by the lawyer on the lending activities.

If yes, is the lawyer excluded from the application of the FAA under exemptions provided by sections 13 and 14?

The position over exemptions is not clear cut and requires consideration.

If the operation of the LNC is the provision of a service that is incidental to the lawyer's practice, then the section 13 FAA exemption for incidental service could be considered. In this case the lawyer's principal activity is the provision of property legal services. Therefore, it is neither easy nor straightforward to argue that a LNC with a loan book of contributory mortgage lending is incidental to other services provided.

If the loan book was small and related to one or two long standing clients then possibly a case could be made for why the lending was required in the bigger scheme of things. However the more time the lawyer spends on this type of work, the more separate clients that are involved and the more significant the lending, then the less likely it is that the exemption will apply. Similarly, if the LNC is an integral part of the practice, and a significant fee earner for the firm, and/ or the lending is significant, then again in all likelihood section 13(1) FAA will not apply.

In this case the section 14(1)(d) ordinary course of business exemption probably is available, as the operation of an LNC by lawyers has been customary or usual practice for a very long time. The LNC activity has been permitted under the Securities Act (Contributory Mortgage – Solicitors and Incorporated Law Firms) Exemption Notice 2013, and previous exemption notices, which has resulted in advice to clients to invest in LNCs to become an activity carried out in the ordinary course of business of certain lawyers or incorporated law firms. If the LNC operation is considered exempt then the lawyer is also likely to be exempt from qualification.

If it is determined that the operation of a LNC is not an activity undertaken in the ordinary course of business for a lawyer then the LNC would need to be registered and the lawyer must become suitably qualified. If the contributory mortgage lending operation is separate and very clearly an adjunct to the lawyer's other areas of practice, then this might further support this exemption not being available as the services being performed are deemed not to be in the ordinary course of business.

Registration of the lawyer under the FSPA needs to be considered separately from possible registration of the LNC. Even though it may be determined that the lawyer's advice will probably be given in the ordinary course of business and therefore exempt, the LNC may still require separate registration. As it is unlikely that the LNC will be able to be established as an agent of a lawyer or incorporated law firm, it probably cannot rely on the exemption from registration provided under section 7(3) of the FSPA.

Note: Lawyers operating contributory mortgage schemes are exempted under the Securities Act (Contributory Mortgage – Solicitors and Incorporated Law Firms) Exemption Notice 2013. However this exemption will cease on 30 September 2016 following which this type of activity carried out by lawyers will be subject to the Financial Markets Conduct legislation meaning lawyers will be subject to the same requirements as other market participants.

From 1 July 2014 all lawyers carrying out this activity will be required to register as a financial provider and join an appropriate financial dispute resolution scheme.

SCENARIO 5: Family lawyer practising on own account, including acting as a professional trustee for clients with mixed portfolio investment trusts comprising land, buildings, private and publicly listed shares and term deposits. During a meeting of trustees, and as part of the trustees' usual decision making process, the lawyer is asked for views on whether the listed shares should be retained or sold.

Is a financial adviser service or relevant service being provided?

As listed shares are a category 1 product as defined, it seems that the lawyer's activities are captured by the legislation.

However, generally the legislation will not apply where the lawyer is a professional trustee and is acting in that capacity when participating in a decision making process. This will not constitute a financial adviser service.

If the lawyer is the sole trustee then the lawyer would effectively be advising him/herself. As such with the absence of a third party to review the recommendation, this will mean that this situation is likely to simply be regarded as part of a trustee's decision making process and therefore not deemed financial advice as such.

Consequently, there is no need to consider whether or not an exemption applies under sections 13(1) and 14(1)(d) FAA.

SCENARIO 6: Property lawyer practising on own account providing real estate services for a client by advertising and handling the sale of shares in company which owns land, used as a bowling club, to a consortium of investors.

Is a financial adviser service or relevant service being provided?

Yes and therefore not excluded under s10 (3) FAA. The lawyer is providing financial advice to clients with respect to financial products (category 1 as defined). The more common situation of a simple land sale would fall outside the legislation.

If yes, is the lawyer excluded from the application of the FAA under exemptions provided by sections 13 and 14?

Again yes, probably the lawyer can rely on an exemption.

The section 13 FAA exemption for incidental service is likely to be available as the principal activity being undertaken is the provision of conveyancing and other land sale related services. The incidental financial adviser service arises as a result of the structure of the sale and the parties involved.

The section 14(1)(d) FAA ordinary course of business exemption may also be available, as the undertaking of real estate related activity has been traditionally considered by lawyers to be in the ordinary course of business for what a property lawyer or incorporated law firm would undertake. Real estate related services have been provided by some property lawyers for many years. However, where the purchase or sale of land involves shares, as in this case, then the exemption may not be available if it effectively involves a lawyer providing advice on complex investment products (the shares).

If for example the land transaction had involved farmland and the sale of farmer owned Fonterra co-operative shares, which have certain rights attaching to the share units, then these units would be classified as category 1 products and any advice on sale or disposal must be provided by an AFA, as opposed to a service provider who is simply registered.

So while there is acceptance over the expectation of a property lawyer to be involved in the handling of land transactions, lawyers are to encourage their clients to seek financial advice before making decisions involving complex investment products. Consequently, as a lawyer maybe considered to be providing financial services for part of the transaction, section 14(1)(d) will not available.

SCENARIO 7: Lawyer employed as in house counsel providing financial advice about the organisation to the executive management team of the employing organisation.

Is a financial adviser service or relevant service being provided?

No. The lawyer is not providing either a financial adviser service or a relevant service to a 'client'.

Consequently, there is no need to consider whether or not an exemption applies under sections 13(1) and 14(1)(d) FAA.

FAMILY TRUSTS

In general, the presence of a third party to review or reflect on the lawyer's recommendation is not critically relevant to making the determination of whether a financial adviser service has been performed. However, the lawyer should remain on alert for any other fiduciary or conflict issues that may arise outside of the FAA legislative framework.

Please note that the FAA does regulate certain types of investment decisions if they are made under a discretionary investment management service or DIMS under section 12 of the FAA. However, most professional trustees would generally be outside FAA because they are not making decisions on behalf of other persons to manage the other person's holdings of financial products. Instead, the professional trustee is the legal owner of the financial products, so is likely to be seen as making investment decisions for itself (as well as the trust).

Alternatively, the professional trustee would be outside FAA because it would not be considered to be providing a financial adviser service in the ordinary course of business under section 9. Instead, the professional trustee is required to make investment decisions under the trust deed and/or in accordance with his or her fiduciary obligations, rather than in the ordinary course of business.

Generally, the mere participation in a decision making process (such as that undertaken by trustees in respect of investments of a family trust as discussed under scenario 5 above) does not constitute a financial adviser service under the legislation.

Being a trustee of a family trust (and therefore managing trust assets on behalf of beneficiaries) is the subject of an express exemption from the requirements to register. This is where the services are provided to beneficiaries of a family trust, but not to any other person.

However, where a person has been engaged as a trustee but, in the course of that engagement, advises or makes recommendations to fellow trustees regarding trust investments the person may come within the ambit of the legislation. In many instances there may be a fine line between contributing to the decision making process as a trustee and providing the trust with advice. One way to reinforce the necessary distinction is for lawyers to clearly define the scope of their services as a trustee by way of their letters of engagement (client care information). This of course must then be strictly adhered to in practice.

A lawyer may also consider that providing services as a trustee occurs in the ordinary course of business and is, therefore, outside the scope of the legislation.

FINANCIAL ADVISER QUALIFICATION

Regardless of the availability or otherwise of exemptions, lawyers should consider whether to secure an AFA status or attain a relevant financial advice qualification to enhance market presence with this type of service, and objectively validate their competence to offer this type of service. The fact lawyers may be able to rely upon an exemption does not necessarily mean that they should. It may be the case that the client is actually better served by referral to a professional adviser who is competent to deliver the services required.

This guidance should be undertaken with reference to section 4 Lawyers and Conveyancers Act 2006 which refers to the fundamental obligations for lawyers in practice. One of these is for the lawyer to act in accordance with duties of care owed by lawyers to their clients. Further, Rule 3 Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008 states that a lawyer must always act competently with a duty to take reasonable care. The giving of sound financial advice can require a considerable degree of knowledge and expertise in the area concerned.

SUMMARY

Although it is believed that financial market regulators may choose to read the FAA exemptions narrowly, any interpretation will still need to be consistent with the original policy intention of ensuring that a regulatory framework exists for all individuals choosing to offer financial advice.

There are potential grey areas with the occupational exemptions in the FAA, which is why it is important for lawyers to not to take an overly technical approach to interpretation but to consider their clients' needs first and foremost, and their own competence to provide the advice.

As noted at the beginning of this Practice Briefing, lawyers should always seek specialist professional advice where they are not certain whether an exemption applies to a service that they wish to provide.

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