

# Financial Services Quarterly

SUMMER 2006

Bell Gully





**Welcome to the Summer 2006 issue of *Financial Services Quarterly*, a review of current legal issues in the financial sector.**

Each quarter, we summarise recent issues and preview upcoming developments under these headings:

In the courts  
In the journals  
Legislation/In Parliament  
Recent developments  
Bell Gully news  
Useful Web links

**In this issue...**

- Subsequent security holder retains priority
- Directors watch out – a signature can bind in both professional and personal capacity
- Guarantee to reflect the underlying facility
- Banks' rights: the right of set-off and nominee accounts
- What is the test for dishonest assistance in New Zealand?

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*Disclaimer: this publication is necessarily brief and general in nature. You should seek professional advice before taking any action in relation to the matters dealt with in this publication.*

## In the courts

### **Subsequent security holder retains priority**

The Court of Appeal has confirmed that the rights of a second ranking security holder are not extinguished by the sale of personal property by a receiver under a first ranking security.

### **Failure to register a security interest does not affect the liability of a guarantor**

A guarantor failed in his attempt to escape liability under a personal guarantee on the basis that the financier had failed to register its security interest on the Personal Property Securities Register.

### **Signature of director does not bind in dual capacity as director and shareholder**

The Court of Appeal has found that a person is not bound in a dual capacity if he signs an agreement as a director but leaves blank the space provided for him to sign as a shareholder.

### **Directors watch out – a signature can bind in both professional and personal capacity**

The High Court has determined that an individual who entered into a contract containing a guarantee and signed as a director could be bound in both her professional capacity as director and in her personal capacity under the guarantee.

## In the journals

### **Sense prevails on appeal in two New Zealand insolvency cases**

In this article, David Craig comments on two judgments delivered on appeal in December 2005 where the New Zealand courts have restored order in two important areas of insolvency law.

### **What is the test for dishonest assistance in New Zealand?**

Jessica Palmer comments that a recent Privy Council decision on dishonest assistance has reinstated an objective test.

### **Does New Zealand recognise the *Etridge* principles?**

This article considers whether financial institutions must follow the principles laid down by the House of Lords in *Etridge* in order to avoid liability where there may be undue influence, and discusses the differences between the decision of the House of Lords in *Etridge* and the decision of New Zealand's Court of Appeal in *Wilkinson*.

### **Guarantee to reflect the underlying facility**

This article discusses a decision of the English Court of Appeal that a lender could not rely on a guarantee provided in connection with an earlier loan facility in respect of a new loan facility where the documentation had not expressly contemplated the guarantee and was not within the "original purview" of the original arrangement.

### **Banks' rights: the right of set-off and nominee accounts**

This article discusses banks' rights at common law to apply the proceeds of a customer's account to set off the debt in another account, or to honour a demand for payment on an account that is in debit.

### **Fixed charges over book debts – law clarified by the House of Lords**

The House of Lords has determined that a charge over book debts was a floating charge and not a fixed charge, determining that, in order for there to be a fixed charge, the account has to be operated as a blocked account controlled by the creditor.

## Legislation/In Parliament

### **Insolvency – latest news from the courts and legislators**

The Insolvency Law Reform Bill was introduced into Parliament on 21 December 2005, following a Government-initiated insolvency law review that began in 1999 and the release for consultation of a draft bill in 2004.

### **Financial Reporting Act changes will reduce business compliance costs**

Commerce and Small Business Minister Lianne Dalziel has announced changes to the financial reporting system that are aimed at reducing business compliance costs.

## Recent developments

### **False passports used to obtain mortgages**

The situation reported in the national press recently of false passports and other identification documents being used to obtain substantial loans is a timely reminder for financial institutions of their obligations in respect of suspicious financial transactions.

### **Commerce Commission publishes guide to section 45 of CCCFA**

The Commerce Commission has recently explained its approach to section 45 of the Credit Contracts and Consumer Finance Act 2003, which relates to fees and charges passed on by a creditor to a debtor under a consumer credit contract.

### **RBNZ releases finalised outsourcing policy for banks**

The Reserve Bank of New Zealand has published its final policy on its requirements for large banks in relation to outsourcing arrangements.

### **Financial intermediaries update – cabinet agreement**

According to an update from the Ministry of Economic Development issued at the end of last year, Cabinet has agreed to the proposed co-regulatory framework under which industry-led approved professional bodies and the Securities Commission (as the government regulator) will work together to regulate financial intermediaries.

### **Securities Commission commences Cycle 2 of financial reporting surveillance programme**

The Securities Commission's review of the standard of financial reporting by New Zealand public securities issuers has moved into its next phase.

## In the courts

### Subsequent security holder retains priority

*The Court of Appeal has confirmed that the rights of a second ranking security holder are not extinguished by the sale of personal property by a receiver under a first ranking security.*

In our Winter 2005 edition of *Financial Services Quarterly*, we advised of a High Court decision that cast doubt on the rights of a second ranking security holder where a receiver sold personal property under a first ranking security.

The rights of the second ranking security holder in that case were found to be automatically extinguished by the sale.

The Court of Appeal has now overturned the High Court decision and confirmed the rights of subsequent security holders in this situation.

#### High Court decision

The High Court case<sup>1</sup> decided, taking into consideration section 30A of the Receiverships Act 1993, that a sale of personal property by a receiver meant that all other subordinate security holders lost priority in the surplus proceeds of sale and were relegated to the position of unsecured creditors.

#### Court of Appeal decision

The High Court's decision has been comprehensively overturned by the Court of Appeal, which confirmed the traditional position that a subordinate security holder ranks ahead of unsecured creditors in relation to those proceeds. The Court of Appeal favoured a narrower interpretation of the "proceeds" in which subordinate security holders' rights are extinguished following a sale by a receiver. It confirmed they are limited to the future proceeds from the asset sold and do not include the sale proceeds.

#### Legislative intervention

Following the High Court's decision last year, Parliament passed amendments to the Receiverships Act 1993, to ensure that subordinate security holders' rights are preserved. These amendments came into effect on 14 December 2005.

#### Consequences of new decision

The Court of Appeal's decision means that the legislative changes were unnecessary, since they have the same effect as the Court of Appeal's decision. However, the new decision does mean that, in relation to any proceeds distributed prior to the enactment of the Receiverships Amendment Act 2005, subordinate security holders were entitled to payment in priority to unsecured creditors. This may upset any distributions made based on the High Court decision.

In our view, the Court of Appeal decision is correct. The decision of the High Court created significant uncertainty in relation to priority and the new determination is a welcome development.

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<sup>1</sup> *Re Building Depot Limited (in receivership and liquidation)* (CIV-2005-404-1347, High Court Auckland, 19 May 2005)

## **Failure to register a security interest does not affect the liability of a guarantor**

*In this case<sup>1</sup>, a guarantor failed in his attempt to escape liability under a personal guarantee on the basis that the financier had failed to register its security interest on the Personal Property Securities Register.*

The Court rejected the guarantor's arguments that, among other things:

- the financier had misrepresented that it would register its security interests, and that he would not have given the guarantee without such representations;
- the financier had acted negligently; and
- the guarantor was discharged from his obligations under the guarantee because the financier had acted so as to prejudice the guarantor's rights.

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<sup>1</sup> *Canterbury Finance Limited v Sergel* [2005] 10 DCR 875 (DC)

## Signature of director does not bind in dual capacity as director and shareholder

*The Court of Appeal has found that a person is not bound in a dual capacity if he signs an agreement as a director but leaves blank the space provided for him to sign as a shareholder.*

In this case, two companies entered a licence agreement that provided for the sole shareholder and director of one of the companies to provide personal guarantees to the other company.

The agreement provided three attestation blocks. The directors of each company signed in one block each. However, the third block (presumably for the shareholders) was not signed.

### **High Court**

The question for the court, in determining whether or not the individuals were bound by the personal guarantees, was whether they had signed the agreement in their dual capacity as both director and shareholder.

The High Court held that one of them, who had initialled each page of the agreement, had signed in a dual capacity as both director and shareholder and therefore was bound under the guarantee.

### **Court of Appeal**

Allowing the appeal, the Court of Appeal<sup>1</sup> noted that there was nothing in the agreement suggesting that either director had signed in a dual capacity as both a director and a shareholder. Each director had signed the agreement in the block designated for directors to sign, and it was clear from the face of the document that they had signed in their capacity as directors.

The Court of Appeal went on to say that initialling each page of a document could not convert a signature into anything other than what it was identified to be, which in this case was a signature of a director.

It is worth contrasting this decision with that of the High Court in *Contributory Mortgage Nominees Limited* also summarised in this issue of *Financial Services Quarterly*.

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<sup>1</sup> *Trotter v Avonmore Holdings Limited* (CA162/04, 1 August 2005)

## Directors watch out – a signature can bind in both personal and professional capacity

*In a recent decision of the High Court<sup>1</sup>, it was held that an individual who entered into a contract containing a guarantee and signed as a director could be bound in both her professional capacity and in her personal capacity under the guarantee.*

An agreement for sale and purchase containing a personal guarantee was signed by the sole director and shareholder of the purchaser.

When payment was sought from the director for default in payment of GST, the director asserted that the agreement was executed in her sole capacity as director of the company and that she was not personally bound by the guarantee.

The High Court determined that the director had signed in a dual capacity, on behalf of the company as its director, and in her personal capacity. She was accordingly bound by the personal guarantee set out in the agreement.

The decision was reached on the basis that there was nothing in the agreement suggesting that the director had not bound herself in both capacities, observing that there was no doubt that she was to be a guarantor and that interpretation of the agreement must be objective.

We consider that the prudent course of action is always to clearly set out the capacity or capacities in which a party is signing an agreement, and to have the parties sign separately for each capacity.

The decision of the Court of Appeal in *Trotter*, also summarised in this issue of *Financial Services Quarterly*, reached the opposite outcome.

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<sup>1</sup> *Contributory Mortgagee Nominee Limited v Harris Road No 10 Limited & Anor* [2005] 22 NZTC 19,580 (HC)

## In the journals

### Sense prevails on appeal in two New Zealand insolvency cases

David Craig, *Journal of Banking and Finance Law and Practice*, January 2006

*In two judgments delivered on appeal in December 2005, the New Zealand courts have restored order in two important areas of insolvency law.*

#### Trans Otway

The Court of Appeal decision in *Trans Otway*<sup>1</sup> was profiled by David Craig in the *Journal of Banking and Finance Law and Practice* last year<sup>2</sup>. That decision was appealed to the Supreme Court, New Zealand's highest court. The Supreme Court upheld the Court of Appeal's decision but, in doing so, it addressed an obvious gap in the lower court's reasoning.

#### The facts

The facts of *Trans Otway* were simple. Trans Otway and Newman, both operators in the freighting business, entered into an agreement to set off mutual debts owed between them. Newman subsequently went into liquidation. Its liquidators sought to set aside Newman's "payment" under the set-off agreement as a voidable transaction that preferred Trans Otway.

#### Court of Appeal's judgment

The Court of Appeal agreed with the Newman liquidators. Significantly, the Court accepted that the set-off did indeed prefer Trans Otway as it enabled it to receive more in Newman's liquidation than the general liquidation rules would permit.

Commentators criticised the Court of Appeal's decision for its failure to consider section 310 of the Companies Act 1993, which provides for the *mandatory* set-off of mutual claims involving a company in liquidation. How, they asked, could Trans Otway have been preferred when the transaction impugned produced the same result as mandatory law?

#### Supreme Court's judgment

Section 310 was considered on appeal by the Supreme Court. The Court acknowledged that there could be no preference where section 310 applies. However, unfortunately for Trans Otway, on the facts of this case, section 310 did not apply. At the time the set-off agreement was made, Trans Otway had reason to suspect that Newman was unable to pay its debts. This knowledge disentitled Trans Otway from being able to rely on section 310.

Interestingly, if Trans Otway's agreement with Newman was a "bilateral netting agreement" under New Zealand's netting legislation (which it may have been), it would have prevailed in the Supreme Court. The set-off regime under the netting legislation, unlike that under section 310, does not require the solvent party to prove it was unaware of its counterparty's insolvency.

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<sup>1</sup> [2005] 3 NZLR 678

<sup>2</sup> [2005] 16 JBFLP 387

## **Building Depot**

The Building Depot Limited (**BDL**) had granted security over its assets in favour of ANZ Bank and, subsequently, Fletcher Distribution. Under a priority agreement, the two secured parties agreed that ANZ would have first priority up to \$2.5m and Fletcher would have second priority up to \$5m.

BDL defaulted to ANZ. ANZ appointed receivers, who sold most of BDL's assets. ANZ was paid in full from the sale proceeds. The receivers then sought directions from the High Court as to how to apply the surplus.

### **High Court's judgment**

In delivering its judgment,<sup>1</sup> the High Court gave effect to the apparently clear (but obviously unintended) meaning of a provision of the Receiverships Act 1993. The result was that Fletcher's security was extinguished by the sale by the ANZ receivers. It therefore ranked alongside BDL's unsecured creditors, not ahead of them.

### **Court of Appeal's judgment**

Fletcher appealed to the Court of Appeal,<sup>2</sup> which reversed the lower court's decision. It did so by adopting a narrower interpretation of the relevant provision and "having regard to the Act as a whole and the legal system generally". As a result, the Court reinstated the long-standing principle of law that, in an insolvency, all security interests are satisfied in priority (according to their ranking), leaving unsecured creditors to share equally in any surplus.

The correct interpretation of this provision has now been clarified by amending legislation that was passed in December 2005. However, the Court of Appeal's judgment is still welcomed as establishing the position for receiverships that occurred prior to this amendment coming into effect.

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<sup>3</sup> [2005] 9 NZCLC 263,830

<sup>4</sup> *Agnew v Pardington*, CA 109-05, Dec 22 2005

# What is the test for dishonest assistance in New Zealand?

Jessica Palmer, *The New Zealand Law Journal*, December 2005

*In an article entitled "Twinsectra: overruled or clarified?", Ms Palmer comments that a recent Privy Council decision on dishonest assistance has reinstated an objective test.*

*Royal Brunei Airlines*<sup>1</sup>, which was considered to be the leading case on dishonest assistance, applied an objective test in determining whether the defendant had assisted with a breach of trust.

In *Twinsectra*<sup>2</sup>, the House of Lords appeared to import a subjective element into the test, deciding that the defendant's conduct must be both:

- dishonest by the ordinary standards of reasonable and honest people (the objective test); and
- known to the defendant to be dishonest by those standards – the defendant must have "a dishonest state of mind" (the subjective test).

In a recent case<sup>3</sup>, the Privy Council has reconsidered the test for dishonest assistance, taking into account the decisions in both *Royal Brunei* and *Twinsectra*. In its decision, the Privy Council stated that the principles of liability established in *Twinsectra* were in fact no different to those in *Royal Brunei*, and clarified that an objective test is applicable.

In the article, Ms Palmer summarises several points made by the Privy Council about the application of the objective honesty standard:

- The defendant's knowledge of the circumstances may be determined by inference.
- It is not necessary for the defendant to know that he or she is assisting a breach of trust.
- The defendant need not know all the details of the breach of trust before he or she can reasonably have grounds to suspect misappropriation.

This means that bank officers must be very careful where there is any suspicion, or any reason to believe that there may be a breach of trust or misappropriation. Failure to investigate further where there may be grounds for suspicion could render the bank liable.

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<sup>1</sup> *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378

<sup>2</sup> *Twinsectra Limited v Yardley* [2002] 2 AC 164

<sup>3</sup> *Barlow Clowes International Limited v Eurotrust International Limited* [2004] UKPC 38

# Does New Zealand recognise the *Etridge* principles?

Palitha de Silva, *The New Zealand Law Journal*, November 2005

*In this article, Ms de Silva considers whether financial institutions must follow the principles laid down by the House of Lords in Etridge<sup>1</sup> in order to avoid liability where there may be undue influence, and discusses the differences between the decision of the House of Lords in Etridge and the decision of New Zealand's Court of Appeal in Wilkinson<sup>2</sup>.*

Ms de Silva comments that the legal position in *Wilkinson*, regarded in New Zealand as a good balance between the guarantor's interest in protection and the need to add certainty to a small business financing transaction, was disturbed by the position in *Etridge*. This led to uncertainty as to which direction trial judges would take in New Zealand.

The first decision was that of *Damesh Holdings*<sup>3</sup> (reported in the Winter 2003 issue of *Financial Services Quarterly*), where Chisholm J decided to follow *Wilkinson*. However, the Court of Appeal allowed an appeal by *Damesh Holdings*, and the case was remitted to the High Court.

The opportunity to consider the conflicts between *Etridge* and *Wilkinson* subsequently arose in *Hogan*<sup>4</sup>, but the factual findings in this case rendered it unnecessary for the Court of Appeal to do so.

## The key differences

- *Wilkinson* requires the guarantor to establish not only that there was an impropriety on the part of the principal debtor, but also that the financier was aware of the relationship of trust and confidence.
- The decision in *Etridge* states that the financier is put on enquiry every time the relationship between the principal debtor and the guarantor is not commercial.
- *Wilkinson* requires steps for the financier to be satisfied that the guarantor has understood the transaction, and the suggestion is that, in the absence of any particular reason for suspicion on the part of the financier, a solicitor's certificate as to the guarantor's understanding should suffice.
- *Etridge* sets out a set of specific steps to be taken by a financier in order to avoid liability where there is undue influence.

The courts' failure to consider the conflicts between *Etridge* and *Wilkinson* in *Damesh Holdings* and in *Hogan* mean that this area of law remains unsettled in New Zealand.

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<sup>1</sup> *Royal Bank of Scotland v Etridge* [2001] All ER 449

<sup>2</sup> *ASB v Wilkinson* [1998] 1 NZLR 674

<sup>3</sup> *Lee v Damesh Holdings Limited* (HC, Christchurch CP 75/02, 14 April 2003)

<sup>4</sup> *Hogan v Commercial Factors Limited* (CA 225/03, 10 November 2004, Glazebrook, William Young and Chambers JJ)

# Banks' rights: the right of set-off and nominee accounts

Palitha de Silva, *The New Zealand Law Journal*, December 2005

*This article discusses banks' rights at common law to apply the proceeds of a customer's account to set off the debt in another account, or to honour a demand for payment on an account that is in debit. This right is often referred to as the "Bhogal principle"<sup>1</sup>.*

The author discusses the effect of a recent decision of the English Court of Appeal<sup>2</sup>, where a case was brought by a customer that held an account with the London branch of Dresdner and instructed the bank to transfer all money in the account to an account with Deutsche Bank in Frankfurt.

Dresdner transferred all but \$49 million, which it claimed to be entitled to on the basis that it was owed the sum by two Saudi Arabian ministers. The bank's argument was that, because the customer held the money on trust for the Saudi Government, it was entitled to set off the debt owed to it. The customer argued that Dresdner's action was unlawful and that it held the money in the account on trust for another party.

The Court had to consider whether the *Bhogal* principle applies where the account holder is not the beneficial owner, but there are two competing claims as to who the beneficial owner is.

The Court of Appeal reiterated the lower Court's view that the general principle applied and that the bank had no right of set off in such circumstances. The Court emphasised the contractual nature of the relationship between banker and customer, where the banker has an obligation to repay a customer that has made deposits with it.

Observing that setting the threshold at an arguable case would have the effect of paralysing the customer's funds until the matter was resolved, the Court considered such an outcome undesirable and contrary to the entire basis of the banker-customer relationship.

We consider that the outcome of this case is based on application of similar principles to those set out in the leading New Zealand case on the issue<sup>3</sup>, in which it was emphasised that, for the efficient conduct of business affairs, third parties' claims should not be allowed to interfere too readily in the banker-customer relationship.

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<sup>1</sup> *Bhogal v Punjab National Bank* [1988] 2 All ER 296

<sup>2</sup> *Saudi Arabian Monetary Agency v Dresdner Bank AG* [2005] 1 LI R 12

<sup>3</sup> *US Marketing Ltd v National Bank of New Zealand Ltd* [2004] 1 NZLR 589

## Fixed charges over book debts – law clarified by the House of Lords

*The House of Lords has overturned the decision of the Court of Appeal in National Westminster<sup>1</sup>, determining that the charge, granted over the customer's book debts in favour of the bank, was a floating charge and not a fixed charge.*

In reaching their decision, their lordships relied on the fact that the customer was allowed to operate its bank account (into which the cash proceeds from the realisation of its book debts were paid) in an unrestricted way and therefore had the ability to remove the book debts from the charge.

For the charge to be fixed, the account has to be operate as a blocked account controlled by the creditor where the customer cannot withdraw funds from the blocked account without the creditor's consent.

Following enactment of New Zealand's Personal Property Securities Act 1999, the issue of whether or not a charge over book debts in New Zealand is fixed or floating has become largely irrelevant. However, the English cases on charges over book debts may still have some relevance in New Zealand post-PPSA in determining whether or not an assignment of accounts receivable takes effect as a "transfer" for the purposes of section 17 of the PPSA and therefore defeats preferential creditors.

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<sup>1</sup> *National Westminster Bank Plc v Spectrum Plus Limited and Others* (HL) Times, July 1, 2005

## Guarantee to reflect the underlying facility

*The English Court of Appeal has decided<sup>1</sup> that a lender could not rely on a guarantee provided pursuant to an earlier loan agreement in respect of a new loan facility where the documentation had not expressly contemplated the guarantee and was not within the "original purview" of the original arrangement.*

Most standard forms of guarantee contain a provision stating that the obligations of the guarantor are not affected by any amendment to, or replacement of, the loan that is being guaranteed. The purpose of such a clause is to address the fact that a material variation or amendment in the loan agreement will discharge the guarantor unless the variation is provided for in the guarantee or has been consented to by the guarantor.

This case has highlighted a risk that, even where the guarantor has given consent, if the amendment or variation is not within the "general purview" of the original agreement, then the guarantee will not extend to any amendments made to the loan agreement.

The Court will analyse the intention of the parties when they entered into the original agreement and the guarantee to assess whether such amendment or variation was contemplated.

According to the article, lenders should now consider:

- amending the guarantee to provide specifically that the guarantee covers any increase in the indebtedness of the borrower and/or any change in the purpose of the loan;
- including provision in the interpretation clause of the loan agreement that the reference to any agreements are to those agreements as amended from time to time;
- obtaining confirmation from the guarantor that the guarantee extends to the amended or varied loan agreement; and/or
- obtaining a new guarantee - particularly if changes to the loan agreement materially increase the borrower's indebtedness or alter any other material commercial terms of the agreement.

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<sup>1</sup> *Triodos Bank N.V. v Ashley Charles Dobbs* [2005] EWCA Civ 630

## Legislation/In Parliament

# Insolvency – latest news from the courts and legislators

### **Bell Gully Insolvency Update, 27 January 2006**

The Insolvency Law Reform Bill was introduced into Parliament on 21 December 2005, following a Government-initiated insolvency law review that began in 1999 and the release for consultation of a draft bill in 2004.

A summary of the main aspects of the draft bill are:

- introduction of a voluntary administration regime for companies, similar to that which exists in Australia;
- changes to the voidable transaction and preferential payments provisions of the Companies Act 1993;
- introduction of new phoenix company provisions to deal with companies that carry on business using a similar name to that of a failed company;
- adoption of the United Nations Commission on International Trade Law (UNCITRAL) Model Law on cross border insolvency; and
- introduction of a no asset procedure as a one-off reprieve from bankruptcy for the small time individual debtor out of his or her financial depth.

The Bill is expected to receive its first reading in Parliament in the first half of this year.

Commerce Minister Lianne Dalziel has stated that, while she expects widespread support for the new "phoenix company" provisions and the tightening of the voidable transaction provisions, she expects that the two areas of reform that will attract the most debate are:

- the streamlining of the bankruptcy administration process and the introduction of a new "no asset procedure" as an alternative to personal insolvency; and
- the introduction of a voluntary administration procedure for companies with potential for rehabilitation.

# Financial Reporting Act changes will reduce business compliance costs

**New Zealand Government, 22 December 2005**

*Commerce and Small Business Minister Lianne Dalziel has announced changes to the financial reporting system, which are aimed at reducing business compliance costs.*

A new "two-out-of-three" test for SMEs extends the current criteria of annual turnover of less than NZ\$1m and total assets of less than NZ\$450,000 to either less than NZ\$2m turnover, less than NZ\$1m in assets and/or five or fewer full time equivalent employees.

According to the press release, changes are also planned to remove reporting requirements for New Zealand incorporated companies with 25% or more overseas ownership. These companies will no longer have to file audited statements with the Registrar of Companies provided they qualify for the exempt companies or differential reporting systems – the latter will also include a "two-out-of-three" test of either annual turnover of less than NZ\$20m, assets of less than NZ\$10m and/or 50 or fewer FTE employees.

The press release also states that the Accounting Standards Review Board will have exemption powers and overseas-incorporated companies will be able to apply for these exemptions. Non-active entities will no longer be required to file financial statements with the Registrar.

Ms Dalziel expects a Bill amending the Financial Reporting Act to be introduced into Parliament in early 2006.

## Recent developments

### False passports used to obtain mortgages

*The situation reported in the national press recently of false passports and other identification documents being used to obtain substantial loans is a timely reminder for financial institutions of their obligations in respect of suspicious financial transactions.*

Financial institutions and other persons, such as lawyers and accountants, who are involved in managing funds on behalf of others currently have obligations under the Financial Transactions Reporting Act 1996 (the FTRA) to verify customers' identity and to report suspicious financial transactions.

A mortgage scam recently reported in the media involved the successful obtaining of bank mortgages totalling over \$500,000 through the presentation of false identification documents such as passports and IRD certificates. The customer only gave a cellphone number and a post office box address by way of contact details and was unable to be located.

The FTRA does not set out any specific guidance as to what documentation is reasonably capable of establishing identity, what signs of alteration to a document should be checked, or when a transaction may be suspicious. The onus is currently on financial institutions to monitor market developments and determine what is reasonably capable of establishing a person's identity and whether any transaction is suspicious<sup>1</sup>.

Following the publication of a lukewarm report on New Zealand's observance with its recommendations to counter money laundering and terrorist financing by the Financial Action Task Force, an international inter-governmental body, the Government has announced that regulation in this area will be increased. Financial institutions should consequently expect a higher level of scrutiny of the level of compliance with their obligations under the FTRA.

Draft legislation dealing with the proposed increased regulation is expected to be available within the first half of this year. It remains to be seen whether this will provide further practical assistance for financial institutions in recognising and defeating fraud and forgery techniques or greater certainty for compliance with their legal responsibilities.

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<sup>1</sup> However, the New Zealand Police Financial Intelligence Unit has released guidelines to assist New Zealand financial institutions on complying with the requirements of the FTRA.

## Commerce Commission publishes guide to section 45 of CCCFA

*The Commerce Commission has recently explained its approach to section 45 of the Credit Contracts and Consumer Finance Act 2003, which relates to fees and charges passed on by a creditor to a debtor under a consumer credit contract.*

Section 45 broadly requires creditors to ensure that any fee or charge payable by a debtor to a creditor in respect of third party costs must not exceed the actual amount payable to the third party by the creditor. Section 45(2) requires the creditor to take into account for this purpose any discount, rebate or other allowance received by it from the third party. However, section 45(5) clarifies that a creditor may charge a reasonable commission in connection with any credit-related insurance taken out by the debtor.

Usefully, the new guide explains that, in the Commission's view, section 45 applies:

- regardless of whether the fee or charge is incurred directly by the creditor (a creditor-third party contract) or paid by the creditor on behalf of the debtor (a debtor-third party contract);
- regardless of whether the fee or charge meets the definition of "credit fee" under the CCCFA; and
- to any fee or charge that would not have been incurred or paid but for the consumer credit contract, or that is included in the initial unpaid balance or otherwise added to the amount due under the consumer credit contract.

The intention therefore is that section 45 catches all fees or charges for credit-related insurance that are financed under the credit contract. "Credit-related insurance" covers optional, as well as compulsory, insurance.

The Commerce Commission goes on to explain that, in relation to the section 45(5) carve-out for reasonable commissions, it proposes to adopt the Australian approach to interpreting the meaning of "reasonable". Under the Australian Uniform Consumer Credit Code, any commission on credit-related insurance that is 20% or less of the gross premium paid by the debtor will be unlikely to be held to be unreasonable.

The Commission has emphasised that this is not a binding legal ruling on the interpretation of section 45(5) and each situation will be assessed on its facts. However, in light of this guide, creditors will wish to consider carefully whether any commission over 20% can be justified.

For more information, see [www.comcom.govt.nz](http://www.comcom.govt.nz)

## **RBNZ releases finalised outsourcing policy for banks**

**Reserve Bank of New Zealand, 18 January 2006**

*The Reserve Bank of New Zealand has published its finalised policy setting out its requirements for large banks in relation to outsourcing arrangements. This follows a draft policy that was issued in October 2005.*

According to Reserve Bank Deputy Governor Adrian Orr, outsourcing is allowed as long as it doesn't undermine a bank's ability to continue to provide core liquidity, payment and transaction services in good times and under stress. Mr Orr has stated that the policy is focussed at ensuring the boards of large New Zealand banks maintain control of outsourced functions and requires them to have meaningful control and oversight over the bank's chief executive and its staff.

For a copy of the policy go to: [www.rbnz.govt.nz/news/2006/2358281.html](http://www.rbnz.govt.nz/news/2006/2358281.html)

# Financial intermediaries update – cabinet agreement

**Ministry of Economic Development, 21 December 2005**

*In August last year, the Financial Intermediaries Task Force released its final report to the Government with recommendations for reform. According to an update from the Ministry of Economic Development (**MED**) issued at the end of the year, Cabinet has agreed to the proposed co-regulatory framework under which industry-led approved professional bodies and the Securities Commission (as the government regulator) will work together to regulate financial intermediaries.*

A discussion paper seeking public comment in conjunction with the MED consultation process, with potential approval from professional bodies, the Securities Commission and other stakeholders, is expected to be released in the first half of this year.

The MED proposes to seek Cabinet approval in mid to late 2006 to start implementing the detailed policy proposals into a draft Bill with the aim to having legislation passed in 2007 or 2008.

## **Securities Commission commences Cycle 2 of financial reporting surveillance programme**

*The Securities Commission's review of the standard of financial reporting by New Zealand public securities issuers has moved into its next phase.*

Following the publication of its report on Cycle 1 of its financial reporting surveillance programme the Securities Commission is now underway with Cycle 2, reviewing the financial reports of 46 issuers against New Zealand Generally Accepted Accounting Practice.

The Commission is also reviewing financial information contained in prospectuses, substantial security holder information, continuous disclosure notices and other sections of annual reports such as the chairman's report.

Later phases of the financial reporting surveillance programme are expected to focus on disclosures and adjustments made by issuers as they move to the New Zealand equivalents of the International Financial Reporting Standards.

A report on Cycle 2 will be published later in the year.

For more information, see [www.sec-com.govt.nz](http://www.sec-com.govt.nz)

## Bell Gully news

### **Bell Gully appoints new partners and senior associates**

Two new partners and eight senior associates have been appointed to leading New Zealand law firm Bell Gully.

### **Bell Gully tops global guide law firm rankings**

Bell Gully has topped the New Zealand law firm rankings for a consecutive year in a leading international legal publication. The just released *2005/06 Chambers Global Guide* shows Bell Gully has achieved the most No.1 ranked practice areas and ranked partners among the New Zealand law firms listed. It is the second year that the firm has led the field in results published by the UK-based independent researcher.

Bell Gully has a No.1 ranking in four of the five practice areas covered by *Chambers Global*:

- banking and finance;
- corporate/M&A;
- dispute resolution; and
- tax.

Bell Gully is also the only New Zealand firm to receive a top tier ranking in the corporate/M&A practice area.

### **Employee surveillance: a new age in hi-tech spying**

Employers have been monitoring their staff since time immemorial. What is changing is the tools they use to do it. The days of punch time clocks are gone - today the employer has access to a bewildering range of technology to spy on workers.

### **Bell Gully tops M&A rankings for third successive year**

Bell Gully has been named New Zealand's leading mergers and acquisitions law firm for the third consecutive year. Thomson Financial figures just released show that in 2005 Bell Gully completed 52 deals worth in excess of US\$7.5 billion. Thomson's figures also reveal that while total M&A deal value in Australasia declined slightly by 0.3% the number of deals in the region went up 3.1%.

**For further details and more news visit: [www.bellgully.com](http://www.bellgully.com)**

## Useful Web links

### *New Zealand government*

- Consumer affairs [[www.consumeraffairs.govt.nz](http://www.consumeraffairs.govt.nz)]
- Inland Revenue Department [[www.ird.govt.nz](http://www.ird.govt.nz)]
- Ministry of Economic Development [[www.med.govt.nz](http://www.med.govt.nz)]
- Ministry of Foreign Affairs and Trade [[www.mfat.govt.nz](http://www.mfat.govt.nz)]
- New Zealand Government [[www.govt.nz](http://www.govt.nz)]
- NZ Government E-Commerce Information [[www.ecommerce.govt.nz](http://www.ecommerce.govt.nz)]
- NZ Treasury [[www.treasury.govt.nz](http://www.treasury.govt.nz)]
- Office of the Clerk of the House of Representatives [[www.clerk.parliament.govt.nz](http://www.clerk.parliament.govt.nz)]
- Parliamentary Counsel Office [[www.pco.parliament.govt.nz](http://www.pco.parliament.govt.nz)]

### *New Zealand financial agencies and organisations*

- Commerce Commission [[www.comcom.govt.nz](http://www.comcom.govt.nz)]
- The Companies Office [[www.companies.govt.nz](http://www.companies.govt.nz)]
- Export Credit Office [[www.treasury.govt.nz/exportcreditoffice](http://www.treasury.govt.nz/exportcreditoffice)]
- NZ Law Commission [[www.lawcom.govt.nz](http://www.lawcom.govt.nz)]
- Office of the Banking Ombudsman [[www.bankombudsman.org.nz](http://www.bankombudsman.org.nz)]
- Office of Insurance and Savings Ombudsman [[www.iombudsman.org.nz](http://www.iombudsman.org.nz)]
- Office of the Privacy Commissioner [[www.privacy.org.nz](http://www.privacy.org.nz)]
- Personal Property Securities Register [[www.ppsr.govt.nz](http://www.ppsr.govt.nz)]
- Reserve Bank of New Zealand [[www.rbnz.govt.nz](http://www.rbnz.govt.nz)]
- Securities Commission [[www.sec-com.govt.nz](http://www.sec-com.govt.nz)]
- Takeovers Panel [[www.takeovers.govt.nz](http://www.takeovers.govt.nz)]

### *New Zealand commercial sites*

- CLANZ [[www.clanz.org](http://www.clanz.org)]
- Financial Services Federation [[www.fsf.org.nz](http://www.fsf.org.nz)]
- Institute of Chartered Accountants [[www.icanz.co.nz](http://www.icanz.co.nz)]
- NZ Bankers' Association [[www.nzba.org.nz](http://www.nzba.org.nz)]
- NZ Business Roundtable [[www.nzbr.org.nz](http://www.nzbr.org.nz)]
- NZ Institute of Economic Research [[www.nzier.org.nz](http://www.nzier.org.nz)]
- NZ Exchange [[www.nzx.com](http://www.nzx.com)]

### *Australian government sites*

- Banking Ombudsman [[www.abio.org.au](http://www.abio.org.au)]
- National Office for the Information Economy [[www.ogo.gov.au](http://www.ogo.gov.au)]

### *Australian commercial sites*

- Australian Financial Markets Association [[www.afma.com.au](http://www.afma.com.au)]
- Australian Securities and Investment Commission [[www.asic.gov.au](http://www.asic.gov.au)]
- Australian Stock Exchange [[www.asx.com.au](http://www.asx.com.au)]

### *International sites*

- Bank for International Settlements [[www.bis.org](http://www.bis.org)]
- Global Banking Law Database [[www.gbld.org](http://www.gbld.org)]
- International Monetary Fund [[www.imf.org](http://www.imf.org)]
- International Swaps and Derivatives Association [[www.isda.org](http://www.isda.org)]
- NASDAQ [[www.nasdaq.com](http://www.nasdaq.com)]
- New York Stock Exchange [[www.nyse.com](http://www.nyse.com)]
- United States Securities and Exchange Commission [[www.sec.gov](http://www.sec.gov)]
- World Bank [[www.worldbank.org](http://www.worldbank.org)]