

Proposed FMC Act designation & exemption for companies used to manage costs in real property communal facilities

We are seeking views on whether corporate vehicles set up by property developers to manage the costs associated with communal facilities in real property such as access ways, lifts, or common garden areas, should be regulated by the Financial Markets Conduct Act 2013 (FMC Act) regime.

About this consultation:

This consultation is for:

real estate developers, property investors and agents, legal advisers and those involved in property development.

It aims to:

seek views on whether corporate vehicles used to manage costs associated with communal facilities should be exempted from FMC Act regime.



Document history

This version was issued on 28 September and is based on legislation and regulations as at the date of issue.

FMA document reference code 2712127



About this consultation

Issue 1

Real property developers often establish corporate vehicles to manage the costs associated with communal facilities and assets such as access ways, lifts and common garden areas. Interests in these corporate vehicles may be caught within the FMC Act definition of 'financial products'. This means the disclosure and other requirements of the FMC Act may apply to an offer of these interests.

If a vehicle is structured as a company

If a corporate vehicle is structured as a company and lot owners are issued shares in that company, those interests will fall under the FMC Act's definition of 'equity securities'. Unless relief is given, the developer must comply with the obligations of an FMC Act equity security issuer.

If a vehicle is structured as an incorporated society

However, if other corporate vehicles are used for the same purpose (eg, an incorporated society), then interests in the corporate vehicle will not be caught by the definition of 'equity security' (a subset of 'financial product') and will generally not fall under any limb of the definition of 'financial product', and thus will not be regulated under the new FMC Act regime¹.

Not financial products

Our preliminary view, taking into account submissions received on the [Consultation paper: Financial Markets Conduct Act exemptions](#) dated 13 March 2015, is that companies set up for managing costs in real property developments should not be regulated under financial market laws. This is because interests in these companies are not, in our view, 'financial markets' activities (see discussion below). There is also no objective reason for treating a company that is used to manage costs in real property differently from an incorporated society that is used to manage costs for the same purpose.

We propose to designate shares in these companies to be outside the scope of the definition of a 'financial product' and will not be subject to the requirements of the FMC Act. Further detail of the proposed designation is provided in this consultation paper.

Issue 2

We have no statutory power to apply a designation to financial products that have already been issued or transferred. For companies that have already issued shares, including those issued under the Securities Act 1978 (Securities Act) that transitioned into the FMC Act regime, we plan to provide a new FMC Act exemption that:

- reduces regulatory obligations and conditions to a minimum
- requires a simple notice to interest holders, informing them of the changes to the regulation of the shares before the reduced obligations take effect.

¹ This assumes that the corporate vehicles are not being used for an investment purpose. If they are then they may be caught by the definition of managed investment scheme.



It is worth noting that a range of different corporate vehicles established under the Securities Act regime (for example, incorporated societies) to manage costs in real property would have been caught as participatory securities, and were subject to Securities Act exemptions and obligations. For these corporate vehicles, the regulatory outcomes are that:

- if they are companies, they continue to have obligations under the Securities Act until they transition into the FMC Act regime, or
- If they are participatory securities that are not ‘financial products’ under the FMC Act regime, they deregulate on 1 December 2016, or sooner if they opt to deregulate under schedule 4 of the FMC Act earlier.

Scope of designation

We propose to introduce a designation to reclassify equities in these property owning companies with the effect that they are not treated as financial products under the FMC Act and will not be subject to the obligations that would otherwise apply. The designation would apply to companies with the characteristics listed below.

- The company’s main purpose is to manage the costs of common facilities in real property.
- Overall, there should be no expectation of a financial return from holding shares. The companies would be allowed to carry out functions other than management of common property, including bringing in some revenue from common facilities to offset costs. While there may be a possibility of a return, it must be unlikely to be material and not the main purpose of the structure.
- Lot owners must retain a controlling interest in these companies although other relevant persons (for example, the developer) may retain some ongoing interest for reasons other than expecting a financial return on shares held, such as to ensure appropriate maintenance.
- Shares must pass with the ownership of lots.

Scope of exemption

Our proposal is to introduce an FMC Act exemption for companies set up to manage common costs in real property that have already transitioned into the FMC Act regime, or that have issued shares under the FMC Act prior to the designation coming into effect, that would provide general relief from FMC Act obligations.

To come within scope of the exemption, a company would have to have the same characteristics as for the designation. However, before being able to rely on the exemption, companies would have to send a notice to shareholders informing them of the change in regulatory status of the shares.

Further detail on designation proposal

The FMA has a number of ‘designation’ powers set out in section 562 of the FMC Act. These enable us to reclassify financial products and securities based on their economic substance, rather than their legal form.

Here we are proposing to exercise the power in section 562(1)(c) to reclassify shares in companies set up to manage common costs in real property developments out of the definition of ‘equity securities’ and ‘financial products’. In our preliminary view, these shares should not be classified as financial products because as a matter of economic substance, they do not relate to financial markets activities.



The reasons we propose the designation are:

1. The interests in the companies set up to manage costs in common facilities for real property will remain tightly associated with a particular piece of real property and would not be traded or offered to persons who do not have an interest in that specific real property.
2. A competition analysis would be unlikely to conclude that interests in cost management vehicles for real property are part of the same market as other financial products. This is because on the demand side, investors in other financial products would not choose to switch and acquire interests in cost management vehicles if the terms of the other financial products became less desirable. On the supply side, businesses that offer typical financial products would not seek to offer interests in cost management vehicles for investment purposes.
3. The reasons for holding shares in companies set up to manage costs in real property are tied to the practical activities associated with the management of real property, rather than the expectation of financial return or managing financial markets risks.
4. The interests in these companies would be acquired as part of a larger transaction to acquire interests in land and contract law and property law would apply to provide remedies to the parties involved across the larger transaction.
5. We also note that companies set up to manage common costs in real property developments are, in terms of their risk profile and economic substance, similar to other corporate vehicles set up to manage costs in real property (such as incorporated societies) that are not financial products.

Overall, the underlying economic substance and purpose of a company set up to manage costs in real property can be differentiated from other equity securities that are more appropriately regulated under the FMC Act.

We have considered whether we should require a warning statement to be provided to shareholders advising them that their membership in the company would not be subject to financial markets legislation as a prerequisite to being able to take advantage of the designation. Our preliminary view is a warning statement that applies just to companies that are not regulated may cause more confusion than clarity for lot owners. For many lot owners, the intuitive expectation would be that they would not be regulated as financial products.

Further, other kinds of corporate vehicle that are not captured by the definition of equity (such as an interest in an incorporated society) but are in substance similar to companies set up for the same purpose would not be subject to warning statements, hence the outcome would be different treatment for unregulated vehicles used for the same purpose.

Further detail on exemption proposal

Broadly speaking, the policy reasons for issuing a designation for companies for which shares have not yet been issued also justifies granting an exemption for companies already set up to manage communal facilities in real property.

The only difference in approach for the proposed exemption is that given an exemption could alter existing rights and remedies of shareholders by removing protections that were already in place under the Securities Act and the FMC Act. We therefore propose that an issuer must provide notification to the shareholders before the exemption can be relied upon to reflect this difference.

Our preliminary view is that a notification should be enough because we expect the transition would be non-contentious. Important feedback we are seeking is whether we should go further and require an issuer to obtain consent from shareholders before they can benefit from an exemption being relied on.



Finally, any exemption would apply on a forward-looking basis only. It would not affect any breaches or disputes that have occurred prior to the exemption.

Your comments

We seek comments from interested parties on the proposed designation and exemption, including on the specific questions we have raised. Refer to the questions below in your submission.

Please contact us with your comments by **6 November 2015**. You can provide your comments via email to us at consultation@fma.govt.nz with this in the subject line: 'Corporate vehicles used to manage costs in communal facilities for real property – Proposed FMC Act designation and exemption: [Your entity name]'. If you have any questions or would like to make a verbal submission contact Simon Haines on 09 967 1217

Questions

1. Do you agree that there is a need for a designation or does the ability to use other corporate vehicles that would not be captured, provide appropriate relief from regulatory obligations?
2. Do you agree with, or have any comments on, the scope of the proposed scope designation and exemption? We propose that the designation and exemption will apply to companies with the characteristics listed below.
 - The company's main purpose is to manage the costs of common facilities in real property.
 - Overall there should be no expectation of a financial return from holding shares. The companies would be allowed to carry out functions other than management of common property, including bringing in some revenue from common facilities to offset costs. While there may be a possibility of a return, it must be unlikely to be material and not the main focus of the structure.
 - Lot owners must retain a controlling interest in these companies although other relevant persons (for example, the developer) may retain some ongoing interest for reasons other than expecting a financial return on shares held, such as to ensure appropriate maintenance.
 - Shares must pass with the ownership of lots.
3. We have not proposed any conditions as part of the designation (we have considered requiring a warning statement to be provided, however, we consider that this will cause more confusion than benefit). Do you agree with this? Do you have any conditions to propose?
4. Do you agree that there is a need to provide an exemption for companies that have already issued their shares because the designation will not apply to them?
5. If an exemption is granted, the only condition we propose is that shareholders are notified the issuer is relying on the exemption. Do you agree with this? Do you have any conditions to propose, such as a requirement for prior consent from shareholders?
6. Are there any other factors we should take into account for either the proposed designation or the exemption?
7. Are there any other options we should consider in lieu of, or in addition, to either the proposed designation or exemption?

Feedback: Corporate vehicles used to manage costs in communal facilities for real property – FMC Act designation and exemption

Please submit this feedback form electronically in both PDF and MS Word formats and email them to us at consultation@fma.govt.nz with this subject: 'Corporate vehicles used to manage costs in communal facilities for real property - FMC Act designation and exemption: [Your entity name]'. Thank you.

Submissions close on 6 November 2015.

Date:

Number of pages:

Name of submitter:

Company or entity:

Organisation type:

Contact name (if different):

Contact email and phone:

Paragraph or Question Number	Comment	Recommendation
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You don't need to quote from the consultation document if you use part & paragraph numbers.

You may attach extra pages - please label each page with your name & organisation.

Feedback summary – if you wish to highlight anything in particular

Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

Thank you for your feedback – we appreciate your time and input.