

Consultation paper: Proposed exemptions for existing property schemes

About this consultation paper

The FMA is considering possible exemptions to address some of the issues faced by existing property schemes or syndicates in complying with certain requirements under the Financial Markets Conduct Act 2013 (FMC Act).

We would like your feedback on our proposals.

About this consultation paper:

This consultation is for:
property scheme managers,
supervisors, custodians and
investors.

It aims to:

- outline the FMA's view on how existing property schemes can approach new compliance obligations, and
- seek views from the industry and investors on whether these schemes should be granted exemptions from certain obligations.

Next steps

We plan to announce our decision by 31 March 2016 to give existing property schemes time to prepare to comply with their FMC Act obligations.

Submissions close on 19 February 2016. The form at the back provides more details.

Document history

This version was issued in December 2015 and is based on legislation and regulations as at the date of issue

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Executive summary

1. Most existing property syndicates or schemes will be managed investment schemes (MIS) under the FMC Act and will need to comply with the FMC Act by 1 December 2016. These property schemes should now be preparing to comply with FMC Act requirements. We encourage schemes to begin this work as early as possible. You can find out more information about MIS obligations and transition to the FMC Act [here](#).
2. This paper:
 - discusses the MIS requirements under the FMC Act that will apply to existing property schemes
 - considers and seeks feedback on whether exemptions should be granted for some existing property schemes from certain MIS requirements because of the particular characteristics of those schemes and the costs they will face to transition to the FMC Act.
3. This paper only relates to existing schemes that invest most of their assets in real property (ie, land and buildings) and are closed. By 'closed' we mean the scheme is not offered to new investors (although existing scheme investors may be able to transfer their interests to others). This paper also does not apply to managed funds or to schemes that do not predominantly invest in real property.
4. We invite submissions on two exemption proposals for property schemes in this paper:
 - An exemption from the FMC Act requirement that scheme property is held by the licensed supervisor or by an independent custodian to allow the manager or an associated person to hold real property assets (ie land and buildings) providing the scheme has effective alternative arrangements to safeguard that property
 - An exemption for schemes that are being wound up to continue their existing governance obligations for one year. This would be limited to schemes that are not large or complex. We consider schemes would be large if they have more than 50 scheme investors or the value of their total assets exceeds \$10 million and complex if they hold more than one investment property or one investment property with more than five leases.
5. These exemptions would not apply to new property schemes. New schemes must be set up to comply with the MIS requirements under the FMC Act and compliance costs can be built into pricing for interests in the scheme. The transition costs faced by existing schemes and their investors will not be faced by new schemes.
6. We will also be seeking views from the industry and investors on whether forestry schemes should be granted exemptions from certain MIS obligations under the FMC Act. Consultation papers on our exemption proposals can be found on our website [here](#).



Background

Securities Act treatment of property schemes

7. Property schemes owned by scheme investors with undivided interests in real property were participatory securities under the Securities Act 1978.
8. The Securities Act (Real Property Proportionate Ownership Schemes) Exemption Notice 2002 (the notice) provided exemptions from the prospectus, investment statement, statutory supervisor requirements and certain other obligations under the Securities Act. Schemes were required to provide an alternative offer document and meet various requirements around the offer and allotment process. There was no exemption from on-going financial reporting requirements of the Financial Reporting Act 1993.
9. The FMA decided not to renew the exemptions in our review of the notice in 2012. We saw no policy justifications to continue these broad exemptions, and considered that these property schemes should comply with the standard requirements for participatory securities. Any offers of interests in real property proportionate ownership schemes made from 1 October 2012 had to comply with the full requirements of the Securities Act. The requirements included having a prospectus and investment statement for the offer and the appointment of a statutory supervisor.

FMC Act treatment of property schemes

10. The FMC Act has replaced the Securities Act. Under the FMC Act, most existing property syndicates and schemes will be considered MIS.

What is a MIS?

11. In general terms, a MIS pools money from a number of investors who rely on the investment expertise of the scheme manager to produce a financial benefit or return. The definition in the FMC Act (s 9) is broad and most existing property syndicates and schemes that were regulated under the Securities Act will be considered MIS under the FMC Act.

When a scheme is not a MIS

12. A scheme will not be a MIS if the investors principally produce the financial benefits or have day-to-day control of the operation of the scheme (s 9(1)(b) and (c) of the FMC Act). Deciding whether a scheme is a MIS is a factual question for schemes and their advisers, and will involve identifying:

- What activities principally produce the financial benefits, and who performs them (s 9(1)(b))

For some property schemes, a property manager will exercise skill, expertise and decision-making in managing the property. In that situation, the property manager plays a significant role in producing the financial benefits and it cannot be said that the investors principally produce the financial benefits. For other schemes, the investors themselves manage the scheme although they may engage contractors to help with some aspects of property management.



- Who has day-to-day control (s 9(1)(c))

Investors may have this role, or their input may be limited to more high-level control, and they may leave the day-to-day control to a property manager.

13. Small schemes are more likely than larger schemes to fall outside the statutory definition as the investors are more likely to be actively involved in producing the financial benefits and have day-to-day control. For efficiency reasons, larger schemes might need to devolve management responsibilities and day-to-day tasks, and they will generally be MISs.
14. Schemes are not a MIS if investors will not receive rights to participate in, or receive, financial benefits produced principally *by the efforts of another person* under the scheme. For example an incidental capital gain resulting from a rise in general property values (where the scheme property is not bought and sold by another person with the intention of producing that capital gain) may not be a financial benefit properly attributable to the efforts of another person under the scheme.
15. Schemes are also outside the definition of a MIS if they meet the criteria in s 9(2)(a). This applies where investors take part in the scheme only by holding one or more interests in property and:
 - each interest is in a separately identifiable underlying property (s 9(2)(a)(i))
 - the participant holds both the legal and beneficial interest in the property or the legal interest is held on a bare trust for the participant (s 9(2)(a)(ii))
 - the value of an investor's interest is not substantially dependent on contributions by other investors or the use of other investors' contributions (s 9(2)(a)(iii)).

An example of a scheme that's likely to fall under s 9(2)(a) would be a unit title development where investors each purchase separate units that are managed by one manager but where the income and costs are specific to the unit.

Companies are not MIS

16. If investors receive shares but no other interest in a scheme, then the scheme is not a MIS. Shares are equity securities under the FMC Act. Companies who issue equity securities are subject to different obligations under the FMC Act from a MIS. Unlike a MIS, companies are not required to have a licensed manager or supervisor, or a governing document. Other obligations apply under the Companies Act 1993 to protect shareholders' interests, such as directors' duties. There is more detail about companies' obligations [here](#).
17. Note that if shares in a company are owned by a MIS (such as a land-owning company where the shares are held by the partners in a limited partnership) the scheme holding the shares will still be regulated under the FMC Act as a MIS.

MIS requirements

18. Under the FMC Act, a MIS must be registered on the Disclose Register and have:
 - a licensed manager
 - an independent licensed supervisor
 - compliant governing documents



- a statement of investment policies and objectives (SIPO)
- scheme property held by the independent licensed supervisor or (if permitted under the governing document) an independent custodian
- financial statements that comply with generally accepted accounting practice (GAAP).



Transition for existing property schemes

19. Existing property schemes need to comply with the FMC Act by 1 December 2016 (or earlier if they choose an ‘effective date’ before then). Scheme managers and supervisors will also need to review their systems and processes in light of new accountabilities and responsibilities. We encourage schemes to begin this work as early as possible. You can find out more information about MIS obligations and transition to the FMC Act [here](#).
20. All property schemes have historically been required to produce financial statements that comply with GAAP so this is not a new obligation. We appreciate however that some or all of the other MIS obligations mentioned in paragraph 18 will be new for some existing property schemes. We have therefore considered each of these MIS requirements and how these can be met by existing property schemes.
21. Our view is that in most cases existing property schemes should be able to comply with the MIS requirements and that there is no need for, and nor is it appropriate to provide, exemption support. In the next section we outline our views on the ability of most existing property schemes to comply with the licensed manager, independent licensed supervisor, SIPO and governing document requirements.
22. In two limited cases, however, we consider that relief may be appropriate from some of the new MIS requirements. This is where we consider the costs of complying with full MIS requirements may outweigh the benefits for investors. These are:
 - the new requirements for independent custody of scheme assets where there are alternative effective safeguards
 - schemes in a wind down stage where the cost of instigating new procedures may not deliver commensurate benefits to investors.
23. We discuss these two exemption proposals in the final section of this paper.



MIS obligations: no exemptions required

Licensed manager and independent licensed supervisor

24. Under the FMC Act, a MIS must have a licensed manager and independent licensed supervisor.
25. A licensed manager has strict responsibilities and liabilities for managing scheme property and investments. Having a licensed manager is important to protect investors' interests. Good management of a property scheme may safeguard scheme investors' investment and maximise the return on that investment. Licensing ensures that a manager is capable of meeting the FMC Act requirements.
26. A licensed supervisor provides an additional layer of protection for scheme investors. The licensed supervisor actively supervises the manager's performance, the issuer's obligations, the financial position of the manager and the scheme. Licensed supervisors act on behalf of the scheme investors in relation to the manager, the governing document, and issuer obligations.
27. Many property schemes were set up with only a licensed supervisor, and not a licensed manager. Other schemes, established before 30 September 2012, may have an unlicensed manager and no supervisor. These schemes will need to appoint an independent licensed supervisor if they do not have one already and either have their existing manager licensed or appoint a new manager who is already licensed.
28. We are not proposing any general exemption from the requirement to have a licensed manager or licensed supervisor for existing property schemes. We consider that these compliance structures are necessary and appropriate for property schemes to ensure effective monitoring and reduce governance risks. We do not consider there are any special characteristics property schemes have that will negate the need to protect scheme investors.
29. There is one exception where we consider exemption support may be appropriate. This is where a scheme is in wind down stage and the costs of implementing complying procedures for a short time may not provide commensurate benefit for investors. See our proposals for exemptions for schemes close to winding up in the final section of this paper.

FMA's approach to licensing MIS managers

30. We note that our approach to licensing MIS managers is to promote the purposes of the FMC Act¹ without unnecessarily restricting the licensees. All licence applications are assessed against the same minimum standards. The standards give the investor the necessary consumer protection, but there is flexibility in establishing how businesses meet the minimum standards. Our approach to licensing managers takes into account the size and nature of the applicant's business. For example, systems and processes we would expect to see in place for a manager of a small single property scheme would be different from systems and processes we would expect for a manager of several property schemes or a large scheme with several properties or multiple tenants. It is up to each applicant to explain what is appropriate for their business.

¹ See paragraphs 39 and 40.



31. In order for a MIS manager to ensure they are able to obtain a licence by 30 November 2016 the FMA must receive a licence application, in the form required, by the end of September 2016. Information about applying for a MIS manager licence can be found [here](#).

SIPO

32. A SIPO or statement of investment policies and objectives for a MIS describes how the manager will manage the scheme including the types of investments that may be made, how much can be invested in each type of asset, and the methodology to be used for developing and amending the investment strategy. A SIPO also details how the investment's performance is measured against the investment objectives of the scheme. A MIS manager must report to the supervisor quarterly on material breaches of any investment limits.
33. We are not proposing any general exemptions from SIPO requirements for existing property schemes. The reason for this is that the SIPO provides an important tool to protect investors and ensure the effectiveness of the overall accountability framework for MIS. We think it is important for all MIS to have standard and comparable SIPOs.
34. We recognise that some SIPO requirements may seem more relevant to managed funds than to other MIS such as property schemes. However, we do consider when applied appropriately they can also work effectively for property schemes. You can find guidance on how to apply SIPO requirements for a property scheme and ensure that the SIPO is meaningful and relevant [here](#).

Governing documents

35. A MIS must have governing documents that meet the requirements of the FMC Act. This means existing schemes may need to amend their governing documents. The governing documents have to include, among others matters:
- whether investors' interests in the MIS are transferrable or redeemable, and how that is achieved
 - the rules for becoming a member, or for withdrawing
 - the contributions payable
 - the method for valuing scheme assets.
- See s 135 of the FMC Act which has a full list of what must be included in the governing documents.
36. In our view, existing property schemes that are MIS should have governing documents that contain all these standard matters. The obligations in the governing documents hold MIS managers to account through the tools contained in these documents. Therefore we are not proposing any general exemptions from governing document requirements.
37. Schemes will need to look at the specific amending provisions in their existing governing document to work out the process for making amendments to meet the new requirements. This may vary between schemes but will often require investor consent. We note that the FMC Act makes provision for a transitioning scheme's existing governing documents to be amended or replaced with the FMA's consent. This path is available where it is impracticable to comply with the usual procedure for replacement or amendment in a scheme's governing document. We will consent to an amendment where we are satisfied that this is necessary or desirable to ensure that document complies with the FMC Act requirements (cl 26(2)(a),



Schedule 4). Any such amendment or replacement is treated as if it were made in accordance with the governing document. You can find out more about amending governing documents [here](#).

Questions

- Q1 Do you agree that existing property schemes should be subject to the same MIS requirements as other MIS for a licensed manager and independent licensed supervisor, SIPO and governing documents? If you disagree, please state the reasons.
- Q2 If you consider an exemption from any of these MIS requirements is necessary and appropriate, please explain the exemption you think is required. State the relevant class of existing property schemes to which this exemption would apply and how the exemption (and any proposed alternative requirements) would promote the purposes of the FMC Act and its benefits justify any increased risks for investors.



Exemption proposals for existing property schemes

FMA's exemption powers

38. We may grant exemptions for up to five years when necessary, or desirable, to promote one or more of the purposes of the FMC Act. An exemption can be no broader than what is necessary to address the matters that gave rise to the exemption.
39. The main purposes of the FMC Act are to:
 - promote confident and informed participation of businesses, investors, and consumers in the financial markets
 - promote and facilitate the development of fair, efficient, and transparent financial markets.
40. The FMC Act's additional purposes are to:
 - provide for timely, accurate and understandable information to help people make decisions about financial products and financial services
 - ensure appropriate governance structures apply to financial products and certain financial services that allow for effective monitoring and reduce governance risks
 - avoid unnecessary compliance costs
 - promote innovation and flexibility in the financial markets.
41. You will see from some of the exemption proposals discussed below, that we may consider granting an exemption from certain FMC Act obligations where we can identify a class or classes of schemes where, given the common features of the schemes, an exemption (with appropriate conditions) will best promote the purposes of the FMC Act. We will have to balance compliance costs against the other FMC Act purposes when we consider property schemes. The statutory test is whether compliance costs are 'unnecessary'.



Proposal: Exemption from independent custody for some property schemes

42. Under the FMC Act, MIS property must be held by the independent licensed supervisor or (if permitted by the scheme's governing document) by an independent custodian. The purpose of this requirement is to ensure that the scheme property is properly safeguarded and monitored.
43. For many existing property schemes, property will be held by the manager or an associated nominee company. The question arises as to whether the scheme should be required to transfer the property to the independent licensed supervisor or (if permitted by the governing document) to an independent custodian to comply with FMC Act requirements. We understand this may result in additional compliance costs. We consider this may not be necessary for all types of scheme property if investors' interests in particular property can be sufficiently protected in some other manner.
44. We are proposing a class exemption for existing property schemes from the requirement for the licensed supervisor or an independent custodian to hold MIS property where there are other safeguards in place. To justify an exemption these measures would need to be sufficiently robust to provide equivalent protection for investors' property interests.
45. Accordingly, our proposal is that the exemption:
 - a) Will only relate to real property assets of a property scheme (ie, land and buildings). The reason is that these are immovable assets and a registration system means no legal interest in land may be created except by registration.
 - b) Will require alternative measures be in place to ensure the property is protected. Two alternative safeguards we are proposing to recognise at this stage are that the supervisor holds a registered encumbrance over real property or that a caveat has been lodged against the title. The effect of a caveat being registered is to prevent the registered owner from selling or otherwise dealing with that land until the caveator has had its claim dealt with and resolved.
46. We propose that scheme property other than real property will still need to be held by the licensed supervisor or an independent custodian.

Questions

- Q3 Do you support the proposed exemption from independent custody requirements for scheme property where there are other alternative safeguards in place to provide robust protection for investors' property interests? Please give reasons for your view.
- Q4 What do you estimate are the likely compliance costs that a scheme will incur if no exemption is granted and scheme property must be transferred to the licensed supervisor or an independent custodian?
- Q5 What alternative safeguards could schemes have that protect investors' interests in real property if it is not held by the licensed supervisor or an independent custodian? Do you consider that a registered encumbrance or registered caveat would provide a robust alternative safeguard that would protect investors' property interests? What costs would be incurred by schemes in putting in place a caveat or registered encumbrance? Are there any other safeguards you think would adequately protect investors' interests? Please give reasons for your views. What costs would schemes incur to put those




safeguards in place?

- Q6 Are there any other types of scheme property for which similar safeguards could also be put in place? If so, what types of property and what are the safeguards? What costs would schemes incur to put those safeguards in place?
- Q7 Are there any issues that may arise for licensed supervisors of property schemes if they hold scheme property? If so, please explain what those issues are.

Proposal: Exemption for existing schemes being wound up

47. We recognise that the costs of complying with FMC Act requirements may outweigh the benefits for investors where the protections provided by the FMC Act will only apply for a limited period because the scheme is being wound up.
48. We are, therefore, proposing a class exemption from certain MIS governance requirements for existing property schemes that are winding up where those requirements will impose obligations that are additional to the scheme's existing obligations under the Securities Act regime. Schemes relying on the exemption would still need to be registered. However we propose that:
- schemes would not need to have a licensed manager
 - schemes with no supervisor would not need to appoint an independent licensed supervisor
 - if scheme assets are held by the manager or an associate then the scheme assets would not need to be transferred to the licensed supervisor or an independent custodian
 - the governing document would not need to be updated if it is not compliant
 - a scheme would not need to prepare a SIPO.
49. Given the higher risks faced by investors where these protections are not in place, we consider that the exemption would only be appropriate for a short period to allow existing schemes in the process of being wound up time to complete this process. In terms of setting a timeframe threshold, we consider that a maximum of one year beyond the existing transition period (that ends on 30 November 2016) sets an appropriate balance. The risks of providing relief from FMC Act requirements for any longer period are more significant and in our view outweigh the compliance costs for investors. We propose to require schemes to notify us in advance if they intend to rely on the exemption and provide confirmation that investors are fully informed. The requirement for notice will ensure that we can monitor compliance with the requirements that apply.
50. We also consider that the exemption should not apply to large or complex schemes. This is because large or complex schemes present more significant risks for investors and we do not consider any further time beyond the existing transition period should be provided for these schemes to have the protections in place. Compliance costs for larger schemes would also be comparatively lower for scheme investors. In terms of setting a threshold we consider an appropriate balance between the positive impact of the protective measures and the negative impact of the costs of compliance would be to provide relief to schemes that are not large (do not have more than 50 scheme investors and the value of their total assets



does not exceed \$10 million) and are not complex (do not hold more than one investment property or hold one investment property with not more than five leases).

51. In summary, we propose that schemes would only be able to rely on this exemption where they:

- will be wound up by 30 November 2017
- are not large (do not have more than 50 scheme investors and the value of their total assets does not exceed \$10 million) and are not complex (do not hold more than one investment property or hold one investment property with not more than five leases), and
- notify the FMA by 1 September 2016 that they intend to rely on the exemption and confirm that they have written to all scheme investors advising them that they intend to rely on the exemption, providing information regarding the process and timetable for winding up the scheme and advising investors of the consequences of the exemptions.

Questions

- Q8 Do you support an exemption for existing property schemes that are being wound up on the basis described above? Please give reasons for your view.
- Q9 What do you estimate are the likely costs that a scheme will incur to become fully compliant under the FMC Act if no exemption is granted?
- Q10 Do you agree that 30 November 2017 is sufficient time for most schemes being wound up to complete that process?
- Q11 Do you agree that the risks of not requiring compliance with usual FMC Act requirements for schemes being wound up become more significant and outweigh the compliance costs for investors more than one year beyond the end of the transitional period ending 30 November 2016?
- Q12 Do you agree that schemes that are large or complex should not be able to rely on this exemption? If not, please explain. Do you agree with the proposed threshold for what is a large or complex scheme? If not, please tell us what you consider the threshold should be and why you think this would provide a more appropriate balance between the positive impact of the new FMC Act protections and the negative impact of the costs of compliance.
- Q13 Do you agree with our proposal that a scheme should be required to give notice to the FMA by 1 September 2016 to rely on the exemption together with confirmation that they have provided relevant information to scheme investors? If not, please explain.
- Q14 Are there any other requirements you think should apply?



Additional questions

- Q 15 Are you aware of any other issues facing existing property schemes for transition to the FMC Act? Please explain what these are.
- Q16 What exemptions (if any) do you consider would be necessary and appropriate to deal with these issues that support the purposes of the FMC Act?
- Q17 Are there any other single asset schemes (other than property or forestry schemes) for which similar issues arise? Please explain what these issues are. We note that we are consulting separately on issues for forestry schemes.

The next steps

How do I make a submission?

Please use the form on the next page – it gives the details of what you need to do. Forms must be submitted electronically in both PDF and word formats and emailed to consultation@fma.govt.nz – please put ‘Proposed exemptions for existing property schemes: your organisation name’ in the subject line.

Submissions close on 19 February 2016.

Where can I get more information?

You’ll find more information on our website www.fma.govt.nz.

If you have questions about the consultation process, please get in touch on 0800 434 567.

Feedback form

Feedback: Proposed exemptions for existing property schemes

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed exemptions for existing property schemes: your organisation name' in the subject line. Thank you.

Submissions close on 19 February 2016.

Date: _____ Number of pages: _____

Name of submitter: _____

Company or entity: _____

Organisation type: _____

Contact name (if different): _____

Contact email and Phone: _____

Paragraph or Question Number	Response
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You don't need to quote from the consultation document if you use a paragraph number or question number.

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.

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