

# How the FMC Act will affect companies and incorporated societies that manage communal facilities

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This information sheet is for:

- property developers
- purchasers
- agents
- advisers
- companies and incorporated societies managing communal facilities.

## Background

Property developers often set up a company or an incorporated society to hold and manage communal facilities in a development or subdivision such as access ways, lifts and common garden areas. Purchasers will acquire an interest in the company or incorporated society alongside the property they buy. This gives them rights to use the communal facilities. These arrangements will no longer be regulated under financial markets law following changes introduced by the Financial Markets Conduct Act 2013.

## What key changes do I need to be aware of?

The **Financial Markets Act 2013** (FMC Act) replaced the Securities Act 1978 on 1 December 2014 but with a transition period in place until 1 December 2016. Two complimentary notices support the new laws introduced by the FMC Act:

- [Financial Markets Conduct \(Communal Facilities in Real Property Developments\) Designation Notice 2016](#) (FMC designation notice)
- [Financial Markets Conduct \(Communal Facilities in Real Property Developments\) Exemption Notice 2016](#) (FMC exemption notice)

Under the Securities Act, shares in a company were caught within the definition of equity securities, and membership interests in an incorporated society were classed as participatory securities. However, the usual rules on offering securities to the public did not apply as these interests were recognised as not being financial investments in the usual sense, but rather a means through which residents in a property development can use communal facilities.

The usual rules under the Securities Act required people offering securities to the public to have a registered prospectus and give investors an investment statement, and those offering participatory securities had to have a statutory supervisor and deed of participation.



However people offering interests in communal facilities were able to rely on the [Securities Act \(Real Property Developments\) Exemption Notice 2007](#) (RPD notice). Instead of the usual rules, they could comply with the alternative requirements in the RPD notice. These included giving alternative information to the purchaser, such as information on the role of the company or incorporated society in managing the communal facilities, and the purchaser's rights and obligations.

### How the FMC Act treats incorporated societies

Under the FMC Act, membership interests in incorporated societies that manage communal facilities will not generally be 'financial products'. This means that the rules in the FMC Act will not apply to these societies.

An incorporated society that manages communal facilities will only be regulated under the FMC Act if it is a 'managed investment scheme'.

### Is your incorporated society a 'managed investment scheme'?

Most incorporated societies set up to manage communal facilities will not be a managed investment scheme<sup>1</sup>. This is because the rights delivered by the scheme are not financial benefits, but are rights to use the communal facilities.

A managed investment scheme has to have all these features:

- the scheme's purpose is to enable people to contribute money to acquire interests in the scheme
- those interests are rights to participate in, or receive, financial benefits produced principally by the efforts of another person under the scheme
- there is no day-to-day control by the interest-holders over how the scheme operates (whether or not they have the right to be consulted or to give directions)<sup>2</sup>.

### Regulation of new incorporated societies

#### Incorporated societies still need to comply with the rules of their society and other laws

From 1 December 2016, developers can continue to use incorporated societies as an effective way to hold and manage communal facilities. Developers who manage communal facilities through an incorporated society will not need to comply with the FMC Act if the incorporated society is not a managed investment scheme, as defined above.

However, the following rules will continue to apply to the incorporated society and the property development:

- the Incorporated Societies Act 1908
- the Fair Trading Act 1986
- the rules of the relevant incorporated society
- contracts entered into
- contract and property law.

These rules will provide for the rights and obligations of purchasers and the management of the communal facilities by the incorporated society.

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<sup>1</sup> This information sheet assumes most incorporated societies managing communal facilities will not come within the definition of managed investment scheme. If your incorporated society does come within this definition, you will be regulated under the FMC Act. You should get advice from a financial markets lawyer about what your obligations are in this case.

<sup>2</sup> See section 9(1) of the FMC Act.



## Regulation of existing incorporated societies

### Incorporated societies will no longer be regulated by the Securities Act, the RPD notice, or Financial Reporting Act

From 1 December 2016 (or an earlier transition date elected by the society), existing incorporated societies that manage communal facilities will no longer be regulated under the Securities Act or the RPD notice. They will also no longer have financial reporting obligations as an 'issuer' under the Financial Reporting Act 1993.<sup>3</sup>

As the interests in an incorporated society that manages communal facilities are not financial products the FMC Act will not apply.

However the incorporated society and the property development will still be subject to the same general laws as outlined above. This will include the Incorporated Societies Act, the rules of the relevant society, any existing contracts that are in place, the Fair Trading Act 1986, and contract and property law. Financial reporting obligations in the Incorporated Societies Act will apply to the incorporated society.

### What changes for companies managing communal facilities from 1 December 2016?

Under the FMC Act, shares in a company are equity securities and financial products. However, we have put relief in place for companies that manage communal facilities from the usual disclosure, governance and financial reporting requirements under the FMC Act.

### Designation will apply for new shares

We have issued a designation that shares in companies managing communal facilities that are issued or transferred after 28 October 2016 will not be financial products as defined in the FMC Act. You can find the designation in the [Financial Markets Conduct \(Communal Facilities in Real Property Developments\) Designation Notice 2016](#).

We have issued this designation as we believe shares in communal facilities companies are not financial market products. This is because the purpose of these shares is not to provide any financial investment and they do not pose financial markets-related risks. The shares are offered as ancillary features in real estate transactions, and they allow residents in a property development to use and enjoy communal facilities, and contribute to their maintenance.

Our view is that the purchasing and holding of these shares is more appropriately governed by general law rather than financial markets laws.

### Does this FMC designation notice apply to my company?

The FMC designation notice only applies to companies whose shareholding, constitution and activities meet these criteria:

- the company must 'manage' 'communal facilities' in a 'development'<sup>4</sup>
- the company's constitution must prohibit the company from carrying on any activities other than managing the communal facilities
- the company's constitution must prohibit the company from carrying on trading activities or a business for profit unless these are 'incidental activities', and the purpose is to offset the costs of managing the communal

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<sup>3</sup> See section 55 of the Financial Reporting Act 2013 and the Financial Reporting Regulations 2015 to work out when Financial Reporting Act 1993 obligations cease to apply to an incorporated society.

<sup>4</sup> See the FMC designation notice for the meanings of these terms.



facilities. The purpose must not be to pay shareholders a financial return in the form of a dividend or other distribution

- the company's constitution must provide that:
  - shares can only be issued or transferred to a person who has agreed to purchase a property in the development
  - after the development is completed, only an owner of a property may be a shareholder
  - every person who owns a property is entitled to be a shareholder.

If the FMC designation notice applies, the shares are not regulated by financial markets law and the FMC Act requirements relating to disclosure, governance, financial reporting or fair dealing will not apply.

However, the company and the property development will be subject to general law including:

- the Companies Act 1993
- the Fair Trading Act 1986
- the company's constitution
- any contracts in place
- contract and property law.

Our FMC designation notice only applies to shares in communal facilities companies issued or transferred on or after 28 October 2016, not to existing shares or shares transferred before this date.

### **Exemption will apply for existing shares**

#### **Existing companies will no longer be regulated by the Securities Act, the RPD notice, or Financial Reporting Act**

From 1 December 2016 (or an earlier transition date elected by the company) existing shares in companies managing communal facilities will not be regulated under the Securities Act or the RPD notice. In addition, the company will have no financial reporting obligations as an issuer under the Financial Reporting Act 1993.<sup>5</sup>

#### **FMC exemption notice granted**

Most of the FMC Act requirements will not apply to the shares as we have granted a new exemption notice called the [Financial Markets Conduct \(Communal Facilities in Real Property Developments\) Exemption Notice 2016](#). This provides relief for existing shares offered in reliance on the RPD notice or certain individual exemption notices. This means that shares transitioning to the FMC Act will not need to meet the usual FMC Act requirements related to on-going disclosure, governance and financial reporting.

The shares are still required to meet the FMC Act rules on 'fair dealing'. These rules are substantially similar to the Fair Trading Act rules which apply more generally to commercial transactions.

The FMC exemption notice does require the company to give a prescribed notice to its shareholders about the impact of these exemptions.

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<sup>5</sup> See section 55 of the Financial Reporting Act 2013 and the Financial Reporting Regulations 2015 to work out when Financial Reporting Act 1993 obligations cease to apply to a company.



General laws, including the Companies Act 1993, the company's constitution, any contracts in place, contract law, the Fair Trading Act and property law will still apply to the company and the property development. The company may still have financial reporting obligations under the Companies Act.

### **What do I need to do?**

Developers, and companies and incorporated societies that manage communal facilities, should:

- read the FMC designation and exemption notices carefully
- familiarise yourself with the application requirements and conditions under these notices and work out whether they apply to your property development
- look to general law, rather than the FMC Act, to provide appropriate management and financial arrangements for communal facilities in your property development
- if necessary, seek legal advice on how the FMC Act, these notices, and the general law apply to you.

Legal advisers acting for people who are buying a property in a development should:

- Read the FMC designation and exemption notices carefully. Be aware that the FMC Act requirements will not apply to companies or incorporated societies that manage communal facilities.
- Make sure you seek information on the communal facilities from the developer. Be aware that you and your client will need to look to general law, rather than to the FMC Act, to ensure your client's interests are protected if they do decide to purchase a property.

The general law will include the Companies Act 1993 or Incorporated Societies Act 1908 (as applicable), the company's constitution or society's rules, any contractual arrangements in place or proposed, contract law, the Fair Trading Act and property law.