

DRAFT (23/7/09)



Review of the overseas investment screening regime

POLICY DOCUMENT AND
REGULATORY IMPACT STATEMENT

23 July 2009

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MINISTERIAL FOREWORD

[To come]

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Regulatory Impact Analysis

Provided with very limited timeframes and documents still subject to change, the Treasury's Regulatory Impact Analysis Team (RIAT) has independently reviewed the draft documents supporting this proposal. The RIAT finds that the analysis is not adequate according to the Cabinet's agreed criteria for regulatory impact analysis and the expectations set out in the terms of reference. In particular, it is not clear that:

- the proposed changes accurately target the areas of genuine concern in the simplest and most cost-effective way; and
- the risks of the proposed changes and implementation issues have been adequately identified.

EXECUTIVE SUMMARY

Problem definition and motivation for review

The objective of the review of New Zealand's overseas investment screening regime is to ensure that the regime promotes and encourages the flow of investment into New Zealand, while addressing valid concerns about foreign investment. The government is focused on making overseas investment in New Zealand simpler and more attractive, while at the same time ensuring that the screening regime protects New Zealand's most sensitive land, assets and resources.

New Zealand relies on overseas investment to provide local businesses with capital to expand and to bring in new technology and skills from offshore. Overseas investment into New Zealand totalled \$27 billion for the year ended March 2008, with the largest sources being Australia, the United States and the United Kingdom.¹ In the current economic environment, New Zealand is competing more than ever for overseas capital. It is therefore particularly important that our investment screening regime does not deter valuable investment that will help the New Zealand economy grow and recover more quickly from recession.

As well as the benefits that overseas investment brings to New Zealand, the government acknowledges that it can create concern in some sections of the community, and that some safeguards are required to address these concerns about overseas investment in our most sensitive assets.

The government has identified the following three criteria that we consider any screening regime should aim to achieve. These criteria have been used to evaluate the impact of the proposed changes to the screening regime.

- *Well-targeted at public concerns:* A screening regime requires overseas investors to meet additional requirements or tests, over and above domestic investors. It is therefore important that the screening regime target public concerns in a way that is proportionate and does not create overly onerous conditions or compliance costs for investors. It is also important that any screening only applies to the types of assets that are most sensitive for New Zealanders. If the scope of screening is too wide it creates unnecessary delays and costs for overseas investment.
- *Simple:* A screening regime should be simple to understand and implement to ensure that it minimises compliance costs associated with investment applications and ensures efficient preparation and processing of applications.
- *Predictable:* A screening regime should provide certainty and predictability of the regime for investors. Such a regime is less likely to distort or discourage investment decisions if investors can understand how their investment will be

¹ Statistics New Zealand, *Balance of Payments and International Investment Position: Year ended 31 March 2008*.

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screened, and if there is a high degree of certainty that the rules of the game will not change suddenly.

This review has found that there is scope to improve the current screening regime against all three of these criteria. The main area for improvement and focus of the review relates to sensitive land. Around 80% of all investment applications relate to sensitive land and they are the most complex applications to prepare and assess. While some changes are proposed to other parts of the regime, the key improvements relate to sensitive land.

The current regime captures investments that the government does not consider to be sensitive. For example, land that adjoins local parks and reserves is not likely to be sensitive, but the Act requires investments in such land to seek consent before proceeding.

The regime also creates additional requirements for overseas investors that are higher than necessary to address community concerns about overseas investment. The requirement for investors to show that an investment in sensitive land will create benefit to New Zealand means overseas investors must meet a much higher standard than domestic investors. The regime also includes provisions that are not necessary to address concerns about overseas control such as the requirement to offer special land to the Crown. Crown ownership of river beds for example, is not required to address concerns about access and usage.

These additional requirements impose significant compliance costs on investors. The complexity of the regime means that some applications can take months to prepare and assess. The monetary cost of preparing an application can be in excess of \$200,000 depending on the complexity and type of the application. Some of the conditions that imposed are well above what a domestic investor would be required to meet and are themselves costly to comply with.

The simplicity of the regime can also be improved. The existing benefit test is assessed against a long list of criteria, and there can be uncertainty over whether certain land is sensitive or not.

The current screening regime does not provide enough predictability for investors. The government is able to add to the factors used to assess investments in sensitive land by regulation. This ability means the basis on which investments are assessed can be changed, potentially at short notice and with application to investments that are already part way through the application process. In addition, when assessing whether an investment will create benefit, Ministers are able to determine which factors are relevant for a particular investment, how much weighting to give to each factor and whether each factor has been adequately addressed.

Recommendations

The table below outlines the key findings of the review, and the expected impact against the three criteria identified above.

Issue (page in policy document)	Status Quo	Proposed change	Impact
A. Purpose of the Act (p.27)	<i>To acknowledge that it is a privilege for overseas persons to own or control sensitive New Zealand assets.</i>	<i>To provide safeguards for investments in sensitive assets by overseas persons while generally maintaining an open and welcoming stance towards overseas investment.</i>	<ul style="list-style-type: none"> • Well targeted. The new purpose will allow the Act to be implemented and interpreted in a way that recognises the importance of investment while protecting sensitive assets.
B. Exemption for residents (p.34)	Holders of New Zealand residence permits must be either domiciled or satisfy minimum New Zealand residence requirements to be exempt from screening.	Persons who hold a residence permit that entitles them to reside in New Zealand indefinitely will be exempt from screening.	<ul style="list-style-type: none"> • Well targeted as residents are able to reside in New Zealand indefinitely and are similar to citizens. Around 0.01% reduction in applications (2 investors affected by this since 2000).
C. Policy change by regulation (p.46)	The factors considered when assessing an investment in sensitive land can be added to by regulation.	Changes to the factors considered when assessing sensitive land applications can only be made through primary legislation, rather than regulation.	<ul style="list-style-type: none"> • More predictability and certainty for investors, less flexibility for Ministers.
D. Business assets: scope (p.54)	Business investments of more than \$100 million are subject to screening.	Increase the threshold to \$200 million. Retain screening for greenfields investment.	<ul style="list-style-type: none"> • Well targeted – only screen the most significant transactions. Reduce business applications by around 20%.
E. Business assets: hurdle (p. 58)	Investors must show they are of good character, have business acumen and have financial commitment to the investment.	Retain the current test and add a reserve power to allow the Minister of Finance to decline an investment in exceptional circumstances where it is not in the national interest.	<ul style="list-style-type: none"> • Well targeted – the reserve power is a better way of addressing concerns about national interest than the current strategic asset provision.
Sensitive land: scope F. Non-urban land (p.66)	Non urban land greater than 5ha (includes both farm land and other non urban land such as forestry).	Farmland and forestry land (rather than all non urban land) is screened. The area threshold is increased to 10ha.	<ul style="list-style-type: none"> • Well targeted – small land holdings are exempted, as are commercial/industrial businesses located on non-urban land. Roughly 8% reduction in land applications.

Issue (page in policy document)	Status Quo	Proposed change	Impact
G. Section 37 (p.69)	Land adjoining local and National Parks and reserves is screened.	No longer screen land adjoining local parks, retain protection for National Parks.	<ul style="list-style-type: none"> • Simpler and well targeted – less land is subject to screening while land of particular importance is still screened. • More predictable – remove uncertainty over whether land that adjoins some parks and reserves is sensitive. Around 6% fewer land applications.
H. Land adjoining historic places (p.70)	Land that adjoins land subject to heritage orders or a historic place is screened.	Remove screening for land that <i>adjoins</i> land with heritage sites/heritage orders/wahi tapu areas.	<ul style="list-style-type: none"> • Simpler and well targeted as above. Around 4% fewer land applications.
I. Sensitive land: hurdle (p.80)	Investor must show that the investment will benefit New Zealand, and that the benefits are substantial and identifiable in the case of non-urban land. This test includes economic criteria and whether the investment provides for adequate walking access, protection of historic places, indigenous flora etc.	A two-part test where the investor must i) identify sensitive features on the relevant land and sign a certificate stating they are aware that New Zealand legislation has provisions to protect these features, ii) agree to provide 'adequate' public walking access over the land or part of the land.	<ul style="list-style-type: none"> • Simplified assessment process for investor and regulator. • Well targeted as Act directly addresses common concerns but relies largely on domestic legislation to provide sufficient protection, with additional protection for walking access. • Predictable for investors as the test reduces Ministerial discretion and the ability to impose additional obligations on overseas investors.
J. Offer back of special land to the Crown (p.82)	Land that includes foreshore, seabed, lakebed or riverbed must be offered to the Crown.	Remove requirement to offer land to the Crown. Rely on other legislation to provide for access to and use of these types of land.	<ul style="list-style-type: none"> • Simplify/remove the complexity associated with the offer back process. • Well targeted –addresses the underlying concerns which relate <i>usage/access</i> rather than <i>ownership</i>. Around 12 days saved on special land applications.
K. Requirement to advertise farm land on the open market (p. 95)	Farm land must be advertised on the open market to New Zealanders before being sold to an overseas person	Remove requirement to advertise farm land on the open market.	<ul style="list-style-type: none"> • Simplify/remove the delays caused by the advertising requirement. • Well targeted – address the underlying concerns of <i>usage</i> rather than <i>ownership</i>.

Issue (page in policy document)	Status Quo	Proposed change	Impact
L. Increases in ownership/control once approved (p.84)	Investors must seek further approval if they wish to increase their level of ownership or control of an asset by more than 5%.	Exempt such transactions from the requirement to seek consent.	<ul style="list-style-type: none"> • Well targeted and simpler– once an investor is approved, there is little reason to require them to seek new consent, and doing so is unlikely to have a different result.
M. Strategic assets (p.93)	Ministers may consider whether sensitive land investments will assist New Zealand to maintain control of strategically important infrastructure.	Remove the regulation relating to strategic assets on sensitive land. No further protections should be provided for strategic assets as the existing restrictions and proposed changes to the business test are sufficient.	<ul style="list-style-type: none"> • Simpler – no additional sub-class of screening. • More predictability for investors, since no ambiguity over whether an asset is strategic.
<i>Areas where no change is proposed</i>			
Sovereign Wealth Funds (p.89)	No additional screening for Sovereign Wealth Funds.	No additional screening for Sovereign Wealth Funds.	
Land: scope (p. 66)	The regime screens foreshore, lakebeds, islands, conservation land, land with heritage value and numerous other categories.	Vast majority unchanged, except for the modifications to the scope described above.	

Expected impacts

The expected impacts of the proposed changes are summarised in the table below.

	Significant business assets	Sensitive land
Scope	Better targeted screening threshold, reducing applications by around 20%, and total applications by around 3% (based on historical data)	Better targeted scope, reducing land applications by around 20%, and total applications by around 16% (based on historical data).
Hurdle	No change.	Significantly simpler and more predictable test for investors. No uncertainty around treatment of strategic assets. No complexity around offering special land to the Crown.
Approval rate	Unlikely to have an impact on the proportion of applications approved (currently 100%).	Unlikely to have a significant impact on the proportion of applications approved (currently around 96%).

As well as improving predictability for investors, these changes will reduce the compliance costs they currently face. Reduced complexity will result in time savings in preparing applications, as well as a lower monetary cost. The changes to the sensitive land test will significantly reduce compliance costs as overseas investors will face similar requirements to domestic inventors. The changes the scope of the Act will mean around 20% fewer applications and result in large savings for these investors who no longer have to seek consent. It is difficult to quantify the value of these savings as they vary depending on the type and complexity of the application.

A major implication of the proposed changes is that improving predictability for investors results in less discretion or flexibility for Ministers in assessing applications. For example, moving to the proposed objective test for investments in sensitive land will mean Ministers are unable to impose higher requirements on overseas investors, although investors may agree to additional protections voluntarily through negotiation.

The proposed test for sensitive land aligns the requirements for overseas investors more closely with those of domestic investors. The government considers that, in general, concerns about issues such as environmental protection and public access should be managed through New Zealand's existing legislation that applies to both domestic and overseas investors. The Overseas Investment Act is therefore targeted at the additional requirements that overseas investors must meet, while recognising that many issues that the Act currently addresses can be managed with other legislation.

Next steps

Cabinet has agreed to the policy changes outlined in this document. The government expects to pass the necessary legislation by the end of 2009. Members of the public will have the opportunity to comment on the proposed changes through the Select Committee phase of the legislative process and the government encourages all interested parties to contribute. Further details about the timing of Select Committee deliberations will be announced once this has been confirmed by Cabinet.

1 INTRODUCTION

Foreign investment and New Zealand's overseas investment regime

Foreign investment is an important driver of economic growth...

- 1.2 Inward foreign investment brings substantial economic benefits.² Foreign investment provides scope for higher rates of economic activity and employment than could be achieved from the domestic levels of savings alone. This leads to higher national output and national income per head, net of the servicing cost of foreign capital. New Zealand is heavily dependent on foreign capital as evidenced by our high external indebtedness and current account deficit.
- 1.3 Foreign direct investment has numerous spill-over benefits. It provides access to new technology and methodologies, whereby domestic firms imitate the products and processes of foreign corporations through personal contact, observation and reverse engineering. It assists New Zealand workers to acquire new skills, in particular management skills, through working in foreign-run corporations. Foreign investment also improves our access to overseas markets, and competition incentivises domestic firms to become more efficient in order to remain competitive.

...but raises community concerns in some circumstances.

- 1.4 There are a number of concerns about the impact of foreign direct investment on New Zealand. Overseas investments may reduce New Zealanders' wellbeing in two broad circumstances:
- *National sovereignty and ownership value.* New Zealanders may have a particular attachment to some types of domestic assets, and simply knowing those assets are in overseas ownership may consequently reduce wellbeing. In this case it is the level of overseas *ownership* itself that reduces wellbeing. Foreign ownership also increases the likelihood of profits going offshore.
 - *Investor behaviour.* New Zealanders may be concerned that overseas investors may behave in a manner that is inconsistent with domestic behavioural norms, and that may have an undesirable impact on economic, political, and cultural life. In this case, it is the way in which investments are managed or used that raises concerns, the primary determinant of which is the level of overseas *control* of New Zealand assets.

² Refer to *International Connection and Productivity: Making Globalisation Work for New Zealand* (<http://www.treasury.govt.nz/publications/research-policy/trpr/09-01/trpr09-01.pdf>) for a fuller assessment of the benefits of foreign investment.

- 1.5 Concerns about national sovereignty and ownership value are best addressed by limiting ownership of assets considered sufficiently important to remain in New Zealand ownership, rather than using a screening regime. Government ownership of state-owned enterprises is one example. Restrictions on foreign ownership of privately held companies – such as those on Telecom New Zealand and Air New Zealand - are another example.
- 1.6 An overseas investment screening regime should be primarily targeted at investor behaviour and foreign control of sensitive assets, which could have a practical impact on the lives of New Zealanders. It should provide safeguards to ensure that, for the types of assets considered most sensitive to New Zealanders, overseas investors will act in a way which is consistent with the value and importance placed on those assets by New Zealanders. These sensitive assets are significant business assets, sensitive land, and fishing quota. A screening regime can also address ownership value to some extent, where the knowledge that investments have been approved through a screening regime may offset the loss in ownership value.
- 1.7 This method of providing safeguards on the use of sensitive land is only partial as it does not extend to domestic investors. If particular behavioural norms are considered worth protecting from overseas investors, they are also likely to be worth protecting from domestic investors. An overseas screening regime should therefore focus on what additional protections are required for overseas investors over and above protections in domestic legislation.

The overseas investment screening regime seeks to strike a balance.

- 1.8 New Zealand's current overseas investment screening regime is governed by the Overseas Investment Act 2005 (the Act), the Overseas Investment Regulations (the Regulations) and sections 56 to 58B of the Fisheries Act 1996 (Fisheries Act). The Act replaced the Overseas Investment Act 1973, the Overseas Investment Regulations 1995 and amended the Fisheries Act. The purpose of the Act is to acknowledge that it is a privilege for overseas persons to own or control sensitive New Zealand assets.³
- 1.9 In addition, New Zealand has foreign ownership restrictions in two large companies:
 - *Telecom New Zealand*. No person who is not a New Zealand national can have a relevant interest in more than 49.9% of the total voting shares without, and in accordance with the terms of, the prior written approval of the Kiwi Shareholder.
 - *Air New Zealand*. Non-New Zealand nationals may not own more than 10% of voting rights without Kiwi Shareholder consent.

³ Purpose, Overseas Investment Act 2005

- 1.10 Both of these restrictions take the form of provisions in the companies' constitutions. Both constitutions also contain a number of other ownership restrictions, such as the number of New Zealand citizens required to be on the board of the companies.
- 1.11 The government promotes foreign investment in New Zealand via Investment New Zealand - a division of New Zealand Trade and Enterprise - which assists international corporate investors to relocate their businesses to New Zealand, establish greenfield operations, and work with New Zealand companies in global ventures.

The Act provides for the screening of investments in sensitive assets...

- 1.12 The Act requires that overseas persons obtain consent for certain investments in:
- sensitive land (including non-urban land over 5 hectares, certain specified islands, foreshore or seabed, reserves and historic areas)
 - significant business assets (exceeding NZ\$100 million), and
 - fishing quota.
- 1.13 Foreign investors need to apply to the Overseas Investment Office for consent to acquire the above investments. Investors are required to provide evidence to show that the investment meets the relevant criteria. The criteria are defined in the Overseas Investment Act 2005⁴ and the Fisheries Act⁵ and differ according to category of investment. Broadly the investor needs to demonstrate the following:
- business experience and acumen relevant to the investment
 - financial commitment to the investment
 - that the investor is of good character
 - [for sensitive land] that the investment, will, or is likely to, *benefit New Zealand*, and
 - [for fishing quota] that the investment, will, or is likely to be, *in the national interest*.

...to ensure they are of benefit to New Zealand.

- 1.14 Whether an investment is of benefit to New Zealand is assessed against 19 factors including:

⁴ See sections 16 (sensitive land) and 18 (significant business assets) of the Act for a full description of the criteria.

⁵ See section 57G of the Fisheries Act for a full description of the criteria for investments in fishing quotas.

- whether the investment creates jobs or opportunities, including new technology or business skills, increased exports, greater efficiency and productivity
 - whether there are adequate mechanisms for protecting the environment, flora and fauna, walking access and historic heritage, and
 - whether the investment will assist New Zealand to maintain control of strategically important infrastructure on sensitive land.
- 1.15 The Overseas Investment Office considers each application and makes a decision (where delegated) or advises the relevant Minister or Ministers on whether consent should be granted. The relevant Ministers then make a decision on the application, which may include conditions that must be met for the investment to progress.

Motivation for the review

In the current economic environment, access to foreign capital is particularly important...

- 1.16 The global financial and economic crisis has seen the worldwide reversal of previously large capital flows between countries. As a nation with a high dependence on foreign capital, foreign investment is always important for New Zealand, but the current economic situation makes it even more essential that New Zealand's screening regime does not unnecessarily deter or prevent foreign investment.

...but the Act may be unnecessarily constraining investment.

- 1.17 The Government's position is that, in general, foreign investment is in New Zealand's national interest, because of the economic benefits it provides. However, in a subset of cases where investments concern sensitive New Zealand assets, the government wishes to ensure that a screening regime is in place to provide appropriate safeguards to address community and national concerns about the investment.
- 1.18 The Government is concerned that some parts of the Act may be creating an unnecessary barrier to foreign investments which would be beneficial to New Zealand. The Government recognises that there is a need to balance the strong economic benefits to New Zealand from foreign investment with the concerns that arise. However, the Government is concerned that current screening levels may exceed the levels required to provide adequate safeguards for sensitive assets, and therefore discourage investment unnecessarily.
- 1.19 There is also a concern that the Act is unnecessarily complex and does not provide the required certainty and predictability for investors. This creates compliance costs for overseas investors which are likely to reduce the attractiveness of New Zealand as a place to invest.

Consequently, the Government has undertaken to review the Act.

- 1.20 The Terms of Reference outline the objective of this review, which is “to create an overseas investment screening regime that promotes and encourages the flow of investment into New Zealand, while addressing valid concerns about foreign investment.”⁶
- 1.21 The scope of the review is limited to considering improvements to the current screening regime, while largely maintaining the current structure and screening categories. It looks at investments in significant business assets and sensitive land, but excludes investment in fishing quota where there are virtually no applications. The review will look at a subset of the most important issues which might produce the biggest gains in terms of promoting the initial and ongoing flow of investment into New Zealand, while targeting relevant concerns about foreign investment. The focus is on avoiding “detering valuable investments and to minimise compliance costs”.⁷

⁶ Refer to Annex for the full Terms of reference for the Overseas Investment Act review

⁷ Terms of reference

2 PROBLEM DEFINITION

- 2.1 This section seeks to assess whether there are improvements that could be made to the regime, within the scope outlined above. It will do so by assessing the operation of New Zealand's current overseas investment screening regime and looking at international comparisons.

International comparisons

OECD principles

- 2.2 The OECD's 2007 Freedom of Investment, National Security and "Strategic" Industries: An Interim Report noted that participating countries agreed to three principles to guide investment policy in such areas:
- *Regulatory proportionality.* Restrictions on investment should not be more costly or more discriminatory than needed to achieve the security objectives and they should not duplicate what is, or could be, better dealt with by other regulation.
 - *Predictability.* While it is in the interest of both investors and national administrations to maintain confidentiality of sensitive information, regulatory objectives and practices should be made as transparent as feasible so as to increase the predictability of outcomes and eliminate sources of misunderstanding.
 - *Accountability.* While improper political interferences in the normal exercise of regulatory power have to be avoided, procedures for parliamentary oversight or judiciary redress should ensure accountability.

OECD's FDI Regulatory Restrictiveness Index

- 2.3 The OECD index measures the extent to which countries treat foreign investors differently from nationals. This can be used as a basis for comparing New Zealand's overseas investment regime with those of other countries.
- 2.4 The measures take the form of a Foreign Direct Investment (FDI) Regulatory Restrictiveness Index.⁸ It takes into account barriers to foreign investment in the form of limitation on foreign ownership, special screening procedures which apply only to foreign investors, and post-entry restrictions and conditions.⁹
- 2.5 The FDI Regulatory Restrictiveness Index is split into three categories:¹⁰

⁸ *OECD International Investment Perspectives*, p.135-151

⁹ *OECD International Investment Perspectives*, p.137

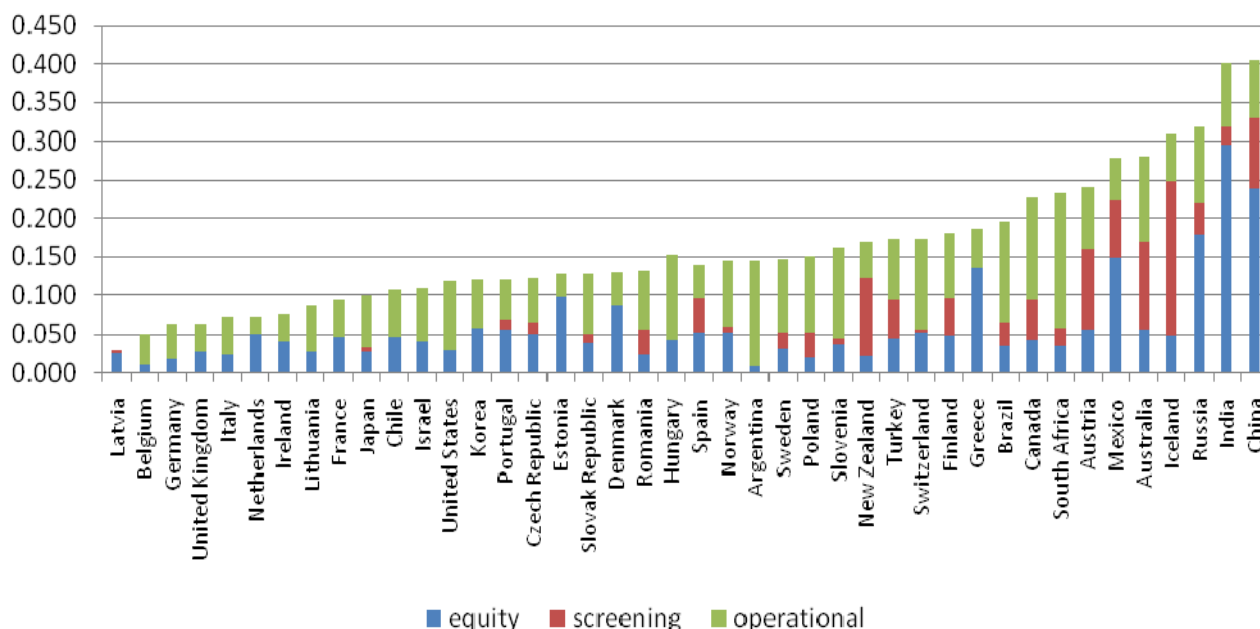
¹⁰ *OECD International Investment Perspectives*, p.145

- equity restrictions – the limitation or prohibition of foreign ownership, including state monopolies¹¹
- screening - obligatory and discriminatory approval procedures, and
- operational restrictions - constraints on foreigners managing or working in companies eg, a requirement that nationals or residents must form the majority of a company’s board of directors.

Overall ranking

2.6 New Zealand ranks 15th most restrictive out of the 42 ranked countries (and 10th in the OECD). New Zealand’s score of is driven by our screening regime; operational restrictions in some industries – notably telecommunications and air and maritime transport – and government ownership in the air transport and electricity industries.

Figure 1: FDI Regulatory Restrictiveness by type of restriction

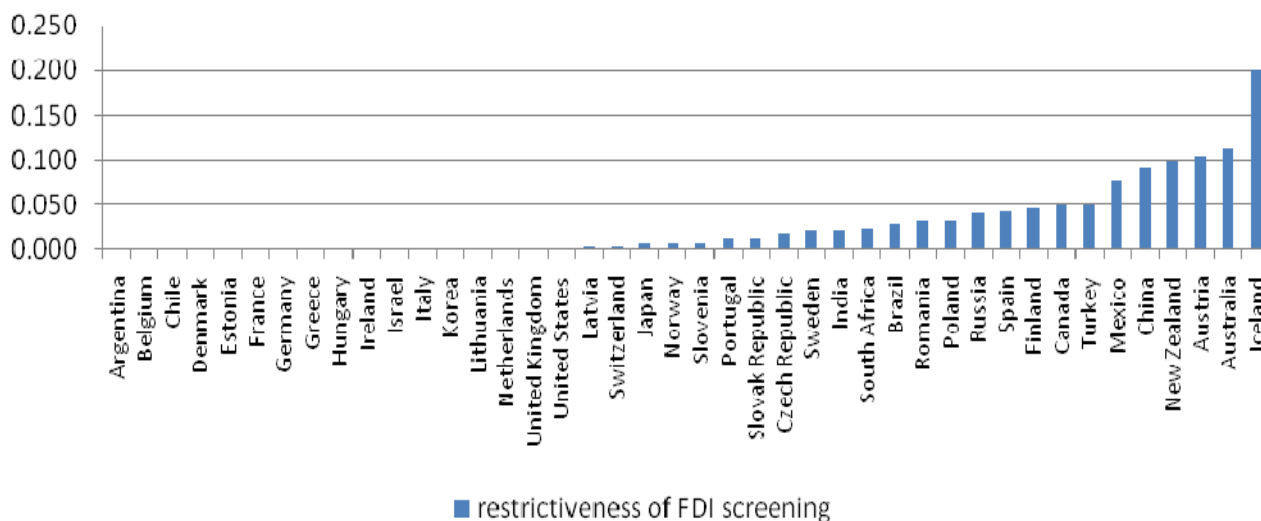


Screening regime ranking

2.7 The OECD data suggests that New Zealand’s screening regime is comparatively restrictive internationally. This is the main reason for our poor ranking overall. Many countries have no formal screening on foreign investments, including the United Kingdom and the United States of America. New Zealand has the fourth most restrictive screening regime in the sample (after Iceland, Australia and Austria), as shown in Figure 2.

¹¹ State monopolies or near-monopolies are effectively a de facto ban on FDI. *OECD International Investment Perspectives*, p.146

Figure 2: Restrictiveness of FDI screening regimes



2.8 Screening regimes are given a high score if a foreign investor must prove that the investment will bring economic benefits. A lower score is assigned if approval is granted unless it is contrary to the national interest. An even lower score is given if only notification of investment is required.¹²

Limitations of the OECD index

2.9 The main limitation of the index is that it only assesses the potential restrictiveness of investment regulations, not the extent to which statutory restrictions are enforced, making it a de jure rather than de facto assessment of restrictiveness. It also includes only overt restrictions on FDI, ignoring institutional or informal restrictions, such as the nature of corporate governance. As noted later in this section, New Zealand turns down very few investment applications, even though the scope and hurdles created by our screening regime are considered high by the OECD.

2.10 The index also places more weight on screening of overseas investments rather than other forms of restricting investments. The US, for example, does not have an investment screening regime which screens all investments meeting certain criteria. However, US legislation¹³ provides authority to the President to prohibit any foreign investment that the President determines threatens to impair the national security of the country. This means that the US can, and does, decline some foreign investments, but this is not reflected in the index (the US receives a perfect score of zero on investment screening).

2.11 The screening regime ranking also does not capture the many nuances of different regimes. It is based on the treatment of different industries and the type of hurdle it presents, but it does not, for example, look at the size of the hurdle

¹² Table 6.A1.1 in Annex 6.A1, *OECD International Investment Perspectives*

¹³ Section 721 of the Defense Production Act of 1950, known as the Exon-Florio amendment.

presented to investors. New Zealand's high ranking is partly because our screening regime covers significant business assets and sensitive land in all sectors of the economy. Modifications to the regime that increase thresholds so fewer investors are screened, but maintain the current economy-wide scope, will not result in a reduction to our score of 1.0 based on the OECD's methodology.

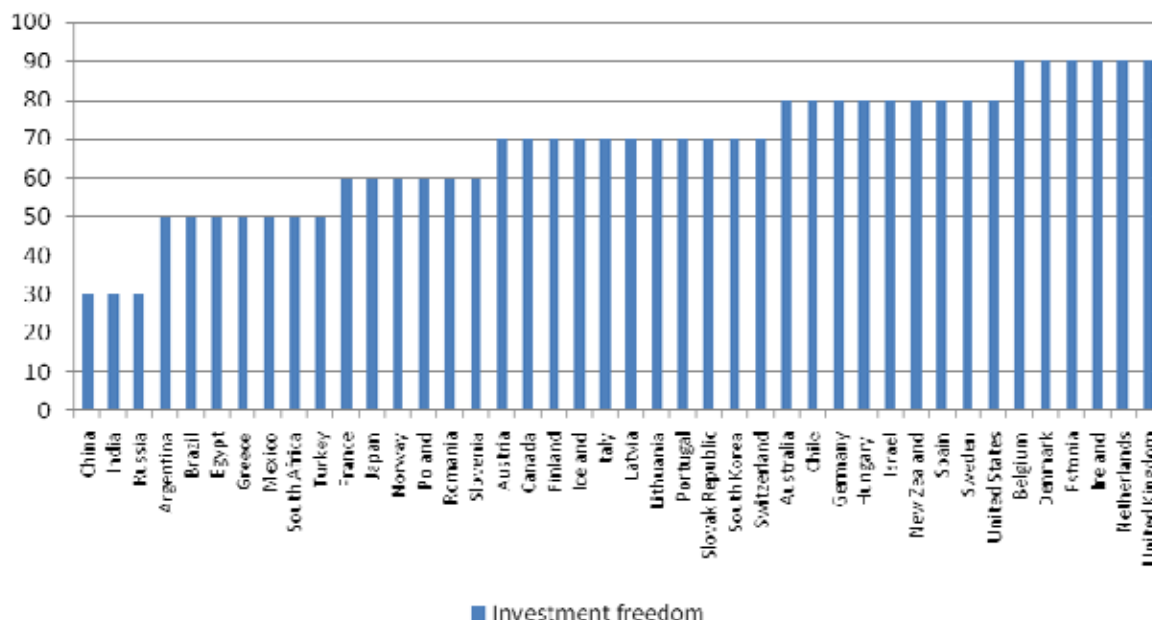
- 2.12 Acknowledging the limitations, the OECD index is useful in highlighting that New Zealand is one of the few countries that operate a screening regime and that the scope of our regime is relatively wide.

Index of Economic Freedom

- 2.13 The Heritage Foundation produces an Index of Economic Freedom each year which can also be used to compare New Zealand's performance in the area of investment freedom with other countries. The Index comprises 10 components of economic freedom: business freedom; trade freedom; fiscal freedom; government size; monetary freedom; investment freedom; financial freedom; property rights; freedom from corruption; and labour freedom.¹⁴ The 10 component scores are averaged to get an overall economic freedom score for each country (out of 100).

- 2.14 New Zealand's overall score in 2009 is 82, making it the 5th most free out of the 183 countries analysed. In terms of investment freedom, New Zealand scored 80, compared with an average over all countries of 48.8. Figure 3 shows how this compares with the 41 other countries which were analysed in the OECD study above.

Figure 3: Investment freedom scores in the Index of Economic Freedom



¹⁴ *Index of Economic Freedom 2009, Methodology for the 10 Economic Freedoms*, pp. 441-452

- 2.15 The Heritage Foundation's assessment of investment freedom in New Zealand is as follows:

New Zealand encourages foreign investment in most sectors. The government does not discriminate against foreign buyers, but it does limit foreign ownership of Air New Zealand and Telecom New Zealand. New Zealand screens certain types of foreign investment through its Overseas Investment Office, and permits or licenses are needed for gold, coal, petroleum, or other minerals mining. In general, regulations and bureaucracy are efficient and transparent. There are no restrictions on current transfers, repatriation of profits, or access to foreign exchange. Land and real estate purchases are subject to strong restrictions.

- 2.16 The Heritage Foundation's assessment of investment freedom differs from that of the OECD in two important respects:

- *Its scope of analysis is wider:* The Index of Economic Freedom includes an assessment of access to foreign exchange, and restrictions on payments, transfers and capital transactions, which are not included in the OECD Index.
- *The methodology is less clear:* The scores allocated to countries do not appear to be based on a consistent weighting of the elements assessed, or at least this is not disclosed. This also means one cannot separate the assessment of New Zealand's investment screening regime from other factors that may be driving the score.

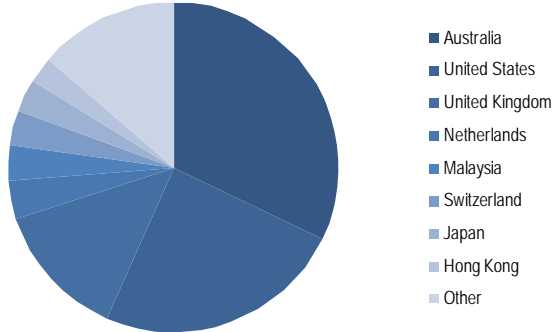
- 2.17 The OECD's FDI Regulatory Restrictiveness Index, notwithstanding its limitations, arguably provides a better comparison of foreign investment regimes for the purposes of this review because it is based on a more robust and transparent methodology. It also enables comparison of New Zealand's screening regime as distinct from other aspects of investment freedom, though this comparison is admittedly limited.

Operation of the current regime

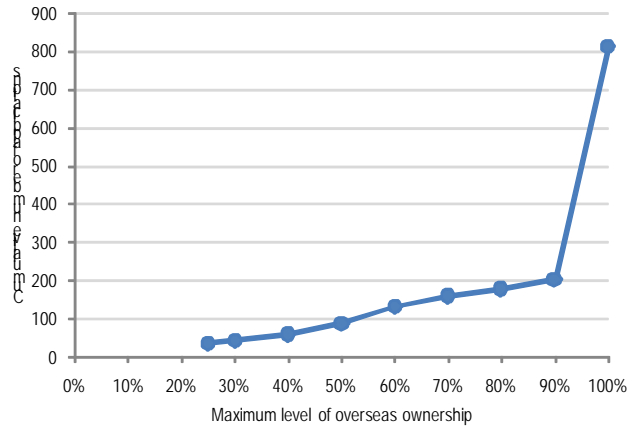
- 2.18 This section looks at how the current regime is operating in terms of number and value of applications, complexity, processing times and how it is perceived abroad in order to assess whether and where there is scope for improvement. The charts below summarise key statistics relating to the operation of the regime, which are discussed subsequently in further detail.

Most applicants are from Australia, the US and the UK...

Applications for consent, decided between 1 July 2004 and 22 April 2009, for which the country holds more than 50% of the applicant

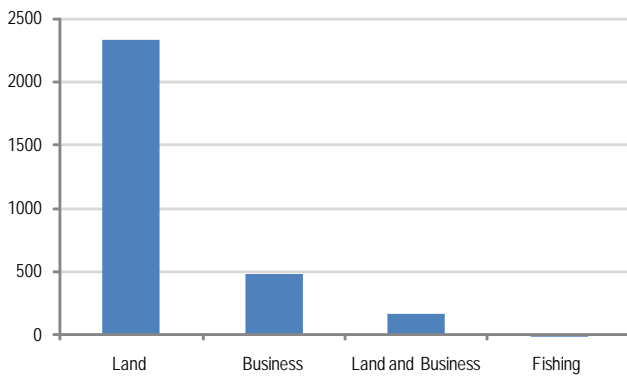


...and generally have a high degree of overseas ownership.



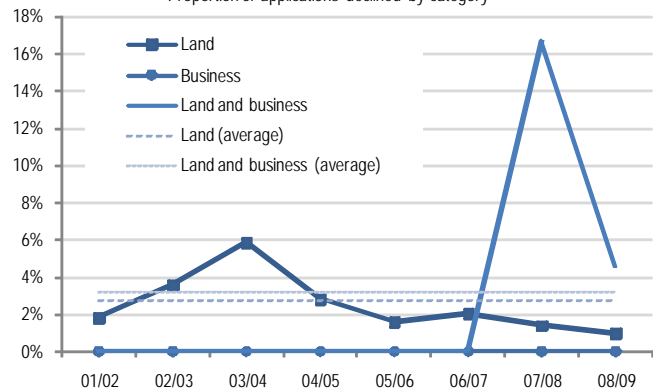
The vast majority of applications involve land...

Number of applications decided by screening category, 2001-2009



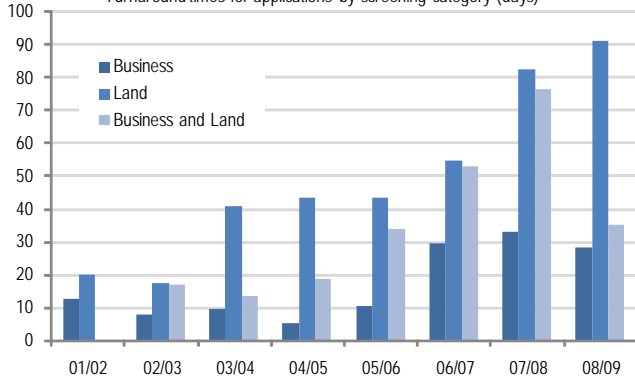
...and the only applications declined involve land.

Proportion of applications declined by category



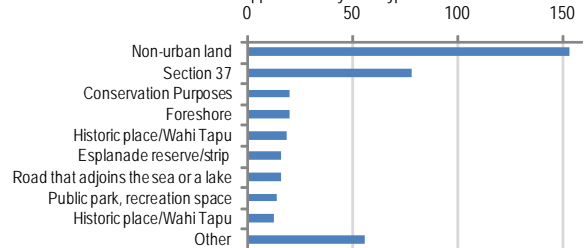
Turnaround times have grown in recent years, especially for land applications.

Turnaround times for applications by screening category (days)

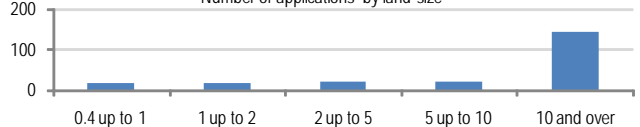


Land applications cover a range of sensitivities and sizes.

Number of applications by land type



Number of applications by land size



Source: Overseas Investment Office

Number of Applications

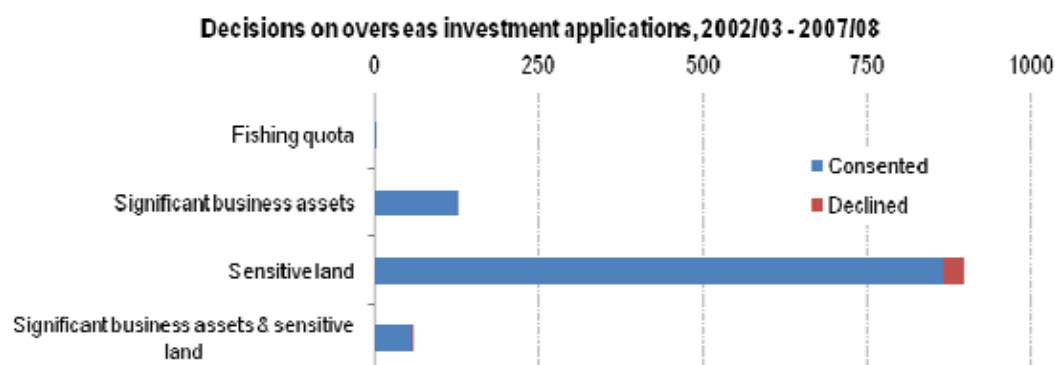
- 2.19 For the period 26 August 2002 to 25 August 2008 the Overseas Investment Office processed 1,609 applications by overseas persons to acquire sensitive New Zealand assets. 1083 of the applications were decided within that period, of which 33 were declined.¹⁵
- 2.20 The following table and figure details the breakdown of applications:

Table 1: Decisions on overseas investment applications, August 2002 – August 2008

Category	Total	Consented	Declined (number)	Declined (%)
Fishing quota	1	1	0	0
Significant business assets	127	127	0	0
Sensitive land	897	866	31	3.5
Significant business assets & sensitive land	58	56	2	3.5
Total	1083	1050	33	3.0

Source: Overseas Investment Office

Figure 4: Decisions on overseas investment applications, August 2002 – August 2008



- 2.21 Since 2002, 97% of investment applications that are decided by the Office have been approved. On one hand, this high level of approval could suggest that there is no reason to be concerned about the operation of the Act. However the 97% approval rate could be a signal that the regime is screening too many applications to begin with, and that there is an opportunity to reduce the scope of what is screened. This figure also does not take into account applications which have been withdrawn before the assessment process is completed. 10% of all applications received by the Office are either lapsed, withdrawn or do not require

¹⁵ A further 526 applications were processed, but involved exemptions, variations to existing consents, consent if proceeds, no consent required or applications that were either withdrawn by the applicant or lapsed by the OIO for the want of further information.

consent. A number of these applications will be withdrawn because the investor does not consider that they will be successful in gaining consent.

- 2.22 The fact that consent is granted to most applications indicates the earlier mentioned divergence between the apparent restrictiveness of the screening regime in law and restrictiveness in its operation. While New Zealand might perform better relative to other countries based on an outcome measure, the fact that the government has the ability to screen overseas investments creates costs for investors, even if consent to those investments is ultimately granted. These costs (discussed further below) include delays to business activity while applications are prepared and assessed, and the potential for uncertainty that the current Act creates.

Complexity of Applications

- 2.23 The Act and investment applications have become more complex since 2005. The scope of the Act was widened in parts in 2005 and the assessment process for screening sensitive land has become more detailed. The number of factors the OIO has to consider when assessing applications has increased. For example, under the pre-2005 legislation, there were 11 criteria and factors that were considered when assessing an investment in sensitive land. Under the current legislation there are now 27 criteria and factors that must be considered. Also, under the previous Act, the requirement to show that an investment would create substantial and identifiable benefits to New Zealand only applied to investments in farmland. Under the current Act this requirement has been extended to cover all non-urban land over 5 hectares.
- 2.24 This additional complexity has resulted in increased costs to investors in understanding the Act and preparing their investment applications, as anecdotal evidence from legal firms dealing with the Act indicates. It typically takes several weeks to prepare an investment application and each application can fill multiple folders.¹⁶

Processing of Applications

- 2.25 The increased complexity is one reason why application assessment times have increased. Average turnaround times for Ministerial applications peaked at 105 days between August 2007 and May 2008. This level of delay creates large costs for investors as they wait for a decision on their application and may turn away potential investors.¹⁷ Application times have since reduced considerably due to the Overseas Investment Office hiring additional staff. However, simplifying the Act (reducing complexity and scope) will help reduce costs of delay for investors.

¹⁶ Simpson Grierson (March 2009), *FYI Corporate Advisory*

¹⁷ For example, investors may hedge their investment capital until consent is provided to proceed. Hedging a NZ\$100m investment (the minimum business investment that would be screened) for two months would cost around \$650,000, increasing to \$2 million for six months. The longer the time taken to seek consent, the greater the cost of hedging.

Providing certainty for investors

2.26 The current Act has two main sources of uncertainty:

- the factors used to assess whether an investment in sensitive land will provide benefit to New Zealand can be added to by regulation, and
- the test for sensitive land involves judgement in assessing whether benefit to New Zealand has been demonstrated.

2.27 The most high profile example of the first source of uncertainty relates to a proposed investment in Auckland Airport. In March 2008 the Canada Pension Plan Investment Board (CPPIB) offered to buy 40% of the fully paid ordinary shares in Auckland International Airport Limited (AIAL). After the investment application was made, the government added the following factor by regulation:

“whether the overseas investment will, or is likely to, assist New Zealand to maintain New Zealand control of strategically important infrastructure on sensitive land.”

2.28 The Regulations Review Committee investigated the government’s decision to use its regulation-making powers to add this factor in response to a complaint from the Business Roundtable and the Wellington Regional Chamber of Commerce. The Committee found that the decision to add an additional factor was an “unusual and unexpected use of the regulation-making power”.

2.29 This example highlights the fact that the current regime can create uncertainty for investors if the criteria for assessing their investments are changed partway through the application process.

2.30 The second source of uncertainty can be illustrated by contrasting the tests for land and business assets. For business, consent is granted if the investor meets four relatively well-defined and objective criteria, such as whether the investor has demonstrated financial commitment to the investment. For sensitive land, in addition to meeting the four objective criteria, an investment must be, or be likely to be, of “benefit to New Zealand”. The additional criterion is intended to address public concern over how land, as distinct from business assets, is used. It requires Ministers to consider a range of factors in assessing benefit, but they need to exercise judgement with respect to the relative importance of the factors and likelihood of particular effects occurring. This introduces an element of subjectivity, and therefore uncertainty, into the consent process.

Compliance cost summary

2.31 The paper notes in a number of places that the current screening regime creates compliance costs for investors. These costs are highly dependent on the type of application (business or sensitive land), the complexity of the application itself, and the types of conditions imposed. For example a sensitive land investment that includes special land that must be offered to the Crown and creates conditions that require the investor to provide improved walking access will be

significantly more complex and costly to prepare and comply with than a business application.

- 2.32 The table below provides an indication of these costs and is based on information from the Overseas Investment Office and law firms who represent investors.

Application costs*

	Business applications	Land applications**
Time costs		
Time to prepare application	~5 days	3-6 weeks
Time to assess application [^]	50 days	50 days
Dollar costs		
Application fees	\$12,000	\$20,000
Legal fees**	\$15,000-\$20,000	\$25,000-\$200,000
Other expertise** (eg surveyors, consultants)	N/A	minimal to \$100,000

*Cost per application, costs are indicative estimates only and vary by the complexity of the application.

[^]OIO's targeted time – recent assessment times have been below this.

**highly dependent on complexity of the application

- 2.33 The cost of delays while applications are prepared and considered can be significant as investors have to put their business plans on hold. Costs such as hedging investment capital against exchange rate risk and the cost of borrowing, increase over time.

Costs of conditions imposed

- 2.34 Additional compliance costs come in the form of any conditions imposed on an investment in order to gain consent. Some of these conditions are imposed to maintain usage rights provided by the previous owner such as walking access. Other conditions, however, can go well above what a domestic investor may be required to do. While these conditions can be seen to create additional benefits for New Zealand, they also impose costs for investors. Some examples of the conditions imposed are outlined below:

- Develop signage along a walkway that outlines the ecological, recreational, cultural and historical values in the area.
- Construct a formed walkway to provide public access over the land.
- Make a \$10,000 donation to a research organisation.
- Undertake wilding pine and noxious plant control, mitigate fertilizer run-off.
- Rehabilitate a camping area to as pristine a state as possible.
- Monitor and protect small scaled skinks on the land.
- Agree not to subdivide the land.

Is the Act deterring investment?

2.35 There is anecdotal evidence that our screening regime has acted as a disincentive or barrier to overseas investors who might invest in New Zealand, but it is difficult to determine how large this effect is. Feedback law firms and *[Withheld - free and frank expression of opinions]*, suggests that investors generally have a negative perception of our screening regime. There are a number of examples of investors who have been frustrated by the complexity of the regime and the “draconian” requirements it imposes. In some cases experience with the screening regime is completely deterring investors from investing in New Zealand, and some are even actively discouraging other investors from considering investing in New Zealand.

2.36 *[Withheld - maintain the effective conduct of public affairs through the free and frank expression of opinions]*

It is thus conceivable that the complexity of the screening regime means that some investors simply do not consider New Zealand as an investment destination.

2.37 As part of the review, information has been collated from New Zealand’s offshore posts on perceptions of New Zealand’s screening regime internationally. The general response was that the screening regime is not the most important factor that influences a decision to invest in New Zealand. Some investors were unaware of New Zealand’s potential as an investment destination. For others legislation such as the Resource Management Act was a deterring factor.

2.38 *[Withheld - maintain the effective conduct of public affairs through the free and frank expression of opinions]*.

2.39 Overall it is hard to assess whether the screening regime is systematically deterring investment, but it is clear that at least in some cases it acts as a significant frustration or a complete barrier to investors who may consider investing in New Zealand.

Conclusions

2.40 Based on the assessment above, three broad areas for improvement in the Act can be identified:

- *Proportionate and well-targeted at public concerns*: The current regime is fairly restrictive, at least at law. This creates considerable compliance costs for investors. It is not clear that all the restrictions are required to adequately protect sensitive assets and ensure that investments are of net benefit to New Zealand. Reconsidering which investments in the significant business assets and sensitive land categories should trigger the screening regime, and what requirements these investments need to meet, with a view to reducing the scope of the regime, will help to ensure that it does not deter or delay valuable investments into New Zealand.

- *Simple*: There is scope to simplify the design and implementation of the screening regime to ensure that it minimises compliance costs associated with investment applications and ensures efficient processing of applications.
- *Predictable*: There is scope to improve the certainty and predictability of the regime for investors. A screening regime is less likely to distort or discourage investment decisions if investors can understand how their investment will be screened, and if there is a high degree of certainty that the rules of the game will not change suddenly.

2.41 The issues appear to be most acute for land applications: Land applications make up the vast majority of investments screening under the Act, are subject to the most complex and stringent requirements, and have experienced the greatest increases in processing times.

3 PURPOSE STATEMENT

Status quo

3.1 The purpose of the Overseas Investment Act 2005 reads follows:

“The purpose of this Act is to acknowledge that it is a privilege for overseas persons to own or control sensitive New Zealand assets by—

- a) requiring overseas investments in those assets, before being made, to meet criteria for consent; and*
- b) imposing conditions on those overseas investments.”*

Problem definition

3.2 A purpose statement outlines the purpose of the Act in broad terms and, in doing so, frames the way the Act is interpreted and applied. The Interpretation Act states that the meaning of an Act, and its parliamentary intent, must be ascertained from its text and in light of its purpose. This means that, when there are legal ambiguities in the body of the Act the purpose is often looked to in the process resolving them, as well as other statements of parliamentary intent such as Hansard.

3.3 Ministers can direct the OIO to implement the Act in accordance with the government’s general approach to foreign investment, by way of a directive letter. That directive letter must be consistent with the purpose of the Act.

3.4 The current purpose statement focuses on the distinction between New Zealanders and overseas persons. This is most clearly conveyed by the use of the word “privilege” with respect to overseas persons investing in New Zealand. This indicates a mindset that foreigners are fortunate to acquire investments in New Zealand and the Government is imposing criteria and conditions on overseas investments to reflect this.

3.5 The proposed changes to the Act represent a shift in approach from a regime that considers overseas investment a privilege and therefore provides for concessions from overseas investors above what would apply to domestic investors, to a regime that provides safeguards largely by ensuring compliance with other legislation. It is therefore appropriate to restate the purpose to reflect this shift in the body of the Act.

Possible alternatives

3.6 Below are a number of alternative wordings of the purpose of the Act with their advantages and disadvantages. In constructing these options it is recognised that while the Government wishes to promote and encourage the flow of investment into New Zealand, the screening regime itself is a qualification to that, and its inherently restrictive nature should be acknowledged.

Option 1

The purpose of this Act is to provide for the screening of overseas investments in sensitive assets to ensure they provide a net benefit to New Zealand, while recognising that overseas investments bring significant economic benefits.

3.6 Advantages:

- Is clear on the restrictive nature of the screening regime
- Identifies more clearly what the safeguards are ie, screening
- Provides a statement on the benefits of investment for economic growth

3.7 Disadvantages:

- Does not clearly state the Government's general stance of welcoming foreign investment
- Focuses purely on economic benefits

Option 2

The purpose of this Act is to address community concerns about overseas investments into sensitive New Zealand assets, while maintaining an open and welcoming stance towards foreign investment generally.

3.8 Advantages:

- Is clear on the restrictive nature of the screening regime
- Identifies the Government's general stance towards foreign investment

3.9 Disadvantages:

- Does not identify what the community concerns are or how they will be addressed

Option 3

The purpose of this Act is to balance two objectives that occasionally conflict:

- a) Encourage the flow of foreign investment into New Zealand, to promote economic growth, job opportunities and additional spill-over benefits, and*
- b) Provide safeguards on investments in sensitive assets by overseas persons, to protect New Zealander's interests in relation to the control and ownership of New Zealand assets.*

3.10 Advantages:

- Identifies that there is a balance between objectives
- Provides additional context

- Puts Government's general stance first

3.11 Disadvantages:

- Identification of balancing act may overemphasise trade-offs
- Possibly excessively wordy
- Does not identify what the safeguards are
- Too focussed on economic benefits

Option 4

To provide safeguards for investments in sensitive assets by overseas persons, while generally maintaining an open and welcoming stance towards overseas investment.

3.12 Advantages:

- Puts the Government's general stance towards foreign investment front and centre
- Identifies restrictive nature of regime
- Identifies what is sought to be achieved by the regime

Preferred option

3.13 The Government considers that the purpose statement needs to be restated to reflect the changes to the body of the Act and the importance of foreign investment to New Zealand's economic development. The general stance of the Government is to be open and welcoming towards foreign investment. The current purpose statement does not adequately reflect this. It should continue to acknowledge, however, that there are some instances in which foreign investment should be restricted to ensure net benefit to New Zealand.

3.14 The Government considers that option four provides the most appropriate balance between emphasising the general approach to investment while acknowledging that the Act is providing some restrictions.

Change 3.1	Change the current purpose statement to Option 4 above.
<i>Dimension</i>	<i>Impact</i>
Simple	n/a
Predictable	n/a
Well-targeted	The new purpose statement better reflects the importance of overseas investment to New Zealand and that any restrictions on investment should be made with this in mind.

ANNEX: PURPOSE STATEMENTS OF OTHER COUNTRIES' REGIMES

Canada

- 3.15 Recognizing that increased capital and technology would benefit Canada, the purpose of this Act is to encourage investment in Canada by Canadians and non-Canadians that contributes to economic growth and employment opportunities and to provide for the review of significant investments in Canada by non-Canadians in order to ensure such benefit to Canada.

Australia¹⁸

- 3.16 The Government's approach to foreign investment policy is to encourage foreign investment consistent with community interests. In recognition of the contribution that foreign investment has made and continues to make to the development of Australia, the general stance of policy is to welcome foreign investment. Foreign investment provides scope for higher rates of economic activity and employment than could be achieved from domestic levels of savings. Foreign direct investment also provides access to new technology, management skills and overseas markets.
- 3.17 The Government recognises community concerns about foreign ownership of Australian assets. One of the objectives of the Government's foreign investment policy (the policy) is to balance these concerns against the strong economic benefits to Australia that arise from foreign investment.

¹⁸ Australia's Foreign Investment Policy, March 2009

4 WHO IS AN OVERSEAS PERSON?

Status quo

- 4.1 An overseas person is broadly defined in the Overseas Investment Act¹⁹ as:
- an individual who is neither a New Zealand citizen nor ordinarily resident in New Zealand, or
 - a body corporate that is incorporated outside New Zealand or is a 25% or more subsidiary of a body corporate incorporated outside New Zealand, or
 - a body corporate (A) if an overseas person(s) has 25% or more of any class of A's securities; the power to control the composition of 25% or more of A's governing body; or the right to exercise or control the exercise of 25% or more of the voting power at a meeting of A, or
 - a partnership, trust or unit trust (A) where 25% or more of A's partners or members are overseas persons or an overseas person or persons have a beneficial interest in or entitlement to 25% or more of A's assets.
- 4.2 A person is ordinarily resident if he or she holds a residence permit granted under the Immigration Act 1987 (or is exempt under that Act from holding that permit), and
- a) is domiciled in New Zealand, or
 - b) is residing in New Zealand with the intention of residing there indefinitely, and has done for the immediately preceding 12 months (has not been absent for more than 183 days in those 12 months).²⁰

Problem definition

- 4.3 The government considers that the current definition of an overseas person may subject some firms²¹ and persons to the Overseas Investment Act unnecessarily.
- 4.4 The ability of overseas persons to control sensitive New Zealand assets can lead to the public concerns about foreign investment that are discussed in paragraphs 1.4 to 1.7 of this document. There may be a case to alter the definition of an

¹⁹ This represents only a summary of the definition in the Act. Section 7 provides the full definition.

²⁰ The 183 day requirement is consistent with the Income Tax Act 2007, which defines a person as a New Zealand resident for tax purposes if they meet this test (among other things).

²¹ To aid discussion, 'firm' is used throughout this paper to refer to all the various ownership structures in the Act such as body corporates, partnerships, trusts and so on. Any changes to the threshold would affect all the definitions in the Act.

overseas person so that it is more effectively targeted at those persons whose control and ownership of New Zealand assets are likely to raise concerns.

4.5 Specifically, this section considers whether:

- the 25% threshold used in the definition above results in the right firms being screened, and
- a person who holds a residence permit (sometimes referred to as a permanent resident) should be screened if they are not ordinarily resident in New Zealand.

Determining whether a firm is foreign owned/controlled

4.6 The government is considering whether the 25% threshold used in the definition of an overseas person is sufficient to create overseas ownership or control of a firm. The current threshold means that firms with majority New Zealand control but widely held minority foreign ownership/control are treated as overseas persons and must seek consent each time they invest in sensitive assets. The government is concerned that the definition of an overseas person results in the unnecessary screening of firms that are majority New Zealand controlled.

4.7 The 25% threshold is also used in the definition of an investment in significant business assets²². The appropriateness of this threshold is addressed in paragraphs 4.24 to 4.37 of this document.

4.8 It is not straightforward to determine what level of overseas ownership or control means that a firm should be considered an overseas person. Where a firm is majority overseas owned/controlled it is clear that they should be considered an overseas person as overseas persons collectively have greater ownership or control than New Zealanders. However, lower levels of overseas ownership may still provide the ability to exert significant control which is why the current Act employs threshold lower than 50%. A person who holds 25% of a firm's voting power may have more influence over decisions if the remaining 75% ownership is dispersed across a number of owners who do not coordinate their voting decisions.

4.9 There is also a difference in the ability of one overseas investor with 25% of the voting rights of a company to exert control and 25 overseas investors who each control 1% of the voting rights. The 25 individuals must coordinate when making their voting decisions in order to exert the same degree of influence that the single owner has. This is one reason why it may not be necessary to screen firms that have widely held minority foreign ownership.

²² An investment in significant business assets includes the acquisition by an overseas person of a 25% or more ownership or control interest in a firm where the value of the consideration provided exceeds \$100 million. Refer to Section 13(1) of the Act for a full definition.

Which firms are currently targeted?

4.10 Many firms that are listed or headquartered in New Zealand have foreign shareholdings of over 25% and are therefore considered to be overseas persons:

- As at March 2007, 37% of NZX-listed equity was overseas held. Of the top 40 companies, 8 had 25-49% ownership, and a further 7 had >50% ownership. *[withheld - protect information which is subject to an obligation of confidence]*
- Statistics New Zealand data shows that 7577 firms were 25% or more overseas owned, as at February 2008. This represents only 2% of all New Zealand firms by number, but is likely to include some of our biggest firms as they account for 18% of all firms' employees.²³

4.11 *[withheld - protect information which is subject to an obligation of confidence]*

4.12 The Capital Market Development Taskforce, law firms who act for investors, and affected firms have raised concerns that the 25% threshold used under the Act is too low and captures too many firms. Being treated as an overseas person means firms must seek consent before they purchase sensitive assets in New Zealand. This requirement creates compliance costs, including the cost of delay to business activity, the cost of preparing and submitting an application and the cost of complying with any conditions of consent. Being treated as an

²³ Statistics New Zealand, Business Demographics Database

overseas person could, at the margin, be a disincentive to a firm remaining listed or headquartered in New Zealand. The government wishes to make sure that the screening regime is correctly targeted so that these costs are not borne by more firms than necessary.

- 4.13 The table below shows the degree of overseas ownership/control of applicants who sought consent to invest since 2004. 87 of these applicants were less than 50% overseas owned or controlled. This corresponds to 11% of all applicants over the period. The large majority (75%) of applicants were 90% or more overseas owned/controlled.

Level of overseas ownership/control	Number of applications	Applications where one overseas person controlled >25%
0%-25%	36	0
25%-30%	6	0
30%-40%	18	0
40%-50%	27	1
50%-60%	44	-
60%-70%	29	-
70%-80%	19	-
80%-90%	24	-
90%-100%	610	-
Total	813	

- 4.14 The data shows that a relatively small proportion of investments that require consent are from applicants who are less than 50% overseas owned or controlled. However, only in one of those cases was the applicant 25% owned or controlled by a single overseas person. This leads us to conclude that most firms with less than 50% overseas ownership/control are being screened because they have multiple overseas persons with small ownership/control stakes, rather than one person who controls more than 25%.

Should residents be subject to screening?

- 4.15 The Act allows holders of a residence permit (also known as permanent residents) to be exempt from screening as long as they are domiciled or intend to reside indefinitely in New Zealand (and not be absent for more than 183 days). In some cases people may hold a residence permit with conditions, such as the requirement to maintain an investment in New Zealand for four years. Holders of conditional residence permits would be exempt from screening if they are not absent from in New Zealand for more than 183 days.

- 4.16 Unconditional residence permit holders have most of the rights and privileges of a New Zealand citizen.²⁴ Nevertheless they would still be subject to screening if they reside outside of New Zealand for more than 183 days. Since most of the unconditional residence permit holders are able to live here indefinitely, it is not clear why they should potentially be treated as an overseas person when purchasing assets (such as property) in New Zealand. To do so appears to conflict with the immigration objectives of attracting migrant investors.
- 4.17 In general most unconditional residence permit holders reside in New Zealand for at least half of the year and therefore are ordinarily resident. The OIO estimates that around two investment applications since 2000 would have been from residents who do not meet the test of being ordinarily resident.

Possible solutions

Residents

- 4.18 One option for addressing the problem of residents being screened is to revoke the ordinarily resident requirement for those who are entitled to reside indefinitely in New Zealand. This change would be more consistent with the commitment to New Zealand shown by that person and would signal that the government considers residents have strong ties to New Zealand. This would also be similar to the case of New Zealand citizens who are not screened but may not necessarily be ordinarily resident.
- 4.19 The practical effect of this change is likely to be small given that most residents meet the test of being *ordinarily resident* in New Zealand. As noted earlier the OIO estimates that around two investment applications would have been avoided since 2000, if such a change was made.
- 4.20 This option would still screen some holders of conditional residence visas which may cause frustration for those people. For example the new Investor Migrant Policy allows people who invest \$10 million in New Zealand equity or bonds to be granted conditional residency as long as they are in New Zealand for 20% of the year. Holders of these visas would still be screened because they would not meet the ordinarily resident test.
- 4.21 Some sections of the public may consider that residents should not be able to invest or purchase land until such time as they become New Zealand citizens. However, residents are already exempt from screening if they meet the domiciled and residence test, so explicitly exempting all residents does not represent a large policy shift.
- 4.22 Looking at overseas examples, Canada exempts permanent residents from its screening regime so long as they have been ordinarily resident in Canada for not

²⁴ Privileges they are excluded from include the ability to hold a New Zealand passport, receive some educational scholarships, or represent New Zealand in some international sports

more than one year after the time when they first became eligible to apply for Canadian citizenship. Australia applies an ordinarily resident test that is similar to the current regime in New Zealand.

Preferred option

4.23 The government proposes to exempt persons who hold a New Zealand residence permit from screening because they are entitled to reside in New Zealand indefinitely. The fact that some residents are undertaking significant investments here signals the level of commitment they are making to New Zealand. Removing the requirement for residents to be domiciled and resident in New Zealand for more than 183 days will assist them to further invest and develop ties to New Zealand. While this change to the definition of an overseas person will affect relatively few investors, the government considers that it will create a better targeted screening regime.²⁵

Change 4.1	Exempt holders of a New Zealand residence permit from screening.
<i>Dimension</i>	<i>Impact</i>
Simple	n/a
Predictable	Improved certainty for investors as they will know that obtaining residence will exempt them from screening.
Well-targeted	Concerns about overseas investors generally relate to investors who are not able or intending to reside in New Zealand permanently. Around two investors would no longer be screened and compliance costs for those investors would be reduced accordingly.

Determining whether a firm is foreign owned/controlled

Thresholds for ownership/control

4.24 The current Act uses a 25% threshold across the various definitions of an overseas person. However, there is no single way of determining the 'right' threshold that defines whether a firm is overseas owned or controlled. The table below outlines some examples of how ownership and control is defined in other legislation and jurisdictions:

	Definition
Reserve Bank Act	<p>This Act uses both 10% and 25% when defining 'significant influence', in relation to a registered bank:</p> <ul style="list-style-type: none"> a) the ability to directly or indirectly appoint 25% or more of the board of directors of a registered bank; or b) a direct or indirect qualifying interest in 10% or more of the voting securities issued or allotted by a registered bank. <p>This definition only applies to one person, rather than a group with 10% or 25% control.</p>

²⁵ Any changes to this section of the Act will need to consider how to take into account proposals in the Immigration Bill to introduce a new permanent residence visa that will provide holders with the ability to reside in New Zealand indefinitely.

	Definition
Companies Act 1993	The directors of a company are appointed by an ordinary resolution (majority of shareholders), unless otherwise specified in the company's constitution. The Act also specifies that special resolutions can only be passed with the approval of 75% of the shareholders. Special resolutions are required to approve takeovers and amalgamations, for example. Overseas companies cannot register (incorporate) in NZ without 75% approval by shareholders.
Takeovers Code	Regulates takeover transactions at a threshold of 20% of voting rights in the target company.
Australia (Foreign Acquisitions and Takeovers Act)	A controlling interest occurs when a single foreigner (and any associates) has 15% or more of the ownership or, several foreigners (and any associates) have 40% or more in aggregate of the ownership of any corporation, business or trust.
Canada (Investment Canada Act)	An entity where non Canadians own 50% or more of the voting interests is considered an overseas person. ²⁶
International Monetary Fund	The IMF uses a 10% threshold when distinguishing between portfolio investment and foreign direct investment.

4.25 The table suggests that in a New Zealand context, a single shareholder who owns/controls more than 25% of a firm does have a degree of control. An example of this control is provided under the Companies Act where they are able to veto special resolutions. Special resolutions can relate to important matters such as making changes to company constitutions and approving amalgamations. This ability to veto a special resolution most strongly applies to the situation where one person holds more than 25% of the voting rights, as they are able to act individually. Where a number of shareholders collectively hold more than 25% of the voting rights, it may be more difficult for those shareholders to veto a special resolution, as they must act in concert to achieve the same outcome.

Possible thresholds

4.26 There are three options to better target the Act at the firms who we consider are overseas persons:

1. *Raise the current threshold*

4.27 The 25% threshold could be increased to reduce the number of firms that are subject to screening. However, as this threshold becomes higher, it is unable to screen ownership/control stakes (such as 25%) that can result in the ability to exercise some control over a firm.

²⁶ http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk00071.html#partV

2. *Distinguish between control by a single shareholder and many shareholders*

- 4.28 This option would be similar to the Australian regime and employ two thresholds. One threshold would consider ownership/control by a single overseas person, and the other ownership/control by two or more overseas persons.
- 4.29 Firms with overseas ownership/control beyond a certain level by **one** overseas person would also be considered an overseas person. Firms with overseas ownership/control number by two or more foreign shareholders would be subject to a higher threshold before they are considered an overseas person.
- 4.30 Such a system has the advantage of recognising that one overseas person with 25% control is more likely to be able to exercise control than 25 overseas persons each with 1% control.
- 4.31 This dual threshold system could be applied to all the ownership structures listed in the Act – body corporates, partnerships, and trusts. However it would require careful drafting particularly in the case of trusts, to ensure that it takes account of overseas persons with the power to veto changes to trust deeds or governing bodies.
- 4.32 The main downside of this dual threshold is that it may introduce additional complexity into the regime as there is no longer a single threshold for determining overseas control. There is also a potential problem of evasion under this option if overseas persons are associated. For example, if two associated overseas investors each acquired 15% in a significant business asset they would not be screened, unless an associate test were applied.

3. *Provide exemptions for firms with minority levels of foreign control*

- 4.33 The Act could be amended to allow for exemptions from screening to be provided to certain firms who have minority foreign ownership stakes. Possible criteria for any such exemptions are outlined in the table below. These criteria are indicators of a firm's ties to New Zealand and would allow for the exemption of firms that would otherwise be subject to the Act. However, as noted in the table, many of them would create the potential for firms to evade the Act.

Basis for exemption	Analysis
Locally headquartered	A firm could set up an administrative centre or rent premises to avoid the application of the Act. Local headquartering does not necessarily result in local control as key strategic decisions could be made offshore.
Company Board is majority New Zealand controlled	Firms could appoint local directors and still maintain control to avoid the application of the Act.
Locally incorporated	Overseas firms could invest through a 100% owned local subsidiary.

Basis for exemption	Analysis
<p><i>If foreign ownership/control by one overseas person does not exceed 25% and control by two or more overseas persons does not exceed 49%</i></p>	<p>Difficult to evade. Acknowledges that large but minority control interests held by a single person can result in control. Ensures majority foreign owned/controlled companies are subject to screening. Would not allow for the exemption of firms who are majority foreign controlled even if that control was dispersed amongst a number of overseas persons.</p>

- 4.34 Given the potential for these criteria to create opportunities for evasion, it would be necessary to use a number or all of these criteria in any exemption scheme to minimise this risk.
- 4.35 The main downside of an exemption based solution is that in practice it may be difficult to design exemptions that are wide enough to cover all possible future situations or scenarios. There may be practical difficulties in extending this type of exemption from body corporates to other ownership structures such as partnerships and trusts.

Preferred option: Determining whether a firm is foreign owned/controlled

- 4.36 The government's preferred option is to retain the existing 25% threshold and rely on the existing provisions in the Act for granting exemptions to overseas investors.
- 4.37 Option two has many theoretical benefits, but there are several practical reasons why it would be difficult to implement:
- An associate test would be needed to make sure that overseas investors do not evade the Act;
 - Implementing an associate test is difficult as companies do not always know whether or not their shareholders are associated.
- 4.38 Moreover, the benefits from a shift to a dual threshold are not likely to be large as they would make a difference to only a small proportion of significant business applications.

5

POLICY CHANGE BY REGULATION

Status quo

- 5.1 The Overseas Investment Act allows regulations to be made to the factors that must be considered when assessing whether an investment in sensitive land will, or is likely to, benefit New Zealand.

Problem definition

- 5.2 This ability was used most recently in 2008 when the Canadian Pension Plan Investment Board sought consent to purchase a stake in Auckland Airport (AIAL). A new regulation was added which allowed Ministers to consider whether an investment in sensitive land “would or is likely to assist New Zealand to maintain New Zealand control of strategically important infrastructure on sensitive land”. In this particular case, Ministers did not consider that the investment would or would be likely to provide benefit to New Zealand and declined the application for this reason.

A complaint was made to the Regulations Review Select Committee...

- 5.3 In the wake of the decision to add the strategically important infrastructure factor, a complaint was made to the Regulations Review Committee²⁷. The complaint was made on five grounds:
1. the regulation trespasses unduly on personal rights and liberties;
 2. the regulation appears to make some unusual or unexpected use of the powers conferred by the statute;
 3. the regulation unduly makes the rights and liberties of persons dependent upon administrative decisions which are not subject to the review of their merits by a judicial or other independent tribunal;
 4. the regulation contains matters more appropriate for parliamentary enactment; and
 5. the regulation is retrospective where this is not expressly authorised by the empowering enactment.

²⁷ The report of the Regulations Review Committee can be viewed in full at http://www.parliament.nz/enNZ/SC/Reports/e/3/4/48DBSCH_SCR4225_1-Complaint-regarding-the-Overseas-Investment-Amendment.htm.

- 5.4 Of these five grounds, the complainants' view was upheld (at least partially) on matters two and three. On matter number two, the Committee found the following:

"Regulating a sensitive asset that is more correctly regarded as a significant business asset under the sensitive land category constitutes an unusual use of the regulation-making power...Our view is that adding strategically important infrastructure to the section 17 criteria introduces significant new policy considerations. Using regulations to do so constitutes an unusual and unexpected use of the regulation-making power."

- 5.5 On matter number three, the Committee found that:

"We consider that section 17(2)(g) is an undesirable regulation-making power. It is a form of Henry VIII clause which permits regulations to add to the factors that may be statutorily taken into account in the decision-making process...The regulations are effectively amending primary legislation."

And went on further to note that "...the proliferation of clauses similar to this is cause for concern. Since receiving this complaint, this committee has consistently advised select committees against including similar provisions in bills without appropriate safeguard. We will continue to do so."

...which made recommendations...

- 5.6 The Regulations Review Committee recommended that steps to be taken "to ensure that primary legislation does not allow regulations to be made adding factors or criteria listed in primary legislation, where such factors or criteria are to be taken in to account in Ministerial decision-making" and to "introduce legislation amending the Overseas Investment Act 2005, either to omit section 17(2)(g), or to add to section 17(2)(g), a requirement to consult with relevant parties."

...providing evidence of a problem.

- 5.7 One of the primary goals of the review of the Act is to ensure our screening regime for overseas investment is predictable. A screening regime is less likely to discourage or distort investment decisions if there is a high degree of certainty that the rules under which investment applications are made will not change unexpectedly as the application is processed. The ability to change the factors used to assess sensitive land applications creates a level of unpredictability for investors.
- 5.8 The usage of this ability in 2008 was a high profile occurrence which has created uncertainty around the predictability of the rules for overseas investment in New Zealand. *[Withheld - prejudice the entrusting of information to the Government of New Zealand on a basis of confidence].*
- 5.9 Two major problems arise from the ability to make regulations that change the factors used to assess sensitive land investments:

1. **It undermines the predictability of the investment environment.** The rules under which an investment application is being considered can be substantively changed at any point while an application is being considered. The ability for Ministers to act flexibly in response to particular investment applications needs to be weighed against the need for predictability in the investment environment.
2. **Substantive policy changes can be made by regulation** when they should more appropriately be made through legislative changes. This effectively allows primary legislation to be altered by the addition of regulations which may undermine the intention of the original primary legislation. When policy changes are made by regulation they are approved by the Executive Council which provides a much lower level of scrutiny than a change made legislatively. Legislative change requires the consent of Parliament and thus creates a much higher threshold for any changes to be made.

Free Trade Agreements and the Act

- 5.10 In reviewing the Act, the government has considered commitments we have already made in international agreements (including Free Trade Agreements, FTAs) or may make in the course of FTA negotiations currently underway or in prospect. Where the Act has been reserved against in the schedules of reservations (which indicate the areas of domestic policy the FTA does not apply to), Agreements such as the P4 agreement or the Global Agreement on Trade in Services (GATS) allow for the ability to make changes to the criteria that are used to assess investment applications. However they do not allow for additional categories of investments to be screened. In other words screening cannot be extended beyond significant business assets, sensitive land and fishing quota where stated in an FTA, unless amendments to these categories decrease, rather than increase, the restrictions on foreign investment.

Options

- 5.11 The options outlined below aim to improve the predictability of the investment environment. In order to address the problems created by sections 17(2)(g) and 61(1)(d) - unpredictability and inappropriate amendment of primary legislation - the options outlined in this section trade off levels of certainty in the investment environment with flexibility for Ministers to respond to particular investment applications that concern them, where those concerns are not able to be addressed by the current factors to be considered in assessing an application from an overseas investor.

a) Remove the ability to add factors by regulation

- 5.12 Removing the ability to make regulations that add to the factors considered in a sensitive land application would ensure predictability for investors that the rules for investment applications will not be changed, particularly once applications have been lodged. Investors could expect reasonable notice of any policy

changes being made and adjust their plans as necessary, as changes would need to proceed through the normal legislative process.

- 5.13 A draw-back of this option would be the loss of flexibility for Ministers to act quickly in response to particular investment applications – any changes would need to be made through legislative processes which are generally much slower. Additionally, the options for making legislative changes would be limited by the FTA commitments we have made.
- 5.14 Consideration would also need to be given to what would happen to regulations that already exist under regulation 28. They would need to be moved back in to the Act if they were still to apply.

b) Add a requirement to consult with relevant parties

- 5.15 Ministers could be required to consult with relevant/involved parties before any regulations are made that add to the factors considered in sensitive land applications. Such a requirement would mean that those affected by additions to the factors have the opportunity to comment and advise how it would affect them.
- 5.16 Consideration would need to be given to how this would be practically implemented, as there would need to be some level of assurance that adequate consultation had been undertaken before changes were decided upon. It may also be difficult to determine who should be consulted on any changes.
- 5.17 A requirement to consult would improve the transparency and awareness of any changes to the factors used to assess investments in sensitive land. It also allows Ministers to retain some flexibility to change the factors relatively quickly if they choose. However it would not necessarily improve investor certainty as it does not stop changes from being made at short notice.

c) Exempt any applications under consideration from the effect of regulation changes

- 5.18 An additional problem with the ability to add factors to the regulations (beyond the adverse effect it will have upon transparency and predictability) is that it may result in an investor finding the factors used to assess their application have changed after the application has been submitted. In order to provide more predictability for investors, the Act could be altered to require that any regulation changes do not apply to applications already submitted to the OIO. Thus the current regime would be locked in for applications which have already been submitted and any changes would only apply to applications submitted after the regulatory change has been approved.
- 5.19 Additional certainty could be provided by requiring that any regulation changes come into effect after a certain period, such as three months. This would mean investors in the process of preparing applications would not be affected by the regulation changes.

5.20 The key drawback of this option is that it reduces the flexibility of Ministers to respond to particular applications about which they may have significant concerns. Ministers would be able to consider any new factors in future applications, however they would not be able to be applied in the assessment of any current applications.

d) Status Quo

5.21 Some consideration needs to be given to retaining the current ability to add to the factors considered in the assessment of sensitive land applications. While its recent high profile usage has led to a perception of unpredictability in New Zealand’s investment screening regime, the current arrangements could equally be used to assist overseas investment. For example, factors could be added that would make it easier for a particular applicant to show that their investment benefits New Zealand.

5.22 As noted elsewhere the major consequence of removing these sections would be the loss of flexibility for Ministers to act in response to particular overseas investment applications that caused them concern, where those concerns were not already able to be addressed within the current framework.

Analysis

Option	Pros	Cons
Option 1 - Remove the ability to add factors by regulation	Predictability for investors or reasonable warning when a substantive policy change is being made.	Loss of flexibility for Ministers to act quickly when a certain situation arises.
	Substantive changes will have to be progressed through primary legislation.	Any changes would have to be made through primary legislation which is a much more time consuming process.
	Legislative changes need to be approved by Parliament which creates a higher hurdle for changes to be made.	
Option 2 - Add a requirement to consult with relevant parties	Investors would receive some warning of any changes to be made.	A substantive policy change could still be made, even after all parties are consulted.
	Investors would have some input into the decision making process.	Since substantive changes can still be made, the rules under which applications are made can still change while an application is being considered
	Ministers retain ability to act flexibly on a case-by-case basis with applications	Options to make legislative changes may be limited due to our international obligations. Removing the clause limits the options to make changes without breaching these obligations.
		Consultation can be an onerous process which may add to the delays and costs the government is trying to minimise.
		It can be hard to identify “relevant parties”, especially when the asset is nationally significant. Failure to consult properly could lead to judicial review.
	Changes to primary legislation via secondary legislation can be made by the Executive Council, rather than the Parliament. This creates a much lower threshold for changes to be made.	

Option	Pros	Cons
Option 3 - Any changes made by regulation do not apply to applications which have already been lodged	Predictability for investors while a particular application is lodged that the rules will remain the same.	Any changes made via regulation will apply to future applications only.
	Ministers retain some ability to act flexibly on a case-by-case basis with applications.	There are still likely to be issues with the general regulation-making power from the Bill (i.e. the current s17(2)(g)) on the basis of the Regulation Review Committee's comments.
		Changes to primary legislation via secondary legislation can be made with the need to consult on the Executive Council, rather than the whole of Parliament. This creates a much lower threshold for changes to be made.
Option 4 - Status quo	Ministers retain ability to act flexibly on a case-by-case basis with applications.	Although used infrequently, retaining the clause still means that it can be used. This creates an unpredictable environment for investors in that a substantive policy change may be made at any point.
	Options to make legislative changes may be limited due to our international obligations. Retaining the clause provides an option to make changes without breaching these obligations.	Substantive policy changes can still be made via regulation, thus undermining the intent of primary legislation.
	Retention of ability to make changes via regulation which make it easier for investment to take place.	Changes to primary legislation via secondary legislation can be made with the need to consult on the Executive Council, rather than the whole of Parliament. This creates a much lower threshold for changes to be made.

Preferred option

- 5.23 The government places a greater level of importance on the need to create a predictable investment screening regime than on the need to retain flexibility for Ministers to react to particular investments. If there is a need to amend the criteria used to assess investments in future, the government is comfortable with making alterations to the legislation.
- 5.24 Removing sections 17(2)(g) and 61(1)(d), and potentially moving the regulation 28 factors into the Act, would create a maximum level of predictability for investors. It would also place the emphasis on ensuring that the criteria under which overseas investment applications are considered appropriately address concerns around overseas investment. Additionally, where substantive changes do need to be made, good practice should be followed in making changes via legislation rather than by regulation.
- 5.25 Taking these considerations into account, option 1 – removing sections 17(2)(g) and 61(1)(d) from the Act – is preferred.

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Change 5.1	Changes to the factors/criteria considered when assessing sensitive land applications can only be made through legislation, rather than regulation.
<i>Dimension</i>	<i>Impact</i>
Simple	n/a
Predictable	Improved predictability and certainty for investors who will have advanced warning of any changes to the criteria used to assess their applications.
Well-targeted	n/a

6 BUSINESS ASSET SCREENING

Status quo

6.1. Overseas investments in significant business assets are defined in section 13 of the Act as:

- The acquisition by an overseas investor of rights and interests in securities²⁸ of a business entity if
 - as a result of the investment, the overseas investor has a 25% or more ownership or control interest in the business entity, or an increase in an existing 25% or more ownership or control interest in the entity; and
 - the value of the securities or the consideration provided, or the value of the assets of A and its 25% or more subsidiaries exceeds \$100 million; or
- the establishment by an overseas investor of a business in New Zealand if
 - the business is carried on for more than 90 days in any year (whether consecutively or in aggregate); and
 - the total expenditure expected to be incurred, before commencing the business, in establishing that business exceeds \$100 million; or
- the acquisition by an overseas investor of property in New Zealand used in carrying on business in New Zealand if the total value of consideration provided exceeds \$100 million

6.2. In simpler (but less legally accurate) words, an investment made by an overseas investor is screened in any of the following three cases:

- investment in an *existing business*, where *both* (i) the share is 25% or more *and* (ii) *either* the value of that share is over \$100 million, *or* the assets of the target investment are more than \$100 million;
- investment in a *new business*, where the value of the new business is over \$100 million; or
- investment in *property used for business*, where the value of the property is over \$100 million.

²⁸ The term "security" is defined in section 6(1) of the Overseas Investment Act 2005 and includes a share in a company or other body corporate, a unit in a unit trust, an interest in a partnership or unincorporated joint venture.

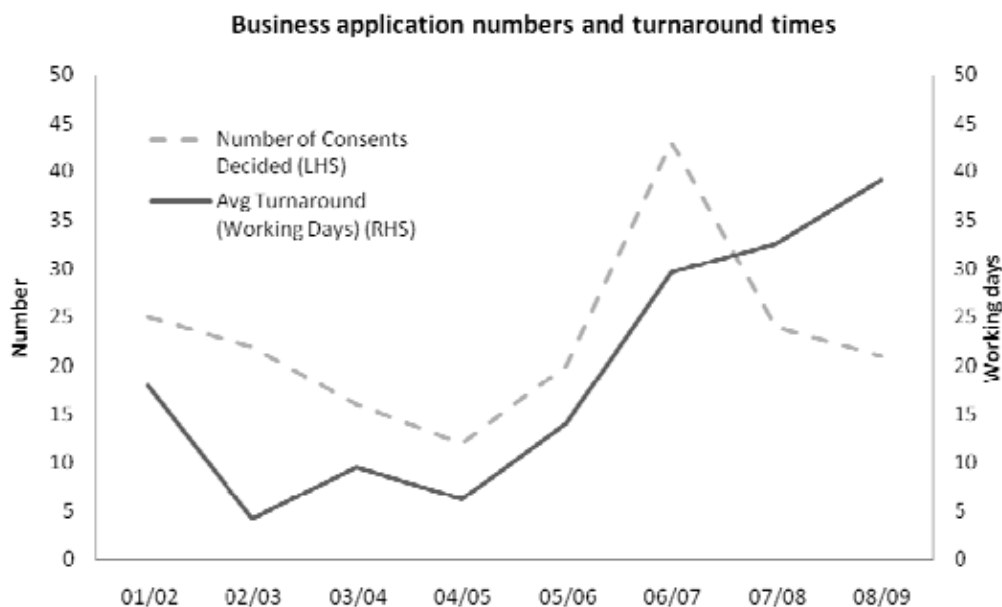
6.3. For consent to be granted to an investment by an overseas investor in a significant business asset they must satisfy the following four criteria:²⁹

- business experience and acumen relevant to the overseas investment;
- financial commitment to the overseas investment;
- that they are of good character; and
- that they are not an individual of the kind referred to in section 7(1) of the Immigration Act 1987.

Problem definition

a) Applications and Screening Times

6.4 Screening of significant business assets has made up, on average, 12% of all applications between 2002 and 2008 (excluding those which involve both business and sensitive land). Under the screening regime, 338 applications were received in the period from 1 July 2001 to 30 June 2009. Over this period, there were no applications declined and consent was granted to 87% of applications received. The remaining 13% of applications were either withdrawn, did not require consent or lapsed. No significant business asset application has been declined since 1984.



6.5 Since the Overseas Investment Act 2005 came into force, processing times for applications have increased significantly. This increase is due to the changes made to the criteria for consent for sensitive land in 2005 (which meant that

²⁹ Refer to sections 18 and 19 of the Act for a full description.

sensitive land applications became significantly more complex to assess) and staff shortages with the Overseas Investment Office. This resulted in backlogs and delays in assessing all types of applications. The substantial increase in significant business asset applications (likely due to increased merger and acquisition activity, primarily driven by private equity interests), which peaked in 2006/07 was not anticipated, and added to the delays.

b) Focus of the review

6.6 The Government wishes to ensure that the current screening regime for business assets is correctly targeted at those assets that are considered particularly significant to New Zealand. Several areas are explored below to ensure that business screening is well targeted:

- the percentage ownership or control threshold applied to business investments
- the monetary value threshold applied to overseas investments in significant business assets
- whether screening of greenfields³⁰ significant business assets is appropriate
- the requirement for an overseas investor who has already received consent to acquire securities, to apply for a new consent when seeking to increase their stake in a significant business asset, and
- the requirement of an overseas investor to apply for consent when purchasing assets from another overseas investor who was previously granted consent.

Percentage ownership/control threshold

6.7 Definitions of foreign direct investment vary internationally. The OECD defines a direct investment enterprise as one in which a foreign investor owns 10% or more of the ordinary shares or voting power.³¹ Canada³² uses a threshold of 33% or more for the acquisition of control of corporations.

6.8 The requirement for screening is triggered only if both the 25% ownership or control threshold and the \$100 million threshold is exceeded (where the threshold can be exceeded in two different ways – either by the value of the purchase being over \$100 million or the assets of the target investment being over \$100 million). Consequently, altering the monetary value threshold also changes the scope of businesses screened.

³⁰ The term “greenfields” refers to investment in setting up a new business from the ground up, as opposed to “brownfields” investment which is investment in pre-established businesses.

³¹ OECD Benchmark Definition of Foreign Direct Investment, Third Edition www.oecd.org/dataoecd/10/16/2090148.pdf

³² Refer section 28(3) of the Investment Canada Act.

- 6.9 Any changes to the 25% threshold would need to be considered in the context of New Zealand's international obligations. The 25% threshold has been specifically mentioned in our WTO GATS commitments and in some FTAs (e.g. the P4 schedules), and so the Government cannot lower the threshold for countries to whom these agreements apply. In addition, a lower percentage threshold could add another layer of complication and potentially encourage investors to structure themselves to be an investor from a country with a pre-existing investment FTA chapter with New Zealand.
- 6.10 Based on the above considerations, the Government does not see a strong case for altering the 25% ownership or control threshold and thus does not propose any alterations.

Monetary value threshold

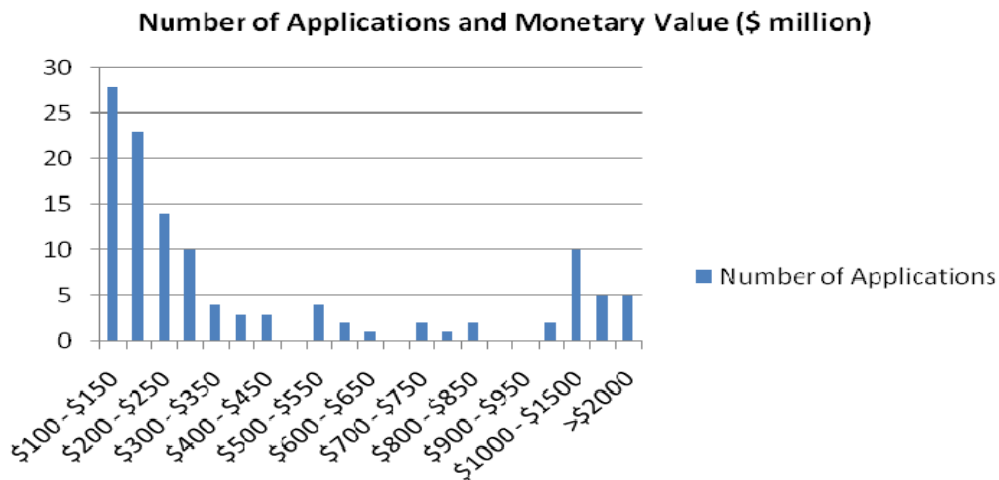
a) Core trade-offs

- 6.11 The three main trade-offs to consider when assessing an increase in the threshold are:
- *Capturing **significant** business assets.* The threshold determines how many business investments will be screened at all. The judgement to make is what level equates to capturing investments (and only those investments) that are considered genuinely 'significant' to New Zealand.
 - *[Withheld - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements].*
 - *Investor cost implications.* Screening investments has both a time and financial cost to investors. A higher threshold would reduce application volumes and, other things being equal, potentially reduce the time and/or cost to investors.³³ The judgement here is the relative importance of these costs to the attractiveness of New Zealand as an investment destination.

Historical OIO data

- 6.12 The chart below outlines the number of applications for consent received by the OIO in \$50 million brackets for the period 2005-2009. On average, 37 investments have been screened per year since 2005.

³³ Whether lower volumes resulted in lower time or cost to investors would depend on trade-offs made between staff levels for the regulator, fee levels for investors, and processing times that could be achieved.



Data on New Zealand’s largest companies

6.13 *New Zealand Management* magazine publishes data on the top 200 New Zealand companies. The table below is based on the most recent survey (December 2008 issue) and lists the largest 50 companies in New Zealand, ranked by total equity. The ownership column indicates whether the company is a co-operative (Co-op), a state-owned enterprise (SOE), listed on the New Zealand stock exchange (NZSX), and majority foreign controlled (*).

Rank	Company Name	Ownership	Total Equity (\$000s)	Rank	Company Name	Ownership	Total Equity (\$000s)	Rank	Company Name	Ownership	Total Equity (\$000s)
1	Housing New Zealand		12,296,000	18	Watercare Services		1,275,144	35	Millennium & Copthorne Hotels New Zealand	NZSX*	510,261
2	Fonterra Co-operative Group	Co-op	4,269,000	19	TrustPower	NZSX	1,257,326	36	Sanford	NZSX	504,468
3	Meridian Energy	SOE	4,204,632	20	Sky Television	NZSX*	1,181,658	37	PGG Wrightson	NZSX	480,501
4	Contact Energy	NZSX*	2,904,071	21	Kiwi Income Property Trust	NZSX	1,135,240	38	SKYCITY Entertainment Group	NZSX	472,355
5	Fletcher Building	NZSX	2,756,000	22	Goodman (NZ)	NZSX	1,085,800	39	Oregon Group	*	453,035
6	Telecom Corporation of New Zealand	NZSX*	2,736,000	23	RTA Pacific (NZ)	*	1,038,232	40	New Zealand Breweries	*	445,817
7	Mighty River Power	SOE	2,257,650	24	Orica Investments (NZ)	*	838,087	41	Wilson & Horton	*	445,361
8	Vector	NZSX	1,901,324	25	Shell New Zealand Holding Company	*	837,531	42	Kura		442,284
9	Auckland International Airport	NZSX	1,896,633	26	Metro Water		715,606	43	Goodman Fielder New Zealand	NZSX*	437,709
10	Tasman Steel Holdings	*	1,794,670	27	Fulton Hogan		713,491	44	Telstra New Zealand Holdings	NZSX*	420,034
11	Air New Zealand	NZSX	1,577,000	28	New Zealand Post	SOE	666,612	45	Ports of Auckland		398,106
12	Infratil	NZSX	1,470,400	29	Fisher & Paykel Appliances Holdings	NZSX	646,448	46	Ryman Healthcare	NZSX	372,204
13	Landcorp Farming	SOE	1,448,658	30	Foodstuffs (Auckland)	Co-op	642,093	47	Solid Energy NZ	SOE	368,445
14	Genesis Energy	SOE	1,406,773	31	Port of Tauranga	NZSX	639,210	48	Nuplex Industries	NZSX	365,061
15	Christchurch City Holdings		1,404,455	32	The New Zealand Refining Company	NZSX	617,277	49	Toll NZ	NZSX*	357,849
16	WOW (NZ) Supermarkets	*	1,321,277	33	Chevron New Zealand	*	532,874	50	Mediaworks NZ	NZSX	352,622
17	Transpower New Zealand	SOE	1,307,489	34	Fairfax New Zealand Holdings	*	531,923				

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6.14 Based on this data, it is possible to give an indication of how many of these companies would be screened under different investment stakes and screening thresholds. Several caveats should be borne in mind:

- investments in many of these companies would still be subject to sensitive land screening, even if they would not be subject to business screening;
- many of the companies are currently owned by central or local government, or in private ownership, so the exercise is indicative only; and
- some of these companies have been granted an exemption from the provisions of the Overseas Investment Act (Infratil and TrustPower).

6.15 Within these caveats, the table below indicates how many of the top 200 companies would be screened under different monetary value screening thresholds. The table is split into two parts to reflect the two aspects of the threshold test:

- *Based on equity stake.* The 25% column shows the minimum number of companies that would be screened, as at least 25% of a business must be purchased for the investment to be screened. However the actual number of business investments that are screened is likely to be higher, because investment stakes of more than 25% will be more likely to exceed the relevant dollar threshold. For example an investment that results in 25% control of a \$200 million company would not be captured by this part of the test (given the investment is worth \$50 million). However an investment that resulted in 50% control of the company would be captured (given the investment is worth \$100 million).
- *Based on total assets.* This column simply shows the number of companies with total assets of more than the threshold. These companies would be screened if an investment were made of more than 25%.

Threshold	Based on equity stake				Based on total assets
	25%	33%	50%	100%	
\$m					
100	44	54	70	110	170
150	32	38	54	86	146
200	25	32	44	70	127
250	23	25	36	63	108
300	19	23	32	54	99
350	15	22	27	50	89
400	10	19	25	44	79

b) Threshold options

- 6.16 Four potential options for the screening threshold are listed below, with the reduction in business applications as indicated, based on historical data (note that some investments may still be subject to screening as sensitive land).

Threshold	Reduction
\$100 million (status quo)	0%
\$200 million	43%
\$250 million	55%
\$300 million	63%
\$400 million	69%

c) Preferred Option

- 6.17 The Government considers that the threshold should be raised to \$200 million for all three parts of business screening (existing businesses, new businesses, and property used for business). This threshold applies a higher test to what is considered a significant business asset but the government believes that this threshold ensures that the regime is well targeted at assets which really are significant to New Zealanders. The government has also taken into account the fact that any investment will still be subject to New Zealand domestic laws, and the fact that a number of applications not captured under the business screening section may be screened as they contain sensitive land.
- 6.18 The economic benefits which we would expect to see are difficult to quantify as evidence around investors who have been deterred by the current regime is not readily available. The main benefit on which we place significant weight is the demonstration effect of raising the threshold - it indicates that New Zealand is 'open for business' and wants to actively encourage investment. This, combined with the added benefit for investors of a potential reduction in screening times with fewer applications needing to be screened, has the potential to produce benefits to New Zealand.
- 6.19 *[Withheld - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements].*

Change 6.1	Raise the screening threshold for investment in significant business assets from \$100 million to \$200 million.
<i>Dimension</i>	<i>Impact</i>
Simple	n/a

Predictable	n/a
Well-targeted	Around 20% fewer applications per year which results in reduced compliance costs for around 25 investors per year.

Screening greenfields applications

- 6.20 The Act screens investment in the establishment of new businesses (greenfields investment). Such screening may not be well targeted, since community concerns tend to be more closely related to investment in existing businesses rather than in new businesses.
- 6.21 However, ensuring that overseas investors in significant businesses meet the tests of good character and business acumen are still relevant, even if the businesses are new rather than existing. It is also worth noting that no applications for greenfields investment have ever been received.
- 6.22 Consequently, the Government does not see a strong case for modifying or removing screening for greenfields investment, apart from the change in threshold outlined above.

Criteria for consent for investments in significant business assets

- 6.23 Currently business investment applications are screened under the following criteria which aim to test that:
- the investor has relevant business acumen
 - the investor has demonstrated a financial commitment to New Zealand
 - the investor is of good character, and
 - the investor is not a person of a kind referred to in section 7(1) of the Immigration Act 1987.
- 6.24 These criteria target the investor's suitability to invest in New Zealand. The guidance on how to fulfil these criteria is provided on the OIO website³⁴. In short:
- *Business acumen*. The OIO requires the investor to have the practical knowledge and ability relevant to the investment they intend to make. This includes:
 - substantial experience in the same industry and type of investment;

³⁴ <http://www.lin.govt.nz/overseas-investment/index.aspx>

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- a track record of successful business activity that demonstrates generic business experience and acumen;
- having sufficient nous to oversee local managers engaged to undertake the investment on the investor's behalf.
- *Financial commitment.* The OIO seeks evidence which proves setting aside or committing resources, or securing an advance or loan to undertake the investment, having already funded aspects of the investment, or having paid a deposit or entered a contract for sale.
- *Good character.* This criterion takes into account any offences and contraventions of the law by the overseas investor and any other matters that may adversely reflect on the overseas investor's fitness to make the investment. Additionally, the Act stipulates that people who are persons referred to in section 7(1) of the Immigration Act 1987 i.e. those who have been imprisoned for serious offences, subject to a removal order, deported, involved in terrorism, or are likely to commit drug offences, do not qualify to invest in New Zealand.

6.25 These tests are largely 'objective', in the sense that there is relatively little discretion in deciding applications – for example, whether the investor has committed resources is largely a factual question. Each criterion has guidance that sets out what is required and, based on experience, the information requested does not appear to be difficult to assess or to comply with. Additionally, as no business investment applications have been declined in the last 25 years, it would appear that the criteria for screening are not causing substantial problems.

6.26 The Government considers that the current criteria for assessing overseas investments in significant business assets are simple, predictable, and well-targeted to underlying concerns, and should be retained. In most cases, the existing criteria are sufficient safeguards for business investments. However, the Government supports introducing a reserve power that allows the Minister of Finance to decline an application in exceptional circumstances where there is evidence that the investment will be harmful to New Zealand.

Options for a reserve power

6.27 An additional criterion could be included in the business screening section of the Act to allow the Government to decline an application under exceptional circumstances. An indicative outline of the criterion is as follows:

[A If an investment is made in any of the following sectors - XYZ] the Minister of Finance retains the right to decline approval of an investment application if the Minister considers [B...] that [C...]. [If an application is declined on this basis then D...]

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6.28 Some options for what could be inserted in the four square brackets marked A, B, C and D above are outlined in the table below.

Parameter	Broader/Flexible	Narrower/Predictable	Trade-off
A. Sectors	Do not include text which specifies sectors - all business applications could be screened.	"If an investment is made in any of the following sectors - energy, telecommunications, air transport, sea transport, or defence -"	Certainty for investors or flexibility for Ministers.
B. Evidence	Do not include	"on the basis of credible evidence"	Higher hurdle for Ministers or less certainty for investors.
C. National interest vs National security	Modified OECD text on national interest – "it is necessary to protect vital economic interests, where these concerns cannot be addressed under existing law."	OECD-based text on national security - "it is necessary to protect public order and/or essential security interests, where these concerns cannot be addressed under existing law."	"National interest" covers economic considerations as well as security/order considerations. "National security" covers only security/order considerations.
	Modified OECD text on national interest – "it is necessary to protect public order, public health, morals or safety and/or vital economic interests, where these concerns cannot be addressed under existing law."	European Commission text on public order/security - "there is a genuine and sufficiently serious threat to a fundamental interest of society, where these concerns cannot be addressed under existing law."	
D. Reporting	Do not include.	"If an application is declined on this basis, then the Minister must table the decision in Parliament, within one month of the investor being notified on the Minister's decision."	Higher hurdle for Ministers or less transparency/certainty for investors.

Preferred option

6.29 The Government's preferred option is the following:

The Minister of Finance retains the right to decline an investment in significant business assets where:

- the investment will harm the national interest by threatening vital economic interests, national security, or public order;
- the Minister has credible evidence to show that the national interest is threatened;
- the concerns cannot be addressed through other legislation; and
- the Minister must table any decision made using this criterion and the evidence used to make the decision, in Parliament within one month of the decision.

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- 6.30 The preferred option does not specify the sectors to which the reserve power applies, so all significant business applications are potentially subject to it.
- 6.31 The preferred option creates a high hurdle for the use of the reserve power, which should provide investors with some certainty. It would only be used in exceptional circumstances where there is credible evidence that the investment threatens vital economic interests or national security, and where these concerns cannot be addressed under existing law. The burden of proof lies with the Minister to show that the investment will not be in the national interest.
- 6.32 This provision brings New Zealand in to line with other countries such as Australia, the United States and Germany who have reserve powers in the case of investments that endanger national security, public order and key economic interests (see Annex below).

ANNEX: INTERNATIONAL APPROACHES TO A RESERVE POWER

International Approaches	
Australia	<ul style="list-style-type: none"> Foreign Acquisitions and Takeovers Act (FATA) prescribes sensitive sectors including media, telecoms, transport (rail, airports, ports etc), investment in the defence sector, encryption technology and uranium/plutonium mining and nuclear power provision. FATA also gives the Treasurer the ability to look across a number of areas which are screened, including acquisition of shares, acquisition of assets, urban land, and control of Australian businesses. If he considers that an investment in these areas is not in the "national interest" then he can reject the application.
United States	<ul style="list-style-type: none"> President can suspend or prohibit any foreign acquisition, merger, or takeover (collectively, "acquisition") of a U.S. company that he determines threatens to impair the national security of the United States. All foreign investments that may affect national security can be screened and "credible evidence" is required to show that national security would be harmed by the investment. He must also consider that existing legislation does not provide adequate safeguards to protect national security.
United Kingdom	<ul style="list-style-type: none"> The UK does not prohibit any type of private sector investment and there are no conditions placed on investment. No permission is required to establish a business presence in the UK, although there are regulation on the use of business names and certain business sectors which may require licences or authorisation (such as finance, defence and oil exploration).
Germany	<ul style="list-style-type: none"> Allows an investment to be prohibited if it constitutes a genuine and sufficiently serious threat to public order or security. This is defined by the EC Treaty as "a genuine and sufficiently serious threat to a fundamental interest of society". Acquisitions of 25 % or more of the voting shares of enterprises producing certain military goods, cryptographic equipment for intergovernmental communication, certain earth observation systems. Done by Ministry responsible for legislation initiating an enquiry into a specific investment (not screening all applications). Evidence supporting the decision must be provided to the investor, and decisions can be challenged in the courts
Denmark	<ul style="list-style-type: none"> Denmark places particular safeguards around sensitive sectors including hydrocarbons, defence, aircraft and ships. The safeguards are contained in specific legislation, for example the law requiring the Minister of Justice to approve investments of 40% or more of the equity or 20% or more of the voting rights in a defence company doing business in Denmark. Approval will be granted unless there are foreign policy considerations or security issues weighing against approval.

7 OVERSEAS INVESTMENTS IN SENSITIVE LAND

Status quo

7.1 “Sensitive land” is broadly defined in the Overseas Investment Act³⁵ as:

Land is sensitive if it is or includes this type of land...	...and that type exceeds this area threshold (if any)...
non-urban land	5 hectares
bed of a lake; land on specified islands; land held for conservation purposes; reserve, as a public park, for recreation purposes, or as open space; land subject to a heritage order; or a historic place.	0.4 hectares
foreshore or seabed; land on other islands (other than North or South Island)	-
...or it adjoins land of this type...	...and exceeds this area threshold (if any).
foreshore	0.2 hectares
bed of a lake; land held for conservation purposes; scientific, scenic, historic, or nature reserve; regional park; reserve, a public park, or other sensitive area; sea or a lake; land subject to a heritage order; or a historic place.	0.4 hectares

7.2 For an overseas investor to be granted consent to invest in sensitive land, they must satisfy the following seven criteria:³⁶

- business experience and acumen relevant to the overseas investment
- financial commitment to the overseas investment
- that they are of good character

³⁵ Refer to Schedule 1 of the Act for a full description.

³⁶ The investor is exempted from proving benefit, or substantial and identifiable benefit, if they are a New Zealand citizen, ordinarily resident in New Zealand or intending to reside in New Zealand indefinitely under section 16(1)(e)(ii) of the Act. Refer to section 16 of the Act for a full description.

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- that they are not an individual of the kind referred to in section 7(1) of the Immigration Act 1987
- that the investment, will, or is likely to, benefit New Zealand
- if the relevant land includes non-urban land that exceeds 5 hectares, that benefit will be, or is likely to be, substantial and identifiable, and
- if the relevant land is or includes farm land, either that farm land or the securities to which the overseas investment relates have been offered for acquisition on the open market to persons who are not overseas persons.

7.3 In assessing benefit to New Zealand, consideration must be had to all of the following 20 factors:

<p>Economic factors</p>	<p>Whether the overseas investment will, or is likely to, result in:</p> <ul style="list-style-type: none"> • the creation of new, or the retention of existing, jobs in New Zealand; or • the introduction into New Zealand of new technology or business skills; or • increased export receipts for New Zealand exporters; or • added market competition, greater efficiency or productivity, or enhanced domestic services, in New Zealand; or • introduction into New Zealand of additional investment for development purposes; or • increased processing in New Zealand of New Zealand's primary products.
<p>Environmental factors</p>	<p>Whether there are or will be adequate mechanisms in place for protecting or enhancing:</p> <ul style="list-style-type: none"> • existing areas of significant indigenous vegetation and significant habitats of indigenous fauna, for example, any 1 or more of the following: <ul style="list-style-type: none"> - conditions as to pest control, fencing, fire control, erosion control, or riparian planting - covenants over the land. • existing areas of significant habitats of trout, salmon, wildlife protected under section 3 of the Wildlife Act 1953, and game as defined in section 2(1) of that Act.
<p>Social factors</p>	<p>Whether there are or will be adequate mechanisms in place for providing, protecting, or improving walking access to:</p> <ul style="list-style-type: none"> - the habitats described above, by the public or any section of the public; - the relevant land or a relevant part of that land by the public or any section of the public. <p>Whether there are or will be adequate mechanisms in place for protecting or enhancing historic heritage within the relevant land, for example, any 1 or more of the following:</p> <ul style="list-style-type: none"> - conditions for conservation (including maintenance and restoration) and access; - agreement to support registration of any historic place, historic area, wahi tapu, or wahi tapu area under the Historic Places Act 1993; - agreement to execute a heritage covenant; - compliance with existing covenants. <p>If the relevant land is or includes foreshore, seabed, or a bed of a river or lake, whether that foreshore, seabed, riverbed, or lakebed has been offered to the Crown in accordance with regulations.</p>

<p>Other factors (in Regulations)</p>	<p>Whether the overseas investment, or the granting of the application for consent, will, or is likely to:</p> <ul style="list-style-type: none"> • result in other consequential benefits to New Zealand (whether tangible or intangible benefits) • give effect to or advance a significant Government policy or strategy • enhance the ongoing viability of other overseas investments undertaken by the relevant person • assist New Zealand to maintain New Zealand control of strategically important infrastructure on sensitive land • result in the owner of the relevant land undertaking other significant investments in New Zealand. <p>Whether the overseas person:</p> <ul style="list-style-type: none"> • has previously undertaken investments that have been, or are, of benefit to New Zealand • is a key person in a key industry of a country with which New Zealand will, or is likely to, benefit from having improved relations. <p>Whether refusing the application for consent will, or is likely to:</p> <ul style="list-style-type: none"> • adversely affect New Zealand's image overseas or its trade or international relations • result in New Zealand breaching any of its international obligations.
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7.4 On the basis of the above factors the relevant Ministers make a decision on whether an overseas investment will, or is likely to, benefit New Zealand, and if the land includes non-urban land exceeding 5 hectares, whether the benefits will, or are likely to be, substantial and identifiable. The relevant Ministers must consider all of the above factors, but they can use their discretion with respect to which factors are relevant to the overseas investment, and the relative importance of those factors in deciding whether the net benefit test is met.

7.5 In order for the Overseas Investment Office to consider each application and advise the relevant Ministers on how the application should be decided,³⁷ the Office requires that investors present an investment plan, including:

- a) a business plan relating to any business to be undertaken on the land (including major proposed developments, proposed level of capital expenditure and likely business income and expenditure in each of the first five years); and
- b) reports identifying whether each of the specified factors are likely to be addressed including (if applicable) detail on and conservation plans for indigenous vegetation/fauna, wildlife, historic heritage and walking access; and
- c) a report identifying the nature of any current business undertaken on the land (including current productivity and gross annual income, operating expenses and net surplus).

³⁷ Refer section 31(a) of the Act.

Problem definition

7.6 The Government wishes to ensure that the definition of sensitive land (scope) and the test investments in sensitive land must meet (hurdle) are optimally achieving the objectives of a screening regime. The OECD's 2007 *Freedom of Investment, National Security and "Strategic" Industries: An Interim Report* noted that participating countries agreed to three principles to guide investment policy in such areas:

- *Regulatory proportionality*. Restrictions on investment should not be more costly or more discriminatory than needed to achieve the security objectives and they should not duplicate what is, or could be, better dealt with by other regulation.
- *Predictability*. While it is in the interest of both investors and national administrations to maintain confidentiality of sensitive information, regulatory objectives and practices should be made as transparent as feasible so as to increase the predictability of outcomes and eliminate sources of misunderstanding.
- *Accountability*. While improper political interferences in the normal exercise of regulatory power have to be avoided, procedures for parliamentary oversight or judiciary redress should ensure accountability.

7.7 The government considers that there are three main problems with the current regime in the area of sensitive land, which are similar but not identical to the points noted by the OECD above: i) it is not optimally targeted, ii) it could be simpler, and iii) it could be more predictable.

a) Not well-targeted at community concerns:

- *Scope*: The government wishes to ensure that the screening thresholds for sensitive land promote the initial and ongoing flow of investment into New Zealand, and that the type and scope of land defined as sensitive only includes land of particular significance to New Zealand.³⁸ It is not clear that all types of land which are screened under the Act are of this level of significance to New Zealanders. For example, it captures land adjoining parks or recreation reserves the foreign ownership which is unlikely to be of significant concern, though access may be an issue. Reconsidering which investments should be considered 'sensitive land' and therefore trigger the screening regime should help to ensure that the regime does not deter or delay valuable investments into New Zealand.

³⁸ Terms of Reference

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- Hurdle:
 - **Number of factors used to assess benefit:** Benefit to New Zealand is assessed with reference to 20 factors in the Act and Regulations. It is unclear whether all these factors are needed to assess benefit.
 - **Overlap with domestic legislation:** The factors include protection of New Zealand's flora and fauna and protection of historic heritage, which are dealt with in other New Zealand legislation to which both foreigners and New Zealanders are subject, such as the Resource Management Act 1991. It is unclear whether the ability to impose conditions on foreign investors under the OIA is necessary or whether domestic legislation in these areas is sufficient. There are some cases where the 'leverage' provided by the OIA does provide significant benefits on top of existing legislation, such as requiring an archaeological survey, access to wahi tapu sites, and public walking access. However, if it is considered that current domestic legislation does not adequately deal with issues of land use, the best way to effect change is to amend those Acts that most directly govern them. The OECD principle of regulatory proportionality outlined above is relevant here.
 - **Height of hurdle:** The Act requires that investors show their investment will be of benefit to New Zealand, and, for non-urban land, that this benefit will be "substantial and identifiable". This hurdle corresponds to a degree of benefit being shown which is somewhat greater than for other land types, which may have resulted in investments which are below this hurdle, but still of some benefit, being declined. It is not clear why this higher hurdle is only applied to non-urban land over 5 hectares and not to other types of sensitive land. Again, this is an issue of regulatory proportionality in that restrictions (or conditions) should not be greater than what is needed to achieve the objectives and they should not duplicate what is, or could be, better dealt with by other regulation.

b) Not simple:

- Hurdle:
 - **Investor preparation required is large:** Consent must be declined if the "benefit to New Zealand" criterion is not met. Investors therefore expend substantial time, energy and money in preparing applications which address all 20 factors in the Act. The "substantial and identifiable" test for non-urban land over five hectares imposes additional costs, as there is a higher hurdle to be met.
 - **Regulator assessment effort is large:** The regulator is required to assess these applications and the OIO must advise the relevant Minister/s on how the application should be decided. The long list of factors and lengthy applications makes these assessments long and costly, and processing times have increased accordingly since the 2005 Act came into force.

c) Not predictable:

- Hurdle:
 - **Subjective benefit test:** The benefit test creates uncertainty as investors do not know which factors Ministers will consider relevant and what weighting they will give to those factors. It is not clear whether the investor must show benefit net of any costs, nor what level of benefit will be considered “substantial and identifiable”. Moreover, what is actually required of investors will depend on the type of investment and whether Ministers view certain factors - such as walking access – as applicable. This uncertainty induces investors to err on the side of caution in terms of the amount of information they provide which further increases preparation and assessment times. There is also considerable difficulty in interpreting what is required from the current test, for example, whether maintaining the status quo should be treated as a benefit or not. The flipside is that the discretion provided by the current test gives Ministers flexibility in decision making and protects them from judicial review.
 - **Ability of government to add new regulations:** The government currently has the ability to add to the list of factors which must be considered in identifying benefit. This creates uncertainty for investors as the rules of the game can change suddenly. This paper recommends that this ability be removed, so that new factors can only be added by legislation.

7.8 The Terms of Reference for the review of the Act set out that in the area of sensitive assets, the following areas should be investigated:

- the screening thresholds to ensure they promote the initial and ongoing flow of investment into New Zealand
- the type and scope of land defined as sensitive under the Act to ensure that only land of particular significance or importance to New Zealand is screened, and
- the tests that investments must meet to ensure they minimise compliance costs and avoid deterring investment.

7.9 This section looks at these areas as follows:

- **Scope:** the definition of sensitive land (both types of land and size thresholds)
- **Hurdle:** options for criteria that need to be passed and design of these

SCOPE: What types of land should be considered sensitive?

7.10 The definition of sensitive land in the Act has two parts: the types of land considered sensitive and (in all but a few cases) a corresponding area threshold. Currently, the Act considers land in a wide range of non-urban categories, to be sensitive. It also defines land adjoining certain types of land as sensitive. The review intends to ensure that the Act is well targeted and that no unnecessary barriers are preventing the flow of ongoing investment into New Zealand. The review is also aiming to ensure that only *sensitive* land purchases of particular significance are captured under the Act.

Table: Sensitive land applications by type 01/07/07 to 22/04/09

Type of land ³⁹	Number of Applications*	Proportion of Applications (%) ⁺
Includes - Non-urban land exceeding 5 hectares	153	37.8%
Adjoins - Section 37	78	19.3%
Adjoins - Conservation Purposes	20	4.9%
Adjoins - Foreshore	20	4.9%
Adjoins - Historic place/Wahi Tapu	19	4.7%
Adjoins - Esplanade reserve/strip that adjoins the sea or a lake	16	4.0%
Adjoins - Road that adjoins the sea or a lake	16	4.0%
Includes - Public park, recreation purposes, open space	14	3.5%
Includes - Historic place/Wahi Tapu	13	3.2%
Adjoins - Scientific, scenic, historic or nature reserve	11	2.7%
Includes - Foreshore or Seabed	11	2.7%
Includes - Conservation Purposes	9	2.2%
Adjoins - Bed of a lake	7	1.7%
Adjoins - Recreation reserve that adjoins the sea or a lake	5	1.2%
Includes - Bed of a lake	4	1.0%
Adjoins - Regional Park	3	0.7%
Includes - Islands	2	0.5%
Adjoins - Heritage order	1	0.2%
Adjoins - Maori reservation that adjoins the sea or a lake	1	0.2%
Includes - Heritage order	1	0.2%
Includes - Specified Islands	1	0.2%

7.11 Some of the above categories refer to land that is clearly of significance to New Zealanders, such as islands, foreshore, seabed and lakebed, and that the Government is committed to protecting. Of the remaining categories, the review is

³⁹ See Schedule 1 of the Official Information Act 2005 for a full description of these types of land

* This column cannot be summed to give the total number of applications as an application can be counted in more than one category.

⁺ This column gives the instances of a particular category as a proportion of total instances. It does not indicate what proportion of applications would cease to be screened if the category were removed, as applications can be counted in more than one category.

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focussed on those land types that make up the bulk of applications, where ensuring that the Act is well-targeted is most important. Those land types are:

- *Non-urban land*: A total of 154 applications fell into the non-urban land category over the last two years, making up about two thirds of total land applications over that period. 97 applications had no other sensitivities, that is, they were only caught by the Act because they were non-urban land greater than five hectares. There may be scope to reconsider the definition of non-urban land and the area threshold.
- *Land adjoining land in section 37*: Section 37 gives the regulator authority to develop a list of reserves, public parks and sensitive areas; any land adjoining these would then be screened. There were 78 applications in this category which made up around 30% of total applications over the last two years. 31 (13%) of those applications were only picked up under section 37.

7.12 The review has also looked at the following categories of land, where it was unclear that screening was adding value above what is already provided for under domestic legislation:

- *Land adjoining land with a heritage order*: Land which is over 0.4 hectares and adjacent to land over 0.4 hectares that is subject to a heritage order is screened.
- *Land adjoining land that includes a historic place*: Land which is over 0.4 hectares and is adjacent to land over 0.4 hectares which includes a registered historic place is screened.

Non-urban land

7.13 Non-urban land greater than five hectares is screened. Non-urban land is defined in the OIA as:

- a) farm land, and
- b) any land other than land this is both:
 - i) in an urban area, and
 - ii) used for commercial, industrial, or residential purposes,

where farm land is defined as “land used exclusively or principally for agricultural, horticultural, or pastoral purposes, or for the keeping of bees, poultry, or livestock”.

Issues

- 7.14 **Definition of urban area:** What constitutes an ‘urban area’ is not defined in the Act, though the OIO website provides guidance for investors on what is likely to be considered an urban or non-urban area.⁴⁰ Determining whether land is urban can be difficult, as, especially on the boundary between urban and non-urban areas, it is very case dependent and relies on district plans which are not always consistent. This lack of certainty creates costs for investors. There is currently no established definition for ‘urban area’ across the many pieces of legislation that govern land use, although one is likely to be developed through the review of the Resource Management Act 1991 that is underway. It is not within the scope of this review to create one.
- 7.15 **Inclusion of non-urban area:** There are questions over whether non-urban land that is not farmland should be screened. About one third of applications that fall into the non-urban land category are not farm land. Such land tends to comprise forestry blocks or industrial, commercial or residential land that is not in an urban area. Some of this land is used for business and residential purposes which the government considers is not particularly sensitive. Forestry blocks, many of which were formerly Maori land, may be considered sensitive. If they contain other sensitivities such as wahi tapu sites they would be caught under the regime even if forestry was excluded from the definition of non-urban land. Options would be to screen only farm land, or farm land and forestry blocks, rather than all non-urban land.
- 7.16 **Area threshold:** The area threshold at which non-urban land purchases are screened is five hectares. The large majority of applications far exceed this threshold. Increasing the threshold to 10 hectares would cut out 12% of applications. The table below indicates the land area of the 154 non-urban land applications over the past two years.

Land Area (Ha)	Number applications involving farmland	Other non-urban land
< 5 *	4	4
5 - 10	7	12
10 - 15	4	5
15 - 20	6	3
20 - 25	4	3
25 - 30	2	1
30 +	73	26
Total	100	54

*There were 8 applications involving non-urban land for less than 5 Ha of land. These were sensitive based on associated land.

⁴⁰ In the majority of cases, an urban area will be characterised by: i) high population density, ii) small land holdings (regularly less than 0.4 hectares), and iii) zoning that is compatible with high density commercial, industrial and/or residential activity. In the majority of cases, a non-urban area will be characterised by: i) open space, paddocks, pastures, forests, ii) large land holdings (regularly in excess of 2 hectares), and iii) zoning that is compatible with agricultural, horticultural, viticultural (etc) activities.

Options for non-urban land

Option	Land type	Area threshold	Impact on application numbers per year ⁴¹
1 (status quo)	Non-urban land	5 hectares	None
2	Farm land and forestry only*	5 hectares	Between zero and 19 fewer applications [°]
3	Farm land only*	5 hectares	Approximately 19 fewer applications
4	Non-urban land	10 hectares	Approximately 7 fewer applications
5	Farm land and forestry only*	10 hectares	Between 7 and 21 fewer applications [°]
6	Farm land only*	10 hectares	Approximately 21 fewer applications

*Other non-urban land would not be screened unless it has other sensitive features.

[°] The OIO does not collect data on how many non-urban land applications are for non-urban land that is neither farm land nor used for forestry. However, it is estimated that very few applications fall outside of these categories.

Preferred option for non-urban land

- 7.16 The preferred option is option 5. This reflects the fact that, of non-urban land applications farm land and forestry are generally considered more sensitive than other types of non-urban land. Moreover, it recognises the difficulties with defining other types of non-urban land. Industrial, commercial or residential lands not in an urban area are not particularly sensitive in and of themselves. The types of non-urban land which are not farm or forestry land but which are screened under the current Act will be picked up in other categories if they have other sensitivities.
- 7.17 This option would also increase the area threshold to 10 hectares. While this change would only have a small impact on application numbers, it would reduce compliance costs for those investors acquiring rural land of a relatively small size (such as lifestyle blocks). It would mean that small horticultural farms, many of which are less than 10 hectares, would fall below the threshold.

Change 7.1	Narrow the definition of non-urban land to include farm and forestry land only.
<i>Dimension</i>	<i>Impact</i>
Simple	It is more straightforward to determine whether land is farm or forestry land than other non-urban land; narrowing the definition will therefore enable investors to more easily see whether they are subject to the Act.
Predictable	n/a
Well-targeted	Reduced compliance costs for between 7 (or 6% ⁴²) and 21 (or 17% ⁴³) investors in sensitive land per year (based on historical data from 01/07/07 to 22/04/09).

⁴¹ Based on historical data from 01/07/07 to 22/04/09. Because the historical data does not indicate how many of those applications that had only one sensitivity were non-urban land other than farm land, this has been assumed to be in the same proportion as non-urban land applications overall (35% were non-urban land other than farmland, so of the 97 that fell in the non-urban land category only 35% are assumed to be non-urban land other than farmland).

⁴² Based on the average number of land applications decided in the 07/08 and 08/09 years (121.5).

Change 7.2	Increase the area threshold for non-urban land to 10 hectares.
<i>Dimension</i>	<i>Impact</i>
Simple	n/a
Predictable	n/a
Well-targeted	Reduced compliance costs for approximately 7 (or 6% ⁴⁴) investors in sensitive land per year (based on historical data from 01/07/07 to 22/04/09).

Land adjoining land in section 37

7.18 Section 37⁴⁵ of the OIA instructs the regulator to keep a list of reserves, parks and other sensitive areas, land adjoining which, and exceeds 0.4 hectares, is screened under the Act. The current list, drafted in 2005, includes:

- land that a regional plan, a district plan or proposed district plan provides is to be used as a reserve, or as a public park for the purposes of:
 - a) protecting natural and physical resources or historic heritage, or
 - b) providing public access to natural and physical resources or historic heritage.
- other land that a regional plan, a district plan or proposed district plan provides is to be used for recreation purposes or as open space, if that land is
 - a) held under statute, and
 - b) has a primary purpose, by or under statute, relating to:
 - i) protecting natural and physical resources or historic heritage, or
 - ii) providing public access to natural and physical resources or historic heritage
- land that is a national park held under the National Parks Act 1980.

Issues

7.19 **Broad scope of section 37:** The types of land that are captured by the list under section 37 currently are very broad. It includes things such as sports and recreation fields which are not typically considered particularly sensitive. Sensitivity in these

⁴³ Based on the average number of land applications decided in the 07/08 and 08/09 years (121.5).

⁴⁴ Based on the average number of land applications decided in the 07/08 and 08/09 years (121.5).

⁴⁵ See section 37 of the OIA for a full description.

cases is most closely linked to public access, which is why land adjoining reserves on the foreshore or lakes is screened under its own category. Reserves or public parks that fall into the first two bullet points above that are not caught by other land types are unlikely to be of particular public significance. The Act already screens land which adjoins the following categories of land without recourse to section 37:

- Regional parks
- Esplanade reserve/strip that adjoins the sea or a lake
- Scientific, scenic, historic or nature reserve
- Bed of a lake
- Recreation reserve that adjoins the sea or a lake
- Heritage order
- Maori reservation that adjoins the sea or a lake

7.20 Moreover, access to parks and reserves is often provided as part of district and regional plans created under the RMA (though the RMA does not provide for access to be established anew without the consent of private landholders unless the use of the land is changing, for example, through subdivision). Screening of land adjoining National Parks could be maintained by adding an additional land category.

7.21 **Predictability:** Section 37 allows the regulator to modify the scope of what is caught under the Act without legislation. This ability creates uncertainty for the investor as the list of land types under section 37 could be changed.

Options for section 37

Option	Land type	Area threshold	Impact on application numbers per year ⁴⁶
1 (status quo)	Adjoining section 37	0.4 hectares	None
2	Remove section 37	n/a	Approximately 17 fewer applications
3	Remove section 37 and replace with an 'adjoining national parks' category	0.4 hectares	Approximately 15 fewer applications

Preferred option for section 37

7.22 The preferred option is option 3. This would remove screening of land adjoining local parks and reserves, unless they have other sensitivities. Land adjoining regional parks and significant reserves, as noted above, would continue to be screened.

⁴⁶ Based on historical data from 01/07/07 to 22/04/09.

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Land adjoining national parks, which are not currently caught elsewhere in the Act, would be added as a new screening category.

Change 7.3	Remove section 37 from scope and add a 'land adjoining National Parks' category to scope.
<i>Dimension</i>	<i>Impact</i>
Simple	n/a
Predictable	Removes uncertainty of what is/is not included under section 37, and removes ability for this to be changed by regulation.
Well-targeted	Remove compliance costs for around 15 investors (12% of land applications) in sensitive land per year (based on historical data from 01/07/07 to 22/04/09).

Land adjoining land with a heritage order/historic place

7.23 Currently land is subject to screening if it *adjoins* properties that are:

- Subject to a heritage order, or a requirement for a heritage order, under the Resource Management Act 1991 or by the Historic Places Trust under the Historic Places Act 1993
- An historic place or area, wahi tapu or a wahi tapu area that is registered or for which there is an application or proposal for registration under the Historic Places Act 1993.

Issues

7.24 **Protection of heritage value:** The setting of a historic place is important and changes to, or activities on, sites adjacent to historic places can impact on heritage values. There are limited opportunities for an investor to assist in the protection of heritage located on a neighbouring site. However, providing a 'buffer zone' between the historic resource and certain activities can assist in the protection of historic heritage.

7.25 **Protection offered elsewhere:** The RMA has provisions to maintain protections on historic heritage and create new protections when the use of the land is changing, for example, as a result of subdivision. It also provides access to heritage sites through district and regional plans. The Historic Places Act also has some protection measures. While these provisions are not always applied to the same standard across the country, they still provide a more consistent approach than the OIA. .

Options for land adjoining heritage/historic land

Option	Land type	Impact on application numbers per year ⁴⁷
1 (status quo)	Continue to screen land adjoining land subject to a heritage order and including a historic place	None
2	Remove screening on land adjoining land subject to a heritage order	None*
3	Remove screening on land adjoining land that includes a historic place	None*
4	Remove screening on BOTH land adjoining land subject to a heritage order, and land adjoining land that includes a historic place	None*

*All applications in these categories over the past two years have fallen into other categories of sensitivity as well, so would still trigger the screening regime.

Preferred option

7.26 Option 4 is the preferred option as it recognises the compliance costs for investors of the application process. Moreover, screening land adjoining land with heritage value will bring little additional benefit under the proposed objective test as the heritage site will not be considered a sensitive feature *of the relevant land*. The land will still be screened if it has other sensitivities.

Change 7.4	Remove screening on land adjoining land subject to a heritage order and on land adjoining land that includes a historic place
<i>Dimension</i>	<i>Impact</i>
Simple	Removing these screening categories will improve the readability of the Act.
Predictable	n/a
Well-targeted	On historical data, there would be no change in applications as previous applications have also been sensitive for other reasons. However, future applications which had no other sensitivities would no longer be screened. The change will mean the Act is better targeted at specific concerns about heritage sites, rather than adjoining land.

HURDLE: How should decisions on sensitive land applications be made?

Do land and business investments differ?

7.27 Section one outlined the main concerns that New Zealanders have about overseas persons investing in New Zealand. The two broad circumstances in which overseas investments may reduce New Zealanders' wellbeing were a loss of ownership value, and investors acting in a way that is inconsistent with domestic behavioural norms. The overseas investment screening regime is primarily targeted at the second

⁴⁷ Based on historical data from 01/07/07 to 22/04/09.

circumstance: where foreign investors may *act* in a manner that differs from New Zealand investors there may be a case for restricting those investments.

The “good investor” test that is applied to significant business investments...

7.28 In the case of investments in significant business assets the Act aims to ensure that the investor is the type of person that we would encourage to invest in New Zealand. A “good investor” test comprising four criteria which are aimed at determining whether the investor is likely to act in a way which is harmful to New Zealand is used to test this. The investor must demonstrate:

- business experience and acumen relevant to the overseas investment
- financial commitment to the overseas investment
- that they are of good character
- that they are not an individual of the kind referred to in section 7(1) of the Immigration Act 1987

7.29 The above criteria reflect the fact that overseas investors are driven primarily by a desire for their business to succeed, as are domestic business investors. Therefore, as long as the investor is deemed capable of running a successful business, and they are of good character, the investment should proceed.

...should also apply to sensitive land.

7.30 The “good investor” test for business investments uses fairly broad criteria to test the character and intention of the investor, which are, on the whole, applicable to land investments as well. The criterion of good character, which relates both to moral factors and the reputation of the person concerned, provides some assurance that an investor in sensitive land is not likely to act in a way which is deliberately harmful to New Zealand. The stipulation that people who fall under section 7(1) of the Immigration Act 1987 (those who have been imprisoned, subject to a removal order, deported, involved in terrorism, or are likely to commit drug offences) do not qualify to invest in New Zealand seems equally appropriate to land investments as to business investments. The ‘financial commitment’ criterion assures New Zealanders that the overseas investor will follow through with the investment.

7.31 The criterion of ‘relevant business acumen and experience’ is less appropriate to some investments in sensitive land which are not business investments and do not require such knowledge and experience. However, as long as this criterion is assessed with respect to the intended use of the investment, compliance costs on investors should not be large. There is also value in the simplicity of using the same “good investor” test for both business and land.

There may be a need for an additional test for sensitive land.

- 7.32 Investments in sensitive land tend to be of greater concern to New Zealanders than those in significant business assets. The concerns held by members of the public with regards land use may not be adequately covered by the “good investor” test. Some of these relate to maintaining social behaviours (preserving walking access and protecting historic heritage) and protecting the environment. It is unclear whether overseas investors are likely to act differently to domestic investors in respect of these factors. However, if protections are required for overseas investors over and above protections in domestic legislation, and the “good investor” test is not considered sufficient to provide these, there may be a need for sensitive land applications to be subject to an additional test.

What existing legislation covers land usage?

- 7.33 In order to assess whether an additional test for land is required, and, if so, what it might look like, it is useful to consider what other legislation governs land use in New Zealand. There are various pieces of legislation which govern the use of land in New Zealand and overseas investors are subject to these laws in the same way that New Zealand citizens are. The following table looks at the factors that are considered in assessing benefit in sensitive land applications and the extent to which the underlying concerns are addressed in existing legislation and district plans. The table only includes those factors stipulated in the Overseas Investment Act 2005 (it excludes those which are in Regulations) which are land-use specific, and which the government considers to be most relevant to the public. Economic factors have been excluded in recognition of the fact that, in general, foreign investment is of economic benefit to New Zealand.
- 7.34 The social and environmental factors used to assess net benefit are largely based on domestic legislation, and they do not set a common standard for overseas investors or necessarily require more than compliance over and above domestic legislation. As such, there is a large overlap between existing legislation that covers land use and the factors used to assess benefit in the OIA (as shown in the table below). In general, the protections or scope of existing legislation regarding land use – in particular the Resource Management Act 1991, the Conservation Act 1987 and the Wildlife Act 1953 – are much broader than those in the OIA.
- 7.35 However, the OIA enables the regulator to impose conditions on particular investors which do require more than compliance with domestic legislation. The OIA can effectively be used as ‘leverage’ to extract benefits from foreign investors which are not required by domestic legislation. This ability has been used to provide significant public benefits, in particular in the area of walking access where the provisions in other legislation are relatively weak.

	Factor	Associated legislation	Additional restrictions provided by OIA
Environmental factors	<p>Protecting habitats:</p> <ul style="list-style-type: none"> existing areas of indigenous vegetation and fauna habitats of trout, salmon, specified wildlife and game. 	<p>Resource Management Act 1991:</p> <ul style="list-style-type: none"> primary piece of legislation controlling use of resources (including land) under RMA authority regional councils create Regional Policy Statements (and City/District councils create Plans) 48 which must provide for the protection of areas of significant indigenous vegetation and fauna persons exercising functions under the Act must have particular regard to the protection of the habitats of trout and salmon (s.7). <p>Wildlife Act 1953:</p> <ul style="list-style-type: none"> protects all wildlife and sets out what wildlife can be hunted. <p>Conservation Act 1987:</p> <ul style="list-style-type: none"> it is under this Act that the government holds land for conservation purposes preserves indigenous freshwater fisheries protects recreational freshwater fisheries and habitats allows voluntary agreements to be entered into between the Minister and land owners. <p>QE II National Trust Act 1977:</p> <ul style="list-style-type: none"> National Trust may enter into covenants with land owners to protect open spaces. 	<p>The OIA does not necessarily place any additional restrictions on investors. However, conditions may be, and often are, imposed.</p>
Social	<p>Walking access:</p> <ul style="list-style-type: none"> to habitats of trout, salmon, specified wildlife and game to the relevant land. 	<p>Walking Access Act 2008:</p> <ul style="list-style-type: none"> established the Walking Access Commission which protects and negotiates for public walking access The Commission cannot require private land owners to provide walking access, but can negotiate for walkways over private land. <p>Resource Management Act 1991:</p> <ul style="list-style-type: none"> councils must maintain and enhance public access to the coastal lands, water, site, wahi tapu and other taonga new access can only be achieved when the use of the land changes, for example, through subdivision. <p>Conservation Act 1987:</p> <ul style="list-style-type: none"> fosters recreation and allows tourism on conservation land, providing the use is consistent with the conservation of the resource established Fish and Game NZ which promotes and protects sport fish and game habitats and promotes access to them. 	<p>The OIA does not necessarily place any additional restrictions on investors. However, conditions <i>may</i> be, and often are, imposed.</p>

⁴⁸ Regional and District Councils put in place rules (by way of Regional Policy Statements and District Plans) which specify how land may or may not be used (land is delineated into zones where certain effects are or are not acceptable). The rules usually describe activities as being either, with increasing restrictiveness, permitted, controlled, restricted discretionary, discretionary, non-complying or prohibited.

	Factor	Associated legislation	Additional restrictions provided by OIA
Social	<p>Historic heritage:</p> <ul style="list-style-type: none"> • conservation and access • support for registration • execution of heritage covenants • compliance with existing covenants. 	<p>Resource Management Act 1991:</p> <ul style="list-style-type: none"> • councils must protect historic heritage from inappropriate subdivision, use and development. <p>Historic Places Act 1993:</p> <ul style="list-style-type: none"> • promotes the identification, protection, preservation and conservation of NZ's historical and cultural heritage • establishes and maintains a publically accessible Register of historic places, historic areas, wahi tapu and wahi tapu areas. • allows for heritage covenants to be negotiated and agreed with a property owner • allows the NZHPT or Minister to give notice of a requirement of a heritage order to protect historic heritage (without limiting the provisions of the RMA which provides for heritage orders) <p>QE II National Trust Act 1977:</p> <ul style="list-style-type: none"> • National Trust may enter into covenants with land owners to protect open spaces. 	<p>Heritage covenants are voluntary and can be modified so the OIA does provide a bit of extra restriction here. (Conservation and access conditions are already required by heritage orders and owners' support for registration of historic places is not needed for their registration).</p>

Possible additional tests

7.36 The first option for testing investments in sensitive land is to apply a modified “good investor” test. If an additional test was considered necessary to reflect the fact that concerns over sensitive land tend to be different than those over business, there are two broad test types which could be applied. The two test types are:

- An objective criteria test
- A subjective cost/benefit test (the status quo)

1. An objective criteria test

7.37 The current “good investor” test for investments in significant business assets uses criteria with very little subjectivity. The first option for expanding on this is to add additional objective criteria that *must* be met for consent to be granted. If an investor meets all those criteria then their application is approved; if they do not their application is declined. The regulator has little discretion in deciding which applications to approve and which to decline.

7.38 The advantages of using only objective criteria is that it should be much clearer what standard is required of investors for them to meet the criteria. Investors should be able to accurately predict whether their investment will be approved or not. In addition, it would be a simpler test which could potentially require much less time and effort both on the part of the applicant and the regulator. However, the regulator and Ministers would have less flexibility to decline applications based on factors which are outside the objective criteria. Ministers may also be at risk of judicial review, which could be costly to the Crown.

2. *A subjective cost benefit test*

- 7.39 The second option for expanding on the “good investor” test is to include a subjective cost benefit test, where the regulator is required to decide whether the investment is of “benefit”⁴⁹ to New Zealand. In this test, the only additional criterion is that the investment must, in the subjective judgement of the regulator, be considered to be of benefit to New Zealand. The regulator would come to this judgement by weighing up a range of factors, which may or may not be stipulated in legislation. In contrast to the objective criteria test, such factors do not *all* need to be met for consent to the investment to be granted. Rather, across the factors the investor must meet the requirement of providing benefit (or net benefit).
- 7.40 The main advantage of the cost benefit test is that it gives the regulator a large amount of flexibility in deciding whether to grant consent to an application in sensitive land. The flipside is that it is hard for investors to predict whether their application will be consented to or not. There are also potentially high compliance costs on investors who have to prepare large amounts of information to the regulator in order for them to assess whether the investment is of benefit or net benefit.
- 7.41 The way in which the test is worded will have an impact on the size of the hurdle that investors need to pass. The two high level options are between requiring net benefit to be demonstrated for an application to be *consented to*, and requiring net harm to be demonstrated for an application to be *declined*. The latter net harm test corresponds to a lower hurdle as the presumption is that the regulator will approve applications, *unless* it can show that it is of net harm to New Zealand.

The following table summarises the advantages and disadvantages of the two test types.

	Advantages	Disadvantages
Subjective cost/ benefit test	Flexibility	Unpredictable High compliance costs Potentially high administration costs
Objective criteria test	Predictable Simple	Loss of flexibility

The main design parameters

- 7.42 There are other factors in the design of an additional test which will impact on how it performs in practice. In particular, they all influence high the hurdle is, that is, how difficult it is for investment consent to be granted.
- 7.43 The key parameters that apply to both the objective and subjective tests are:

⁴⁹ The assessment in the current Act of whether an investment will be, or is likely to be, of benefit to New Zealand, is an example of such a subjective test. In that case it is defined in terms of benefit, but it can also be defined in terms of net benefit as in a typical cost benefit test, where the benefits are netted off against the costs.

- *Number of factors/criteria:* The higher the number of criteria in an objective test the higher the hurdle as more conditions *must* be met for consent to be granted. For the subjective test, more factors for consideration may, but not necessarily, produce a lower hurdle. Factors may be grouped together under ‘umbrella’ headings which would aim to increase simplicity while ensuring that the regulator considers a wide range of factors.
- *Stringency of factors/criteria:* The more stringent the criteria/factors the higher the hurdle for both the objective and subjective tests.

7.44 Other parameters which apply to only the subjective test are:

- *Focus on benefit or harm:* A cost benefit test can *either* require the regulator to approve an application if net benefit is demonstrated, *or* to decline the application if net harm is demonstrated. The latter will in most cases correspond to a lower hurdle as the presumption is that applications will be approved *unless* harm can be demonstrated. The presumption in a net benefit test is the opposite.
- *What level of benefit/harm needs to be demonstrated:* A cost benefit test could stipulate that benefits must outweigh costs (or vice versa) by a certain amount. For example, a subset of applications in sensitive land currently requires “substantial and identifiable” benefit to be shown. If such a qualification is added to a net benefit test, the hurdle becomes higher; if added to a net harm test, the hurdle becomes lower.
- *What is the comparator:* A cost benefit test can be conducted with respect to either the status quo or the counterfactual situation⁵⁰, ie. what is expected to happen if the investment does not go ahead. The impact this would have on the hurdle would differ on a case by case basis.

Indicative options

7.45 The following are four indicative options which demonstrate the difference between an objective and subjective test and some of the design parameters above.

- *Good investor test only*

7.46 Under this option the same criteria that are applied to investments in significant business assets would also apply to investments in sensitive land. Investors must demonstrate the following⁵¹:

- business experience and acumen relevant to the overseas investment
- financial commitment to the overseas investment

⁵⁰ The current subjective benefit test is considered with respect to the status quo, rather than the counterfactual.

⁵¹ Refer to section 16 of the Act for a full description.

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- that they are of good character, and
- that they are not an individual of the kind referred to in section 7(1) of the Immigration Act 1987.

7.47 This would remove the ability to use the OIA as a 'lever' to extract additional benefits from overseas investors which are not required of domestic investors.

- *Good investor test plus other objective criteria*

7.48 Under this option the "good investor" test would be supplemented by one or more additional criteria, all of which the investor must meet for consent to be granted.

7.49 One indicative option would require overseas investors in sensitive land to do the following:

- identify any sensitive features on the relevant land⁵² including: indigenous vegetation and significant habitats of trout, salmon, and other wildlife protected under section 3 of the Wildlife Act 1953; places of historic heritage; and areas where walking access has been customarily provided for the public or a section of the public, or where the public has a continuing interest in access being provided;
- sign a certificate stating they are aware that the relevant land contains sensitive features and that New Zealand legislation has provisions to protect these features; and
- demonstrate that there are, or will be, in the judgement of the Ministers of Finance and Land Information, adequate mechanisms in place for providing, protecting, or enhancing walking access, where appropriate and practicable.

7.50 The first two bullets are aimed at addressing concerns about whether overseas investors are aware of sensitive features on the sensitive land and their obligations with respect to these under New Zealand law. This test requires overseas investors to perform a due diligence which is not required of domestic investors.

7.51 The third bullet of adequate provision of walking access goes further than what is required by other legislation. The Walking Access Act only enables negotiations with private land holders over walking access. The proposed test requires that, at the point of sale to an overseas person, the Ministers of Finance and Land Information are satisfied that adequate public walking access will be provided over the land or part of the land.

⁵² Guidance on how to generate such a list of sensitive features (and a list of obligations) would be provided to investors via the OIO website. For example, investors would be encouraged to consult the New Zealand Archaeological Association Site Recording Scheme to find information on archaeological sites.

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- *Net benefit test*

7.52 For an overseas investor to be granted consent to invest in sensitive land, they must, in addition to passing the “good investor” test, demonstrate that the investment is of net benefit to New Zealand. The regulator must be satisfied that the benefits of the investment (with respect to the likely counterfactual situation) outweigh the costs to New Zealand across the following spheres:

- Economic
- Social
- Environmental
- Cultural

7.53 The investor would be required to provide information in a business plan which addresses the impact the investment will have on the above spheres. The spheres are purposely broad so as to ensure that all relevant costs and benefits are taken into account. This test differs from the current subjective test in that it requires an explicit assessment of costs as well as benefits. This means that, for an investment to be consented to, it must provide benefit to New Zealand net of any costs.

7.54 This would not be intended to require a large increase in the cost of assessment, as the OIO would still assess the application primarily on the basis of information provided to them by the investor, rather than taking on an investigatory role. However, if required, the regulator would be able to seek more information from the investor

- *Net harm test*

7.55 For an overseas investment in sensitive land to be *declined*, the regulator must show one of the following: *either* that the investor does not pass the good investor test *or* that the investment is of net harm to New Zealand (with respect to the likely counterfactual situation). In order to decline an investment for the latter reason the regulator must demonstrate that the costs to New Zealand outweigh the benefits, taking into account the impact of the investment on the following factors:

- Job creation in New Zealand
- Technology development and adoption
- Market competition, efficiency and productivity
- Export industry development
- Profits and income accruing to New Zealanders
- Protection of indigenous flora and fauna
- Provision of walking access

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- Protection of historic heritage.

7.56 The investor would be required to provide information in a business plan which addresses the impact the investment will have on the above factors. The factors are intended to be broad enough that all major benefits and costs are considered, but specific enough that the investor knows exactly what will be considered. This test differs from the current subjective test in two ways: i) it requires an explicit assessment of costs as well as benefits, and ii) it requires that costs outweigh benefits for an application to be declined. This shift in focus is likely to result in the test being less stringent than the current test.

7.57 This test would not be intended to require a large increase in the cost of assessment, as the OIO would still assess the application primarily on the basis of information provided to them by the investor, rather than taking on an investigatory role. However, if required, the regulator would be able to seek more information from the investor.

Preferred option

7.58 Option two is the Government's preferred option. This is for two key reasons:

- The government considers that, given the particularly sensitive nature of land that falls under the Act, more than the good investor test is required.
- The government places a lot of emphasis on the simplicity and predictability of the screening regime. As such, option two is preferable to a subjective test because it provides the most certainty for investors and potential investors to New Zealand and should be simpler and easier to administer, while still providing safeguards for public walking access.

7.59 Option 2 would achieve a considerable improvement in the simplicity and predictability of the test. The government considers that the protections provided by existing legislation are, in general, sufficient to provide for community concerns around indigenous vegetation, habitat conservation and heritage protection. If there are deficiencies in legislation governing land use, the government supports considering amending the relevant Acts. Using the OIA as a lever to extract benefits from a subset of land owners in New Zealand is a less direct method of protecting sensitive features of the land from harmful behaviour.

7.60 There is a case that social norms result in domestic investors providing a greater level of benefit than the minimum that is required by law. This is particularly strong for walking access. For example, a New Zealand owner may voluntarily allow the public to walk across their land without being required to do so by law. As such, removing additional requirements for walking access might result in the public receiving less benefit from overseas investment than domestic investment.

7.61 Option two requires two things of overseas investors which are not required of domestic investors, in order to close this gap. Overseas investors must:

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- a) identify the sensitive features on their land and certify that they are aware of provisions to protect these under New Zealand legislation;
- b) agree to continue or enhance public walking access to a level that is considered 'adequate' by the Ministers of Finance and Land Information..

7.62 Walking access has been singled out because it is the area where: the provisions in other legislation are weak, there is the most widespread public concern about overseas investment, and where New Zealand social norms and behaviours are most likely to differ from those of overseas persons. That is, some New Zealand land owners are prepared to allow walking access across their land even though they are not required to do so under law. The new test ensures the provision of walking access at least to a level that would occur under domestic ownership.

Change 7.5	Remove the existing subjective benefit test and replace it with Option 2
<i>Dimension</i>	<i>Impact</i>
Simple	This change will make the test for sensitive land applications much simpler. It will reduce the 27 criteria and factors that need to be considered to just 7 criteria. Compliance costs in the form of investor preparation and regulator assessment effort will drop considerably.
Predictable	This change will make it much clearer the standard that is required of investors (largely compliance with domestic legislation with the exception of walking access) and will remove the interpretation difficulties of the benefit and "substantial and identifiable" benefit test.
Well-targeted	The new test relies primarily on the protections already in place in domestic legislation. It also specifically targets walking access, which is the area which cause the most widespread concern for New Zealanders.

Specific issues

- 7.63 This section deals with two requirements on persons that are selling sensitive land to an overseas person. They are:
- a) The requirement to offer foreshore, seabed, river or lake bed to the Crown for purchase, and
 - b) The requirement for farm land to be advertised on the open market to New Zealand buyers.

Offer back to the Crown

Status quo

- 7.64 One of the factors for assessing benefit of overseas investments in sensitive land in section 17 of the Overseas Invest Act 2005 is:

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- a) if the relevant land is or includes foreshore, seabed, or a bed of a river or lake, whether that foreshore, seabed, riverbed, or lakebed has been offered to the Crown in accordance with regulations.

7.65 Regulations 12 to 26 of the Overseas Investment Regulations 2005 (Regulations) set out the procedure for offering foreshore, seabed, riverbed or lakebed ('special land') to the Crown.

Issues

- 7.66 *Complicated and costly process:* The process set out in the Regulations is long and costly. The Crown can waive the right to acquire special land at any time, in which case the applications by the overseas person to acquire the sensitive land can proceed. However, if the Crown chooses to exercise its right to acquire the special land, a lengthy valuation and survey process must be followed. In many cases the special land will also need to be surveyed which adds to potential delays. Following the valuation, the owner must formally offer the land to the Crown who may accept or reject the offer. In order to bypass the survey and valuation process and fast track the sale, most vendors offer the special land to the Crown for no consideration.
- 7.67 *Ad-hoc nature of land returning to Crown ownership:* The offer back requirement only applies to sensitive land going to overseas ownership/control. As a result there is no co-ordinated way of returning ownership/control of the full area of special land. For example if an overseas person purchases land which borders part of a river, only a small portion of the riverbank will be returned to the Crown.
- 7.68 *Burden falls on existing owner:* Currently the burden of making the offer-back to the Crown falls on the existing owner of the land, rather than the proposed overseas investor. Depending on who appoints the public valuer, the valuation costs may also fall on the land owner. The cost of offering special land to the Crown for free, if the owner chose to do so to process the sale quickly, also falls on the current land owner. This presents a strong disincentive for existing owners to sell any land that includes 'special land' to an overseas person. It is important to note that the 'special land' may constitute only a small proportion of the land being sold.
- 7.69 *Issues with river beds:* There are particular issues with the inclusion of river beds in the definition of special land:
- The Coal Mines Act 1903 (maintained in subsequent legislation) specified that the 'beds' of all rivers which are navigable are owned, and have always been owned, by the Crown. Determining whether a river is navigable under the Act and so already in Crown ownership is a difficult exercise. The flipside is that confirming who owns the river bed improves certainty around property rights. It is not clear however that this is the best way to do this.
 - River beds do not appear in schedule 1 of the Act. This indicates that land with a river on it would need to have other sensitive features to be triggered by the screening regime. It is inconsistent that rivers are not considered

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sensitive enough to be in schedule 1, yet are included in the definition of 'special land'.

Options

Option	Requirement	Impact
1 (status quo)	'Special land' must be offered to the Crown	None
2	Simplify process	Reduce disincentive to sell to overseas persons; reduce compliance costs for investors
3	Remove requirement for river beds	Reduce compliance costs (which are particularly high for river beds) and improve the targeting of the regime
4	Remove requirement	Remove disincentive and compliance costs

Preferred option

7.70 The preferred option is option 4. The current requirement to offer special land to the Crown before sale to overseas investors has high compliance costs, most of which fall on the current owner of the land. It reduces the value of the land which disadvantages its current owner. Moreover, it is not clear that the Crown gets much benefit from acquiring land on such an ad hoc basis, whereby small pockets of piece of special land come in Crown ownership but not an entire river for example. Concerns around special land tend to centre on how it is used, rather than who owns it, and this is addressed through the land test.

Change 7.6	Remove requirement to offer special land for sale to the Crown.
<i>Dimension</i>	<i>Impact</i>
Simple	This change significantly reduces compliance costs on owners of special land selling to overseas investors.
Predictable	n/a
Well-targeted	The change will mean the Act is better targeted at concerns about <i>usage</i> which do not require Crown <i>ownership</i> to address.

Requirement to advertise on the open market

Status Quo

7.71 Section 16(1) of the Overseas Investment Act includes the following criterion for overseas investments in sensitive land, which must be met for the investment to proceed:

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- a) if the relevant land is or includes farm land,⁵³ either that farm land or the securities to which the overseas investment relates have been offered for acquisition on the open market to persons who are not overseas persons in accordance with the procedure set out in regulations (unless the overseas investment is exempt from this criterion under section 20.)

7.72 The procedure for offering farm land or farm land securities for acquisition on the open market is set out in the Regulations (5 to 11). The purpose of the requirement is to ensure that persons who are not overseas persons, but who wish to acquire the farm land or farm land securities, have reasonable notice that they are for sale. The farm land or farm land securities must be:

- offered for acquisition on the open market, to persons who are not overseas persons, in accordance with regulations 6 to 8; and
- available on the open market for at least 20 working days from the placement of the advertisement (regulation 9); and
- advertised within a 12 month period prior to the earlier of either the date on which an application for consent is made, or the date on which the transaction that requires consent is given effect to (regulation 10).

7.73 The Act and the Regulations do not impose an obligation on the vendor of the farm land to enter into a contract with a New Zealand purchaser who becomes aware that the land is for sale and makes an offer for the land. However, in order to make the advertising requirement process operative, the vendor should stipulate that the agreement for sale and purchase contain a “cash out” provision, so that if a better offer is received during the advertising process, the vendor can require the proposed purchaser to match or better that offer.

7.74 Section 20 of the Act provides the ability to exempt particular investments from the need to advertise on the open market as follows:

“Section 16(1)(f) does not apply to an overseas investment if –

- a) the relevant Ministers consider that the overseas investment need not meet this criterion by reason of the circumstances relating to the particular overseas investment, interest in land or rights or interests in securities; or
- b) the overseas person making the overseas investment belongs to a class of overseas persons, or the overseas transaction belongs to a class of transactions, that is exempted from this criterion by the relevant Ministers by notice in the *Gazette*.”

⁵³ “Farm land” is defined in the Act as meaning land used exclusively or principally for agricultural, horticultural, or pastoral purposes, or for the keeping of bees, poultry or livestock.

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Issues

- 7.75 *Usage concerns addressed elsewhere:* The government is concerned with ensuring that the land is used in a manner consistent with New Zealanders' wellbeing. Consistent with this, the Act screens purchases of non-urban land and targets the underlying concerns around land use by requiring investors to negotiate with the relevant government agency over how to protect any sensitive features. Overseas investors are also subject to requirements under existing central and local government legislation about land use, particularly if they wish to change the use of the land.
- 7.76 *Costly process:* The process of advertising on the open market adds at least one calendar month to the contract process. This delays settlement of the purchase which is costly for the vendor and operates as a disincentive for vendors to sell to overseas persons. In cases where a sale includes many small pieces of farm land the costs are significant, unless an exemption is granted.
- 7.77 *Outcome unlikely to change:* Advertising on the open market provides an extra layer of protection aimed at ensuring that New Zealanders have a chance to purchase in what otherwise might be a private sale. However, there is no obligation for the seller to accept, or even consider, a domestic offer above a foreign offer. Since the vendor has likely chosen not to advertise the sale more widely because they are confident they have been offered a price above the market value, the outcome is unlikely to change.
- 7.78 *Land use may change:* The definition of "farm land" under the Act is an objective test of the use of the land at the time the transaction is entered into. However, the definition of "farm land" does not take into account proposed uses of the land - for example, the land may be zoned for residential, commercial or industrial purposes by the territorial local authority, and its current use as farm land may be temporary, pending re-development of the land.
- 7.79 *Unpredictability for investors:* The requirement creates unpredictability for investors because of the risk that a vendor may receive a more favourable offer from another bidder as a result of the advertising process. This unpredictability could lead to potentially significant losses being incurred, if expenses have been incurred prior to entry into the contract, but the transaction does not proceed.

Options

Option	Requirement	Impact
1 (status quo)	Farm land must be advertised on open market	None
2	Investment-type exemption: ie. exempting overseas purchasers intending to sub-divide or develop the land (ie. property developers). Land which will not remain farm land (but will be developed for residential, commercial or industrial purposes) will not be required to be offered on the open market before sale to an overseas investor.	Will reduce compliance costs for the vendor and investor in the event that the land is not to remain as farm land

Option	Requirement	Impact
3	Remove requirement for all investors	Removes disincentive and compliance costs for vendors and improves predictability for investors

Preferred option

7.80 Option 3 is the preferred option. Concerns around how the land will be used by the investor are addressed in other ways and future changes are protected against, if necessary, by the ability to impose conditions and the application of domestic legislation. The requirement to advertise farm land on the open market to persons who are not overseas persons has high costs both for the vendor – who must comply with the advertising requirement and face a delay in the sale process – and for the investor – who faces an additional barrier to closing a deal. Moreover, the Crown is not able to require a vendor to enter into a contract with a domestic investor, so the requirement can impose additional costs without changing the end outcome.

Change 7.7	Remove requirement to advertise farmland on the open market.
<i>Dimension</i>	<i>Impact</i>
Simple	This change reduces compliance costs on owners of special land selling to overseas investors. At least 20 days will be saved in the sale process, as well as costs of advertising.
Predictable	n/a
Well-targeted	This change recognises that the Act is targeted at control/usage concerns, rather than overseas ownership in itself.

8 SOVEREIGN WEALTH FUNDS

Status quo

8.1 The IMF defines Sovereign Wealth Funds (SWFs) as:

“...special purpose investment funds or arrangements, owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets. The SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.”

8.2 New Zealand does not have any specific screening procedures for SWF investments. Investments by SWFs will be screened if they fall within the categories of investments caught under the Overseas Investment Act.

Problem definition

8.3 The government wishes to examine whether there is a case for specific screening of investments from SWFs.

Increased prevalence

8.4 SWFs have grown in value and their assets are estimated to total around \$US3 trillion with projections that foreign assets under SWF management could reach \$US6-10 trillion by 2013.⁵⁴ SWF growth is partly linked to growth in international reserves and strong earnings on commodities.

8.5 The table below outlines the size of the world's 10 largest SWFs. A large and disparate group of countries have SWFs, including New Zealand, Australia, Alaska, Russia and Trinidad and Tobago.

Country	Assets (\$US Billion)	Inception	Origin
UAE	627	1976	Oil
Saudi Arabia	431		Oil
China	347		Non-Commodity
Norway	326	1990	Oil
Singapore	248	1981	Non-Commodity

⁵⁴ IMF (2008), Sovereign Wealth Funds – A Work Agenda.

Country	Assets (\$US Billion)	Inception	Origin
Russia	220	2008	Oil
Kuwait	203	1953	Oil
Hong Kong	193	1998	Non-Commodity
China	190	2007	Non-Commodity
Singapore	85	1974	Non-Commodity

Source: Sovereign Wealth Fund Institute, as at April 2009.

Concerns about SWFs

- 8.6 There has been an increasing level of debate on the benefits and risks associated with cross border sovereign investment. Critics have argued that SWFs may:
- cause market volatility due to growth in their size
 - make politically motivated investments or be linked to wider foreign policy objectives
 - be aimed at monopolising global natural resource reserves, and
 - exploit an unfair competitive advantage through access to official information sources.

Evidence to support concerns

- 8.7 The fact that SWFs are government owned provides the potential for such concerns to materialise. However the IMF has noted that there is no clear evidence that SWF investments have been motivated by political objectives. Thus far, it has not been evident that SWF governments have directly interfered with individual investment decisions of their funds or used them for political objectives.⁵⁵
- 8.8 The general policy response to these concerns has been to call for SWFs improve their transparency by providing more information on their investment strategies, the extent of government influence over operating decisions. Such information can help allay fears about the intentions of SWFs. A number of governments already publish this information.
- 8.9 The IMF has also noted that SWFs can have a number of positive attributes. SWFs allow income to be shifted between generations, aid in smoothing the consumption of volatile export earnings, improve diversification, and improve the return on foreign reserves. They also may provide liquidity through market downturns as evidenced by current investments in troubled companies.

⁵⁵ IMF (2008) Sovereign Wealth Funds – A Work Agenda

International responses

OECD

8.10 In June 2008, Ministers of OECD countries adopted a declaration to express their commitment to preserve and expand an open investment environment for SWFs. The following policy principles were endorsed for countries who are recipients of SWF investments:⁵⁶

- Recipient countries should not erect protectionist barriers to foreign investment.
- Recipient countries should not discriminate among investors in like circumstances. Any additional investment restrictions in recipient countries should only be considered when policies of general application to both foreign and domestic investors are inadequate to address legitimate national security concerns.
- Where such national security concerns do arise, investment safeguards by recipient countries should be:
 - transparent and predictable,
 - proportional to clearly-identified national security risks, and
 - subject to accountability in their application

Australia

8.11 Australia recently clarified the criteria that are used to determine whether an investment by a SWF is in the national interest. The new principles assess whether:

- i. an investor's operations are independent from the relevant foreign government
- ii. an investor is subject to and adheres to the law and observes common standards of business behaviour
- iii. an investment may hinder competition or lead to undue concentration or control in the industry or sectors concerned
- iv. an investment may impact on Australia's national security
- v. an investment may impact on the operations and directions of an Australian business, as well as its contribution to the Australian economy and broader community.

⁵⁶ OECD (2008) Sovereign Wealth Funds and Recipient Countries – Working together to maintain and expand freedom of investment

IMF guiding principles for Sovereign Funds

- 8.12 In response to increasing international debate, the IMF has developed a voluntary set of 24 best practice principles for SWFs (The Santiago Principles). These principles address some of the common criticisms of SWFs and are aimed at ensuring SWFs are focused on commercial objectives and behave transparently. Some of the key principles are:
- i. The policy purpose of the SWF should be clearly defined and publicly disclosed.
 - ii. The operational management of the SWF should implement the SWF's strategies in an independent manner and in accordance with clearly defined responsibilities.
 - iii. The accountability framework for the SWF's operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.
 - iv. If investment decisions are subject to *other than* economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed.
 - v. The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.
 - vi. The governance framework and objectives, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed.

Options

Screening for SWF investments

- 8.13 If there is concern that SWFs may be taking investment decisions for non-commercial or political reasons, this could be screened for as part of the investor test. Such a test could require a SWF investor to meet the following factors:
- that the management of the SWF is separated or independent from direct government influence
 - that the SWF is committed to complying with IMF guidelines for investment (or other best practice guidelines)
 - that the SWF regularly publishes information on their performance and operating intentions.
- 8.14 The key aim of any additional screening would be to address concerns that the investment may be occurring for non-commercial reasons. Other concerns such as whether the investment will reduce competition or is being made in 'strategic' areas would be addressed with more targeted policies.

Preferred option

- 8.15 For New Zealand, as a net importer of capital, sovereign funds are likely to become an increasingly important source of long-term investment funds. SWFs could provide significant benefits to New Zealand businesses in the form of additional capital.
- 8.16 Given lack of supporting evidence, we do not consider that SWFs present a significant problem beyond those presented by other major foreign investors. New Zealand has strong investment and corporate law, which provides protection against a wide range of potential threats. The government considers that the existing screening regime provides sufficient safeguards to ensure that investors are of good character and business focused.
- 8.17 The rapid growth in SWFs does suggest that there is a case for having some form internationally agreed standard to guide their management. If nothing else, such standards will help allay fears about the motivations of SWFs. The government considers that the Santiago Principles represent a good start to this process and any additional standards should be developed and agreed internationally. Obtaining international support is more likely to create awareness and compliance with such standards than if New Zealand was to do so alone.

9 STRATEGIC ASSETS

Status quo

- 9.1 When assessing whether an investment in sensitive land is likely to benefit New Zealand, one of the factors Ministers may consider is (regulation 28(h)):

whether the investment will, or is likely to, assist New Zealand to maintain New Zealand control of strategically important infrastructure on sensitive land.

Problem definition

- 9.2 There are two main problems with the status quo:

- **Regulatory uncertainty.** Two aspects to this uncertainty are set out below. This uncertainty is likely to be making foreign investors more wary when considering investing in large New Zealand companies.
- **Policy stability.** The additional factor was introduced by regulation in response to an application under consideration for and investment in Auckland International Airport Limited – it did not require Parliamentary approval. The ability to make significant policy change to the regime by regulation is considered in section 5.
- **Policy clarity.** There is currently a lack of clarity over (i) what is “strategically important infrastructure” and (ii) what threshold overseas investors have to meet to demonstrate that the investment will, or is likely to, assist New Zealand to maintain New Zealand control..
- **Poor targeting.** The factor applies only to sensitive land applications. It is not immediately apparent that infrastructure on sensitive land is likely to be more strategically important than infrastructure that is not.

- 9.3 Standing back from problems with the existing restrictions on strategic assets, the prior question is: Does the Overseas Investment Act need to refer to ‘strategic assets’ explicitly, over and above other screening for significant business assets and sensitive land?

Analysis

Restrictions on strategic assets beyond the Overseas Investment Act

- 9.4 New Zealand currently has a number of foreign ownership restrictions on assets that could be considered strategic outside the Overseas Investment Act. The restrictions fall into three main types:

- **Company constitutions.** The following two restrictions take the form of provisions in the companies' constitutions. Both constitutions also contain a number of other ownership restrictions, such as the number of New Zealand citizens required to be on the board of the companies.
 - *Telecom New Zealand.* No person can have a relevant interest in 10% or more of the total voting shares, and no person who is not a New Zealand national can have a relevant interest in more than 49.9% of the total voting shares. These restrictions can be relaxed only with the prior written approval of the Kiwi Shareholder (and the Board in the case of the first restriction).
 - *Air New Zealand.* Non-New Zealand nationals may not own more than 10% of voting rights without Kiwi Shareholder consent.
- **Banking sector.** Banks operating in New Zealand must be locally incorporated. *[Withheld - maintain the effective conduct of public affairs through the free and frank expression of opinions]*
- **Crown ownership.** Large companies in major sectors of the New Zealand economy are currently owned by the Crown:
 - *Energy.* Three of the four largest electricity generators are 100% owned by the Government (Meridian, Mighty River Power, Genesis). The transmission grid is 100% owned by the Government (Transpower).
 - *Aviation.* The national carrier is 76% owned by the Government (Air New Zealand).

Screening for strategic assets within the Overseas Investment Act

9.5 The Overseas Investment Act already provides for screening of significant business assets and sensitive land, which together are likely to capture assets considered strategic:

- *Business screening.* For example, with a screening threshold of \$200 million, a 50% stake by an overseas investor in any of the following infrastructure companies would be screened: Contact Energy, Telecom New Zealand, Vector, Auckland International Airport, Infratil, Watercare Services, TrustPower, Metro Water, Port of Tauranga, the New Zealand Refining Company.
- *Land screening.* Many assets that could be considered strategic are likely to have assets on sensitive land, and would therefore also be screened.

Designing a test for strategic assets

9.6 Any restrictions on strategic assets in the overseas investment regime have a number of design parameters. The following table sets out the main parameters and gives an indicative sense of the range of options:

Parameter	Broad range of options
Type of definition	<ul style="list-style-type: none"> • a relatively broad definition (e.g. simply "strategically important infrastructure") • a narrow definition (e.g. specific businesses).
Sectors	<ul style="list-style-type: none"> • all sectors • specific sector(s) (e.g. infrastructure) • specific sub-sector(s) (e.g. airports)
Nature of restriction	<ul style="list-style-type: none"> • simple ownership restrictions (e.g. maximum 49.9% overseas ownership) • restrictions related more to control by a small number of overseas investors (e.g. 25.0% by any one investor).
Extent of the restriction	<ul style="list-style-type: none"> • a net benefit test • explicit restrictions
Location in the regime	<ul style="list-style-type: none"> • separate class of assets • part of screening for significant business assets • part of screening for sensitive land

9.7 Core considerations within these options are:

- *Possible degree of specificity.* The definitions of (i) what assets are covered by any restrictions, and (ii) what the hurdle is for investment to be successful, are both crucial to designing a credible regime. Is it possible to specify adequately the businesses that are 'strategic'?
- *Flexibility vs certainty.* Providing flexibility for Ministers comes at a cost of certainty for investors. How should this trade-off be made?

Preferred option

9.8 The Government's view is the explicit coverage of strategic assets is not required within the overseas investment regime for three reasons:

- *Existing restrictions.* Overseas ownership restrictions are already in place for a number of large businesses, through constitutional provisions (Telecom, Air New Zealand), requirements to locally incorporate (the banking sector), and Crown ownership (electricity sector, Air New Zealand).
- *Existing screening.* Strategically important assets are highly likely to be captured by screening for significant business assets and/or sensitive land, providing a level of protection for such assets.

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- *Difficult to design anything additional.* The complexities in designing specific provisions for strategic assets mean that they are likely to create a potentially large degree of regulatory uncertainty for investors.

Change 9.1	Remove the existing provision for strategically important infrastructure (regulation 28(h)), without replacing it.
<i>Dimension</i>	<i>Impact</i>
Simple	Uses existing generic provisions for significant business assets and sensitive land, rather than complex specific provisions.
Predictable	Removes existing significant uncertainty over (i) what is "strategically important infrastructure" and (ii) what threshold overseas investors have to meet.
Well-targeted	Uses existing screening that is targeted at underlying concerns (such as good character, business acumen, and land access).

10 ASSETS ALREADY UNDER OVERSEAS OWNERSHIP/CONTROL

Status quo

10.1 There are two cases in which the Act requires an overseas person to seek consent when the asset may already be in overseas ownership/control:

- *Increase in ownership/control of asset.* Investors must seek consent to increase their level of ownership/control in a significant business asset or sensitive land asset. The investor's previous consent will relate to a specific level of ownership or control and will generally lapse after one year. It is relatively common for investors to increase their stake in sensitive assets over time, such as through share offers.
- *Sale of asset to another overseas investor.* If the ownership or control of a significant business asset or sensitive land is moving from one foreign investor to another, the new investor must gain consent. The underlying concern that this screening is seeking to address, is to ensure that the new investor has business acumen, good character and financial commitment, and, in the case of sensitive land, that they will use the land in accordance with local norms and laws.

Increases to existing levels of ownership/control

10.2 A recent change to the Overseas Investment Regulations 2005 provides an exemption that allows investors to increase their level of ownership or control in a significant business asset or sensitive land by up to 5% without needing to re-apply for consent. The government wishes to consider whether any increases in ownership/control by the same overseas person in the same investment to seek consent under the Act.

Significant business investments

10.3 The main objective to screening business investments is to ensure the investor is fit to purchase significant New Zealand business assets, by testing for the investor's business acumen, character and financial commitment. Once the investor has satisfied these tests for an application, it is not clear that re-screening provides any additional benefit to New Zealand, since the investor's characteristics are unlikely to have changed.

Sensitive land

10.4 The main objective to screening sensitive land investments is to ensure, first, that the investor is fit to purchase sensitive New Zealand land, by testing for the investor's business acumen, good character and financial commitment, and second, that the investor will use the land in a way which is consistent with domestic behavioural norms and legislation. Once the investor has met the proposed test for

sensitive land, and has understood and committed to comply with relevant New Zealand laws on land use, it is not clear that re-screening provides any additional benefit to New Zealand.

Preferred option

- 10.5 The Government considers that the requirement to seek a new consent creates unnecessary compliance costs for overseas investors without providing any additional benefit to New Zealand, since the investor has already previously shown that they comply with the criteria for making an investment in significant business assets or an investment in sensitive land. The risk that needs to be considered is that the nature of the overseas investor does not always remain the same. An investor who was screened and approved could have, within a short period of time, changed from being an investor of good character to one of unsavoury character, or they may have demonstrated business acumen relevant to a certain level of shareholding but not necessarily more than that. While acknowledging that this is a risk, the government considers this risk to be low.
- 10.6 Consequently, the Government considers that further consent should not be required if the investor is the same overseas person. For example, if an overseas person had a 30% stake in a firm which owns sensitive land, or in a significant business asset, and wished to increase their stake to 40% (or more) they would no longer be screened. However, if the same overseas person wished to make a new investment, which exceeded the screening threshold, then they would need to seek consent under the Act.

Change 6.2	Remove the requirement for an investor to seek consent to increase their existing level of ownership or control in a significant business asset or in a particular piece of sensitive land.
<i>Dimension</i>	<i>Impact</i>
Simple	n/a
Predictable	n/a
Well-targeted	Concerns about the investor are addressed at the initial time of screening. Unnecessary additional screening is removed.

Changes in ownership/control from one foreign investor to another

- 10.7 The underlying concern around the ownership or control of a significant business asset or piece of sensitive land moving from one foreign investor to another is whether the new investor has business acumen, good character and financial commitment, and, in the case of sensitive land, whether they are aware of domestic norms and laws with respect to its use.
- 10.8 Given that the asset in question may already be in overseas ownership or control, there may be a perception that additional screening is not required. However, the

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government considers that the concerns outlined are still likely to be relevant in the case of the new overseas investor. For example, while the existing overseas investor may be of good character, it is possible that a subsequent investor may not be. Equally, while the existing overseas investor has demonstrated that they understand, and has undertaken to comply with, domestic legislation, another overseas investor has not.

- 10.9 As such the government considers this part of the screening regime is well targeted at community concerns and no changes are proposed.

11 IMPLEMENTATION AND REVIEW

- 11.1 The policy proposals will require amendments to the Overseas Investment Act 2005 and the Overseas Investment Regulations 2005.
- 11.2 A Bill will be introduced to Parliament in approximately September 2009. Allowing a six week period for the receipt of public submissions, the Finance and Expenditure Select Committee will hear oral submissions and deliberate from late October to late November. The Bill should be reported back to the house in early December and be enacted as soon as possible afterwards. Interested members of the public will be able to have input into the review through the Select Committee process.
- 11.3 An evaluation of the effectiveness of the changes to the screening regime will be considered by Cabinet in August 2010. This evaluation will assess how the changes have affected application numbers, the time taken to assess applications and whether the negotiation requirements in the sensitive land test are working effectively. The evaluation will also include feedback from law firms and on how they view the changes. The report back will also include an assessment of whether the fees charged to overseas investors are correctly set to recover the Overseas Investment Office's costs.

12 CONSULTATION AND FEEDBACK

Consultation

- 12.1 This review was led by Treasury, in consultation with Land Information New Zealand and the Overseas Investment Office. The following government departments and agencies were consulted in the preparation of this Policy Document:
- 12.2 Ministry of Economic Development, Ministry of Foreign Affairs and Trade, Ministry of Fisheries, Ministry of Agriculture and Forestry, Ministry for Culture and Heritage, Te Puni Kōkiri, Department of Labour, Department of Conservation, Ministry for the Environment, Department of Internal Affairs, Investment New Zealand, the Walking Access Commission and the Historic Places Trust. The Department of Prime Minister and Cabinet has been informed of the proposals.
- 12.3 In addition, a Technical Reference Group was established to assist with the development and review of the policy proposals. This Group consists of partners from five law firms who have detailed knowledge of the operation of the Overseas Investment Act. The following firms were represented in the Group: Bell Gully, MinterEllisonRuddWatt, Simpson Grierson, ChapmanTripp and RussellMcVeagh. The Terms of Reference for this group are available from:
- 12.4 <http://www.treasury.govt.nz/publications/informationreleases/overseasinvestment/review2009>

Summary of feedback

- 12.5 There has been a large amount of agreement with proposed changes and a significant amount of feedback has been incorporated in the document.
- 12.6 The area that has attracted the most debate is the proposed change to the test that investors must meet before purchasing sensitive land. On this issue views have been expressed that range from the test not being sufficient to protect domestic norms, to whether the test should be for sensitive features only, or nothing at all.
- 12.7 The table below outlines the main issues raised through consultation and how they have been addressed:

Issue	Concern	How addressed
Overall review	The case has not been made to justify the proposed changes.	Additional information on the compliance costs faced by investors has been included. All proposals include an assessment of the impact against the criteria of simple, predictable and well targeted.

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Issue	Concern	How addressed
Interaction with the fishing quota screening regime	The proposed changes to the purpose of the Act, definition of an overseas person, and increases in ownership control once approved, may affect the Fisheries Act.	Clarification that any changes in these areas will not be carried over to the Fisheries Act.
Definition of an overseas person.	Implementing a dual threshold would not be workable if a company is required to assess whether any of its shareholders are associates.	No associate test is required.
	That the proposal to rely only on control rather than ownership would create avoidance opportunities.	A test of both ownership and control is retained in the definition of an overseas person.
Changing the sensitive land test from the current subjective benefit test to the proposed objective test.	That the ability to provide extra safeguards (for things such as walking access and heritage protection) will be lost.	The recommended test still addresses key community concerns about access and usage, but relies on domestic legislation and negotiation with the relevant agency to do this. The current Act allows Ministers to set conditions, which can far exceed that required by domestic legislation.
	The proposal for investors to demonstrate compliance with relevant legislation (eg RMA, Walking Access Act) would not be workable - many obligations do not take effect until the land use is changed, and the obligations are largely voluntary.	This proposal has been removed.
	That the OIA should not be used to pursue other policy objectives which can be achieved with legislation that covers domestic and overseas investors.	The government considers that screening of overseas investors is required to ensure they are aware of significant features on the land and the value placed on them by New Zealanders.
	That the effective provision of public benefit will be less, due to overseas persons not having the same social norms.	This risk is mitigated by requiring overseas investors to identify the sensitive features on their land and to negotiate in good faith with the Walking Access Commission, Historic Places Act and Department of Conservation over their protection.
	Ministers should have discretion via the net benefit test; they may otherwise face judicial review.	The government places greater importance on improved predictability and certainty for investors.
<i>[Withheld - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements]</i>		

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Issue	Concern	How addressed
Changing the purpose statement.	The new purpose reflects a large shift from discrimination against foreigners to near equivalence and this has not been acknowledged.	The new purpose reflects a balance between the <i>benefits</i> of overseas investment and the safeguards the Act provides. Advice to Ministers has highlighted this change.
	The Act is primarily about restricting overseas investment, which makes it unusual for the purpose to consider the benefits that investment provides.	The government considers some balance is required between providing safeguards while acknowledging the benefits overseas investment provides.
Removing the requirement to advertise farm land on the open market.	Rural communities will be concerned that their right to make an offer on farm land is removed.	Screening is better targeted at land <i>usage</i> rather than ownership. This requirement is unlikely to change the final outcome of the transaction and it creates delays in the consent process.
Remove screening for land that <i>adjoins</i> land with heritage sites/ heritage orders/ wahi tapu areas.	The setting of a historic place is important and changes to sites adjacent to historic places can impact on heritage values.	The RMA provides some protection for historic sites, especially when the use of the land is changing. Screening this land will bring little additional benefit under the proposed objective test which does not provide for significant additional protections to be imposed.
Narrowing the scope of non-urban land to farmland and forestry only.	The initial proposal to remove forestry land from the scope of the Act raised concerns that issues such as access and protection of environmental values would not be addressed.	Forestry is now retained within the scope of sensitive land.
Increase in ownership/ control once approved.	Some members of the public will be concerned that an overseas person gaining consent at a low level of ownership could then dramatically increase level of ownership/control.	The investor has already passed a test targeted at their <i>usage</i> of the asset, and additional screening is unlikely to provide a different result to the initial screening. Investors will still have to seek consent before investing in <i>another</i> sensitive asset.
Foreigner to foreigner transactions	Such transactions should not be screened because the asset is already in overseas ownership and it restricts investors from operating in a fully commercial and manner.	Concerns about good character and awareness of sensitive features on land are still relevant when an asset moves from one overseas owner to another.

12.8 The Technical Reference Group has also raised a number of issues with the Act that have not been explicitly considered in this review, either because they are outside the scope of the review or because there has not been sufficient time to consider them. These include:

- That the definition of associates is too wide and is capturing parties who are not associates of the investor;
- That the location of the Overseas Investment Office in Land Information NZ should be reassessed;

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- That there should be a statutory limit on the amount of time that Ministers have to assess applications;
- That the Act should clarify how land area is to be calculated when determining if land is above or below the area thresholds in the Act.