Chair
CABINET ECONOMIC GROWTH AND INFRASTRUCTURE COMMITTEE

IMPROVING THE OVERSEAS INVESTMENT ACT

Proposal

1. This paper proposes improving the screening process for overseas investments to ensure that it is simple, predictable and well-targeted at the underlying concerns that New Zealanders hold about overseas investment.

EXECUTIVE SUMMARY

2. A number of problems have emerged with the operation of the overseas investment regime since it was amended in 2005. The proportion of investments declined has remained low, and no business investment has been declined for 25 years (where sensitive land has not been involved). However, compliance costs for investors have increased significantly, both time cost and financial cost, often for investments that are not particularly sensitive. Some specific decisions, such as Auckland Airport, have created regulatory uncertainty.

3. One of the six pillars of the Government's medium-term economic agenda is improving the regulatory environment for business [CAB Min (09) 24/7 refers]. I propose a number of amendments to the Overseas Investment Act, as summarised on the table on the next two pages. The changes will significantly reduce compliance costs and make New Zealand more attractive internationally as an investment destination. The most significant changes are:

- moving from a 'benefit' test for investments in sensitive land, to a test that largely relies on existing legislation that covers domestic and overseas investors but provides for additional provision of public walking access;
- removing the current strategic assets provision and introducing a reserve power to allow the Minister of Finance, in exceptional circumstances, to decline a business investment if it is not in the national interest;
- removing the ability to make substantive policy change by regulation;
- moderately narrowing the scope of sensitive land that is screened;
- moderately increasing the business screening threshold; and
- removing the requirement to offer 'special land' to the Crown or to advertise farm land on the open market before sale to an overseas person.

4. The main judgements in making these changes are (relative to the status quo):

- greater predictability for investors, and less flexibility for Ministers;
- lower compliance for investors, slightly less coverage, [*Withhold - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements]*; and
- relying primarily on protections in other legislation, except for walking access.

5. The proposed changes do not fundamentally alter the types of assets screened nor the types of concerns being addressed. I consider that the proposed test for sensitive land still provides adequate safeguards to address New Zealanders' underlying concerns and represents better regulatory practice by relying primarily on legislation that covers both domestic and overseas investors.

Issue (page in policy document)	Status Quo	Proposed change	Impact
A. Purpose of the Act (p.30)	*To acknowledge that it is a privilege for overseas persons to own or control sensitive New Zealand assets.*	*To provide safeguards for investments in sensitive assets by overseas persons while generally maintaining an open and welcoming stance towards overseas investment.*	• 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.
Definition of an overseas person: B. Exemption for residents (p.37)	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.	• Well targeted as residents are able to reside in New Zealand indefinitely and are similar to citizens. The expected impact is around 0.01% fewer applications per year.
C. Policy change by regulation (p.48)	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.	• More predictability and certainty for investors, less flexibility for Ministers.
D. Business assets: scope (p.57)	Business investments of more than $100 million are subject to screening.	Increase the threshold to $200 million. Retain screening for greenfields investment.	• Well targeted – only screen the most significant transactions. Reduce business applications by around 20%.
E. Business assets: hurdle (p. 60)	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.	• 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.71) G. Section 37 (p.74)	Screens non urban land greater than 5 hectares (includes farm land, forestry, and other non urban land).	Screen farm land and forestry land only (rather than all non urban land). Increase the area threshold to 10 hectares.	• Well targeted – small land holdings are exempted, as are commercial/industrial businesses located on non-urban land. Roughly 8% reduction in land applications.
	Screens land adjoining local and National Parks and reserves.	No longer screen land adjoining local parks. Retain screening for land adjoining National Parks.	• 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.75)	Screens land that adjoins land subject to heritage orders or a historic place.	No longer screen land that *adjoins* land with heritage sites/heritage orders/wahi tapu areas.	• Simpler and well targeted as above. Around 4% fewer land applications.

Issue (page in policy document)	Status Quo	Proposed change	Impact
I. Sensitive land: hurdle (p.85)	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.	• **Simplified** assessment process for investor and regulator. • **Well targeted** as Act directly addresses common concerns but relies largely on other 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.87)	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.	• **Simplify/remove** the complexity associated with the offer back process. • **Well targeted** –addresses the underlying concerns which relate *usage/access* rather than *ownership*. Around 12 days saved on special land applications.
K. Requirement to advertise farm land on the open market (p. 90)	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.	• **Simplify/remove** the delays caused by the advertising requirement. • **Well targeted** – address the underlying concerns of *usage* rather than *ownership*.
L. Increases in ownership/control once approved (p.101)	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.	• **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.99)	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.	• **Simpler** – no additional sub-class of screening. • **More predictability** for investors, since no ambiguity over whether an asset is strategic.
Areas where no change is proposed			
Sovereign Wealth Funds (p.95)	No additional screening for Sovereign Wealth Funds.	None.	
Land: scope (p. 68)	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.	

BACKGROUND

6. The Overseas Investment Act 2005 ("the Act") regulates investments by overseas persons in certain New Zealand assets. An "overseas person" is an individual who is neither a citizen nor meets certain residency conditions, or a business that is 25% or more owned or controlled by individuals who are overseas persons.

7. Three categories of sensitive assets are covered by the regime: significant business assets, sensitive land and fishing quota. Broadly, business investments by overseas investors of over $100 million are screened. Investors must show that they have business acumen and experience, financial commitment and good character (the 'investor test').

8. Overseas investments in land are screened if the land is of a type considered sensitive under the Act and exceeds a certain area threshold. Examples include non-urban land that exceeds five hectares, foreshore and seabed, land on islands, and land held for conservation purposes. Investors must pass the investor test and must also demonstrate that the investment will benefit New Zealand, and, in the case of non-urban land, that the benefit will be 'substantial and identifiable'.

9. In February 2009 the Government agreed to a regulatory review programme for this year, which includes reviewing the Act and Regulations [CAB Min (09) 6/5A refers]. In July 2009 the Government agreed to adopt a medium-term economic agenda based on six pillars [CAB Min (09) 24/7 refers]. Improving the regulatory environment for business is one of these pillars, and the review of the Overseas Investment Act is one component.

10. Aspects of the screening regime that are outside the scope of the review include: fishing quota (covered by the Fisheries Act 1996), and organisational and implementation issues.

COMMENT

Problem definition

11. The Act is intended to address public concerns about the impact of overseas investment on New Zealand. In particular, New Zealanders may be concerned that an overseas investor may use an asset in a way that differs from local norms.

12. In recent years, a number of problems have emerged with the operation of the regime. Compliance costs for investors have increased significantly, both time cost and financial cost in terms of legal fees and consultants (see Annex 1 for an indicative range of costs). Some decisions by Ministers, such as Auckland Airport, have created significant regulatory uncertainty. The proportion of investments declined has remained low, and no application for investment in significant business assets (where sensitive land is not involved) has been declined for 25 years. However, a number of business transactions involving applications for sensitive land have been declined, including high-profile investments such as Auckland Airport and Bluescope Steel.

13. The problems are most acute for sensitive land screening: Land has been involved in 85% of all applications since 2001/02. Land applications are large and complex, requiring 27 factors to be addressed, and in the past have taken on average 70 days to assess. The OIO now aims to assess applications within 50 days of receiving them and has made good progress reducing assessment times. However, this timeframe does not include the time taken to prepare the application, and often the whole process takes several months due to the complexity of the requirements.

14. There is anecdotal evidence that the complexity of the screening regime is making overseas investors cautious about investing in New Zealand, or putting them off completely. New Zealand is one of the few developed countries operating a screening regime at all and the comprehensive nature of the screening regime across sectors is also an outlier. The OECD highlighted the screening regime as an area for improvement (or removal) in its 2009 economic survey of New Zealand.

15. In short, I consider that the Act is currently putting New Zealand at a competitive disadvantage internationally. New Zealand is heavily reliant on foreign capital and the current international economic circumstances make it even more important that the screening regime does not unnecessarily deter overseas investment. I propose that the Act can be improved in three broad areas, while maintaining appropriate safeguards:

- *Simple:* The Act is currently complex and creates significant compliance costs for investors.

- *Predictable:* The regime can be uncertain and unpredictable for investors, which may be acting as a disincentive to invest in New Zealand.

- *Well-targeted at underlying concerns:* The current scope of the Act screens investments that are not particularly sensitive. The sensitive land test requires consideration of 27 factors, not all of which relate to underlying concerns of New Zealanders.

Main judgements

16. The main judgements underlying the proposed changes are as follows:

- Predictability for investors is an important objective for the screening regime. Some reduced flexibility for Ministers in deciding applications is warranted to improve predictability.

- Only businesses and land investments considered most sensitive to New Zealanders should be screened. The scope of investments screened should be reduced where appropriate, with the trade-off being less opportunity to review overseas investments in relatively less sensitive assets, *[Withhold - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements.]*

- Protecting sensitive New Zealand assets should primarily be achieved by other legislation, so that both domestic and overseas investors are captured. The implication is that the overseas investment regime should generally be ensuring awareness of, and consistency with, domestic norms and legislation, rather than imposing additional obligations on overseas investors.

17. The overall structure and scope of the Act would remain largely unchanged: the proposed changes do not fundamentally alter the types of assets screened or the types of concerns being addressed. The changes to sensitive land are a significant simplification and represent a shift in approach from a regime that considers overseas investment a privilege, and therefore an opportunity to impose additional obligations across a range of factors, to one which is better targeted at the most significant concerns of New Zealanders.

18. I consider that this shift is justified because of the significant benefits that overseas investment brings, and that adequate safeguards are still in place to address New

Zealanders' underlying concerns. I also consider that this test better targets the core issues of concern relating to the usage and protection of sensitive features on the land, particularly public walking access. This approach represents better regulatory practice by relying primarily on legislation that covers both domestic and overseas investors.

Proposed changes

Purpose of the Act (change A on the table above)

19. I propose to change the purpose of the Act to reflect the importance of ensuring sensitive New Zealand assets are protected while acknowledging the importance of overseas investment to New Zealand's economic growth.

Definition of an overseas person (change B)

20. I propose to exempt persons who hold a residence permit that entitles them to reside in New Zealand indefinitely from screening under the Act.

Policy change by regulation (change C)

21. I propose to remove the ability to add by regulation to the factors that must be considered when assessing a sensitive land application. Any changes to the factors that investments must meet would then require legislative change.

22. The trade-off is a loss of flexibility for Ministers to act quickly in response to particular investment applications. For example, this ability was last used in 2008 when the Canadian Pension Plan Investment Board sought consent to purchase a stake in Auckland Airport and a new regulation was added. Similar actions would not be possible if the clause allowing this is removed from the Act.

23. I consider that improved predictability for investors – that is, investors knowing that the rules of the game will not change – outweighs the loss of flexibility, and that any substantive policy changes should be addressed by amending primary legislation.

Business assets: scope (change D)

24. I propose that the monetary threshold for business screening should be increased from $100 million to $200 million, reducing business applications by around 20%. Unilaterally increasing the screening threshold would reduce compliance costs for investors and send a signal to investors that New Zealand is open to overseas investment.

25. A threshold of $200 million would ensure that investments in New Zealand's most significant businesses are still screened. As an indication, this threshold would still screen investments that result in 25% overseas ownership in at least New Zealand's 25 largest companies (by equity), compared to the largest 44 companies which are caught under the current threshold.

26. Any change to the business threshold will have implications for New Zealand's existing Free Trade Agreements (FTAs) [*Withhold – disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements.]*

27. [*Withhold – disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements.]*

28. New Zealand has international obligations under World Trade Organisation (WTO), and certain FTAs around changes to the screening regime. In a number of FTAs, New Zealand has agreed that increases to the business screening threshold will become binding commitments on New Zealand through the application of the "ratchet" provision in those FTAs. The "ratchet" mechanism means that any increase in the business threshold would be "locked in" for those trading partners, and could not be subsequently lowered.

29. In short, the key judgements are:

- how large the economic benefits are from having a higher screening threshold;
- *[Withhold - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements]*;
- how important policy flexibility is in the future.

30. Weighing up these judgements, I consider that raising the threshold to $200 million is warranted because of the economic benefits of the positive signal it sends to investors that New Zealand is open for business and the reduction in compliance costs for investors. It is hard to quantify both the economic benefits of this change *[Withhold - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements.]*

Business assets: hurdle (change E)

31. I propose to add an additional criterion to the test used to assess investments in significant business assets. This criterion would be a reserve power allowing the Minister of Finance to decline an investment in significant business assets where the investment is not in the national interest. This power 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.

32. To ensure transparency, if this factor is used, the Minister's decision and the evidence of the threat to the national interest must be tabled in Parliament within one month of the decision.

33. This provision brings New Zealand in 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 vital economic interests. The design is based on the standard OECD text for such provisions in relation to national security and draws on the OECD principles of predictability, proportionality, and accountability.

Sensitive land: scope (changes F, G & H)

34. I propose that the definition of sensitive land be narrowed, to exclude types that are not particularly sensitive, by:

- excluding non-urban land which is not farm land or forestry;
- increasing the area threshold for non-urban land from 5 to 10 hectares;
- removing section 37, which requires the regulator to keep a list of reserves, parks and other areas, and makes the adjoining land sensitive;
- adding 'land adjoining national parks' greater than 0.4 hectares (to replace section 37); and
- removing screening on land that *adjoins* land that is subject to a heritage order, includes a historic place or wahi tapu area.

35. Narrowing the scope of the Act will reduce screening of overseas purchases of New Zealand land. The increase in the area threshold to 10 hectares will mean that lifestyle blocks and many smaller farms, particularly horticultural blocks, will no longer be subject to the Act.

36. Removing screening for land that adjoins historic places or wahi tapu areas means that these areas may be adversely affected by developments on the adjoining land. As this land *adjoins* rather than includes sensitive sites, I consider that the land being excluded is not of a particularly sensitive nature and therefore does not require screening.

37. The types of land *c*urrently captured by section 37 are very broad and include sports and recreation fields which I do not consider are particularly sensitive. The list can also be modified, which introduces uncertainty for investors.

38. Land which falls under the categories that are proposed to be removed will still be screened if it has other sensitivities; for example, if it adjoins the foreshore.

39. The proposed changes to the scope of sensitive land would be subject to "ratchet" provisions in our current FTAs with China and P4 (Singapore, Chile and Brunei). The ratchet provision means that any types of land removed from the definition of sensitive land could not subsequently be reinserted into the definition in relation to investments from those countries.

Sensitive land: hurdle (change I)

40. The most significant proposed change is to replace the existing 'benefit' test for sensitive land with a new two-part test.

- First, investors would need to identify any sensitive features on the relevant land that relate to historic heritage, wildlife, indigenous vegetation, and walking access provisions, and sign a certificate stating they are aware of the sensitive features and that New Zealand legislation has provisions to protect these features.

- Second, the Ministers of Finance and Land Information must be satisfied that, where relevant, there are, or will be, adequate mechanisms in place for providing, protecting, or enhancing walking access over the relevant land.

41. The first requirement will help to address 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.

42. The second requirement 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. If appropriate, it could be a condition of consent that walking access be provided.

43. Overseas investors will no longer need to address the other 19 factors in the Act and Regulations and Ministers will not be able to impose additional obligation with respect to those factors. I consider that, in general, other legislation such as the Resource Management Act and Historic Places Act, provide sufficient protections for sensitive features. I do not consider it necessary for investments in land to show economic benefits,

because commercial incentives, such as the incentive to generate profits, are sufficient to ensure that an investor's interest will align with the national interest, and legislation such as the Commerce and Company Acts address concerns about monopoly power and a board not acting in the best interests of a company.

44. Walking access has been singled out because the provisions in other legislation are relatively weak, there is public concern about access under overseas ownership, and New Zealand social norms and behaviours are 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.

45. This proposal has two main trade-offs:

- Ministers would have less discretion when assessing applications: if an investor meets the investor test, and agrees to provide adequate walking access, the investment must be approved;
- investors have to meet domestic standards with regard to land use, and additional obligations are imposed on them only in the case of walking access.

46. I consider that the reduced flexibility for Ministers is outweighed by the improvement in the simplicity and predictability of the land test. This change is expected to significantly reduce compliance costs for investors, both in terms of preparing their application and awaiting a response.

Offer back of special land to the Crown (change J)

47. I propose to remove the current requirement to offer 'special land' (i.e. foreshore, seabed, lakebed and riverbed) to the Crown before sale to an overseas person.

48. I do not consider that Crown ownership is required to provide adequate protections for special land. The underlying concern around special land, as with other types of sensitive land, is predominantly how it will be used (for example, whether there will be adequate public access), rather than who owns it. I consider that the sensitive land test which addresses the usage of land is sufficient to address concerns around special land.

49. If there were a desire for the Crown to own this land, the requirement to offer special land to the Crown is unlikely to be the best way to address it. It results in special land being returned to the Crown on an ad hoc basis (as land around it moves into foreign ownership) and means that the Crown owns portions of land that are not necessarily connected. For example, the Crown may own a portion of a riverbed, up to the centre line, but no more. Moreover, the process by which the offer back occurs is complex and costly, and currently results in the land being offered to the Crown for no cost.

Requirement to advertise farm land on open market (change K)

50. I propose to remove the requirement to advertise farm land on the open market before it can be sold to an overseas person. This requirement creates delays to the consent process and is unlikely to change the final outcome of the transaction because the vendor does not have to consider any alternative offers.

Increases in ownership/control once approved (change L)

51. I propose to remove the requirement for investors to reapply for consent to increase their *existing* level of ownership or control in a significant business asset or sensitive land.

Additional screening is unlikely to provide a different result to the initial screening as the investor has already satisfied the investor test (good character and business acumen), and will have become aware of sensitive features and agreed to provide walking access in the case of sensitive land investments. This change will not remove the requirement for investors to seek consent before investing in *another* sensitive asset.

Strategic assets (change M)

52. I propose that the Act contains no additional screening for strategic assets, over and above what is required for the screening of land and business assets. That is, the factor currently in the regulations that allows Ministers to consider whether an investment will *assist New Zealand to maintain control of strategically important infrastructure on sensitive land* will be removed, and not replaced.

53. The trade-off is a reduction in the government's flexibility to decline an application on the basis that it is a strategic asset, and therefore should not be under overseas ownership or control.

54. I consider that explicit coverage of strategic assets in the Act is not required for four key reasons.

- the reserve power provided in the proposed national interest test provides the ability to decline an investment in exceptional circumstances;
- overseas ownership restrictions are already in place for a number of large businesses, through:
  - provisions in the company constitutions of Telecom and Air New Zealand restricting foreign ownership;
  - requirements for banks operating in New Zealand to locally incorporate; and
  - Crown ownership of Air New Zealand and large parts of the energy sector (e.g. three of the four major electricity generators);
- strategically important assets are highly likely to be captured by screening for significant business assets and/or sensitive land, and if a business investment is considered by the Minister of Finance to not be in the national interest it can be declined; and
- designing specific provisions for strategic assets is complex, and likely to create a potentially large degree of regulatory uncertainty for investors.

Areas where no change is proposed

55. I propose no change to the following areas of the screening regime:

- *Sovereign wealth funds:* There will continue to be no additional screening or requirements specifically for sovereign wealth funds.

- *Land scope:* The vast majority of sensitive land types will remain unchanged. The regime will still screen foreshore, lakebeds, islands, conservation land, land with heritage value and numerous other categories.

Likely impact of proposed changes

56. The overall estimated impact of the proposed changes to the scope, hurdle, and approval rate is 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	• The reserve power will only be used in exceptional circumstances	• 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%)

Relative importance of proposed changes

57. The following table indicates the order of priority for the most significant proposed changes and some possible trade-offs that could be made.

Priority	Proposed change	Possible trade-offs
1	Sensitive land test	• Retain the offer back of special land to the Crown • Make no or fewer changes to the land scope • Add additional requirements for other aspects (e.g. conservation)
2	Strategic assets/ reserve power	• Raise the business threshold by a smaller amount, or not at all • Include a specific test for Sovereign Wealth Funds
3	Policy change by regulation	• Allow change by regulation, but exempt any applications currently under consideration from the effect of regulation changes
4	Narrowing of land scope	• Raise the land threshold for farm land and forestry by a lower amount, or not at all • Retain screening for land adjoining historic places
5	Increasing business threshold	• Include a specific test for Sovereign Wealth Funds

Priority	Proposed change	Possible trade-offs
6	Offer back of special land to the Crown	• Retain the offer back apart from for river beds (which are the most problematic and least sensitive) • Retain the requirement to advertise farm land on the open market

OTHER MATTERS

58. Screening of fishing quota is outside the scope of this review. The only proposed change that will carry over to the fishing quota screening regime is the recommendation to remove New Zealand residents from the definition of an overseas person. The proposed dual threshold will apply only to business and land investments. The Fisheries Act contains its own purpose statement in relation to the screening of fishing quota, and it also requires investors to seek consent before increasing any existing interest in fishing quota.

59. A legislative amendment is required to allow lake bed and riverbed that has already been offered back to the Crown to be vested into Crown ownership and held by the Commissioner of Crown Lands under the Land Act 1948. In cases where the Crown has exercised its right to obtain special land, it has put a caveat on the title of the land to protect its interest in the land. However the Overseas Investment Act does not provide for this land to be vested into Crown ownership.

CONSULTATION

60. 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 Cabinet paper and the attached Policy Document:

> 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.

61. 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 on the Group: Bell Gully, MinterEllisonRuddWatt, Simpson Grierson, ChapmanTripp and RussellMcVeagh.

62. There is broad agreement about many of the proposed changes, including removing the ability to make policy change by regulation, reducing the scope of what is considered sensitive land, and removing explicit reference to strategic assets.

63. The area that has attracted the most comment is the proposal to move to a sensitive land test that largely relies on other legislation to address concerns about investment. Views on this issue range between strong opposition (Department of Conservation, Ministry of Agriculture and Forestry), relatively neutral (Ministry for the Environment, Te Puni Kōkiri), and strong agreement or arguing that the changes do not go far enough (Investment NZ, members of the Technical Reference Group).

AGENCY COMMENTS

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

Ministry of Agriculture and Forestry

67. MAF agrees with the objectives of improving the predictability and speed of decision making under the Act. We also agree that policy changes to the overseas investment regime should only be made by primary legislation with parliamentary scrutiny and that the current ability to make regulations which add to the factors used to assess sensitive land applications should be removed.

68. However we are not yet able to support the other changes proposed because the paper does not present clear evidence demonstrating that they are, on balance, in the national interest and we believe further analysis is required. The recommendations involve fundamental changes to the intent and effect of the Act many of them will be contentious.

69. We also suggest that further analysis be undertaken on the potential future impact of Sovereign Wealth Funds acquiring New Zealand assets, in particular agriculture and forestry land, given recent trends in international land acquisitions.

70. These proposed changes also have implications for our international negotiating position in that they will result in a loss of 'negotiating coin'. Further, some of the changes will be irreversible as a consequence of other treaty commitments contained in current (and potentially future) free trade and economic integration agreements.

Walking Access Commission

71. The NZ Walking Access Commission fully supports the retention of the protections provided by the Overseas Investment Act for walking access customarily provided on a voluntary basis and to remedy gaps in water margin access and access to public land and other public resources that is available as a condition of an overseas purchase of sensitive land.

Ministry for Culture and Heritage

72. The Ministry for Culture and Heritage believes that there should be no diminution of the level of protection that can be afforded historic heritage under the Overseas Investment Act. If the approach set out in this paper is agreed, it will be important overseas investors:

- identify the full range of heritage values on sensitive land; and
- are fully aware of their obligations towards historic heritage under domestic legislation.

Overseas Investment Office

The Overseas Investment Office (OIO) supports a simpler, better targeted and more predictable screening process for overseas investments. The OIO considers that the following measures will simplify and streamline the screening process:

- removing, or at the very least substantially streamlining, the current requirement to offer 'special land' – foreshore, seabed, lakebed and riverbed – to the Crown before sale to an overseas person;
- the changes to the sensitive land scope, in particular, the removal of section 37; and
- removing the requirement to offer farm land on the open market before sale to an overseas person.

73. The OIO agrees that the ability to add additional factors by regulation should be removed. The advantage of retaining this provision is flexibility, but that is outweighed by lack of investor certainty. However, the OIO observes that under the proposed new "sensitive land test", there will no factors.

74. The OIO has no particular concern about increasing the significant business asset threshold. This change will be administratively simple. However, the OIO considers the issue of "negotiating coin", or the issues surrounding sovereign wealth funds, are issues about which other Departments, such as MFAT, are better qualified to comment.

75. The OIO likewise has no concern about the change to the purpose of the Act, the removal of screening for persons who hold a New Zealand residence permit but do not meet the domicile or minimum residence tests.

76. The OIO has reservations about removing the requirement for investors to seek consent to increase their existing level of ownership or control in a significant business asset or sensitive land. The OIO has similar concerns about the replacement of the current "benefit" test with the new proposed "sensitive land" test. These are reasonably far-reaching changes where more consultation is required.

Ministry of Foreign Affairs and Trade

77. MFAT recognises that open and transparent investment regimes create a favourable policy environment for economic benefits and supports the intention of the review of the Overseas Investment Act to reduce the complexity around investment applications, with a view to attracting overseas investment. We broadly support the recommendations in this paper that work to this end. We do not consider, however, that this paper or its underlying analysis provides sufficient rationale - including evidence about potential economic benefits - to support a number of its recommendations, in particular the recommendation to unilaterally raise the threshold to $200m.

78. *[Withheld - avoid prejudicing the security or defence of New Zealand or the international relations of the Government of New Zealand.]*

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

Department of Conservation

80. The Department of Conservation believes that dropping the requirement to offer special land to the Crown and removing the requirement for Ministers to be satisfied that adequate measures will be in place to maintain or enhance areas and habitats of significant indigenous flora and fauna or the habitats of trout, salmon and wildlife will be detrimental to the protection of those values. This is particularly in the case of the transfer of rural areas to overseas investors. The Department believes that improvements in the processing of applications could speed up the process of obtaining consent without losing the opportunity to enhance the protection of the values included as factors to be considered under the current legislation.

FINANCIAL IMPLICATIONS

81. There are no direct financial implications for the Crown arising from this paper. However the proposed changes to the screening regime are expected to reduce the number and complexity of investment applications. As a result, there is likely to be scope to reconsider the balance between fees charged to overseas investors, funding requirements for the Overseas Investment Office, and application processing times.

82. Cabinet recently agreed to increase the fees charged to overseas investors to fully recover costs, but noted that the fees would be reassessed once changes from the review have been operational [EGI Min (09) 13/2 refers]. I therefore propose a report back to reassess fees by 31 August 2010, once the new regime has been in operation for around six months.

LEGISLATIVE IMPLICATIONS

83. The policy proposals will require amendments to the Overseas Investment Act 2005 and the Overseas Investment Regulations 2005. At present there is no place on the 2009 legislation programme for amending the Overseas Investment Act 2005.

84. I expect a Bill to be ready for introduction to Parliament in September 2009. If issues of substance arise in the course of drafting I will refer these back to Cabinet, but I propose that decisions about minor or technical issues be delegated to me. Allowing a six week period for the receipt of public submissions, I expect the Finance and Expenditure Select Committee to hear oral submissions and deliberate from late October to late November. The Bill should be reported back to the house in early December.

85. Given the above considerations, a category 2 priority is sought in order to pass the Bill by the end of 2009.

REGULATORY IMPACT ANALYSIS

86. Treasury confirms that the principles of the Code of Good Regulatory Practice and the regulatory impact analysis requirements, including the consultation RIA requirements, have been complied with. The near final RIS was circulated with the Cabinet paper for departmental consultation.

87. This proposal is likely to have a significant impact on economic growth and therefore requires independent assessment by the Treasury's Regulatory Impact Analysis Team (RIAT).

88. A detailed Policy Document explaining the review findings has been prepared for public release following Cabinet consideration. This document is attached and a draft was circulated with the Cabinet paper for departmental consultation. The Policy Document incorporates the matters normally included in a Regulatory Impact Statement.

89. 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.

OTHER IMPLICATIONS

90. There are no human rights, Treaty, gender or disability implications associated with this paper.

PUBLICITY

91. I propose that this Cabinet paper (with appropriate withholdings) and the attached policy document be released publicly once Cabinet has taken policy decisions on the review. I expect this to be after 20 August so that the Prime Minister can let the Australian Prime Minister know about any changes to the business screening threshold. The release of this documentation will allow the public to consider the changes before the Bill is considered by Select Committee.

92. I will make a media statement when I release these documents to outline the next steps in the process.

93. There are a number of publicity risks associated with changes to this legislation. Any changes are likely to attract significant public debate, particularly the changes to the sensitive land test and removing the requirements to offer special land to the Crown and to advertise farmland on the open market before sale. Releasing the policy document publicly will help to provide the rationale for the changes, but I still expect there to be a large amount of comment on the proposals.

REVIEW

94. I propose to report back to Cabinet by 31 August 2010 with an evaluation of how effective the changes to the screening regime have been. This evaluation will assess how the changes have affected application numbers, the time taken to assess applications, and the operation of the new sensitive land test. The evaluation will also include feedback from law firms 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.

RECOMMENDATIONS

95. I recommend that the Committee:

1. **note** that in February 2009, Cabinet agreed to review the Overseas Investment Act and Regulations as part of the Government's regulatory review programme for 2009 [CAB Min (09) 6/5A refers];

2. **note** that one of the six pillars of the Government's medium-term economic agenda is improving the regulatory environment for business, and reviewing the Overseas Investment Act is one component [CAB Min (09) 24/7 refers];

3. EITHER [Treasury recommended]

    3.1. **agree** to proceed with consideration of this paper;

    OR [MAF recommended]

3.2. **agree** to recommendation 7 (below) and agree that this paper be deferred pending more substantive consultation and analysis by officials;

IF 3.1 agreed:

4. **agree** that the Act be amended with the aim of ensuring the screening regime is simple, predictable and well-targeted at the underlying concerns that New Zealanders hold about overseas investment;

Purpose of the Act

5. **agree** that the purpose of the Act be restated to reflect the importance of overseas investment to New Zealand's economic growth as well as the importance of ensuring sensitive New Zealand assets are protected;

Definition of an overseas person

6. **agree** that persons who hold a residence permit that entitles them to reside in New Zealand indefinitely be exempt from screening under the Act;

Policy change by regulation

7. **agree** that substantive policy changes to the overseas investment regime can only be made by primary legislation with parliamentary scrutiny, by removing the ability to make regulations which add to the factors used to assess sensitive land applications;

Business assets: scope

8. **agree** that the screening threshold for significant business investments be raised from $100 million to $200 million;

9. **note** *[Withhold - maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*;

10. **note** that a unilateral increase in the screening threshold will be bound-in due to the ratchet provision in some of New Zealand's FTAs *[Withhold - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements]*;

Business assets: hurdle

11. **agree** to retain the existing 'investor test' for investments in significant business assets;

12. **agree** to add an additional criterion to the significant business asset test that allows the Minister of Finance to decline an investment in significant business assets where:

    12.1. the investment will harm the national interest by threatening vital economic interests, national security, or public order;

    12.2. the Minister has credible evidence to show that the national interest is threatened;

12.3. the concerns cannot be addressed through other legislation;

12.4. 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.

Sensitive land: scope

13. **agree** that the definition of non-urban land be narrowed to include farm land and forestry only;

14. **agree** that the area threshold for non-urban land be increased from five to ten hectares;

15. **agree** that the regulator no longer be required to keep a list of reserves, parks and other areas, the land adjoining which is sensitive;

16. **agree** that land adjoining National Parks that exceeds 0.4 hectares be added to the types of land which are screened;

17. **agree** that land that adjoins land subject to a heritage order, or a requirement for a heritage order, no longer be screened;

18. **agree** that land that adjoins land that includes a historic place, historic area, wahi tapu, or wahi tapu area no longer be screened;

19. **note** that changes to the scope of sensitive land that is screened will be bound-in due to the ratchet provision in some of New Zealand's Free Trade Agreements and New Zealand will be unable to reverse these changes in the case of investments from those countries;

20. **note** that the majority of categories of sensitive land will be unchanged;

Sensitive land: hurdle

21. **agree** that the criteria for investments in sensitive land should continue to include the 'investor test' that is also applied to investments in significant business assets;

22. **agree** that the requirement that an overseas investment in sensitive land must benefit New Zealand be removed and replaced with a new test that :

22.1. improves overseas investors' awareness of sensitive features on the relevant land and their obligations under other legislation in relation to historic areas, indigenous vegetation, wildlife protected under the Wildlife Act, and walking access;

22.2. for walking access, imposes requirements on overseas investors over and above domestic investors in relation to continuing existing informal access and enhancing access, where appropriate and practicable;

22.3. for all other sensitive features, relies on other relevant legislation to provide protection;

23. **note** that an indicative wording for the new test would require overseas investors in sensitive land to:

    23.1. detail sensitive features on the relevant land that relate to historic areas, indigenous vegetation, salmon and trout habitat and other protected wildlife, and walking access;

    23.2. 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

    23.3. 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;

Offer back of special land to the Crown

24. **agree** to remove the requirement that 'special land' – foreshore, seabed, lakebed and riverbed – be offered to the Crown before sale to an overseas person;

25. **agree** that the Overseas Investment Act be amended to allow lake bed and river bed to be vested in Crown ownership under the Land Act 1948, where the Crown has previously accepted offers of special land.

Requirement to advertise farm land on open market

26. **agree** to remove the requirement for farm land to be advertised on the open market prior to sale to an overseas person;

Increases in ownership/control once approved

27. **agree** that investors who increase their existing level of ownership or control in a significant business asset or in a particular piece of sensitive land no longer be screened;

Strategic assets

28. **agree** that there be no additional screening or criteria for strategic assets and that the existing provisions be removed;

Sovereign Wealth Funds

29. **agree** that there continue to be no additional screening requirements for investments by Sovereign Wealth Funds;

Fishing Quota

30. **note** that screening of fishing quota is outside the scope of this review;

31. **note** that the only recommendation that will carry over to the fishing quota screening regime is the recommendation to remove New Zealand residents from the definition of an overseas person (recommendation 5 above);

Legislative process

32. **note** that a Bill is required to amend the Overseas Investment Act 2005;

33. **agree** to add the Overseas Investment Bill to the 2009 legislative programme with a priority of category 2 (must be passed in 2009);

34. **invite** the Minister of Finance to instruct the Parliamentary Counsel Office to draft the required changes to the legislation as outlined in this paper;

35. **authorise** the Minister of Finance to take decisions on minor policy issues that arise as the Bill is drafted;

Publicity

36. **agree** that this Cabinet paper (with appropriate withholdings) and the attached Policy Document entitled 'Improving the Overseas Investment Act' be publicly released;

37. **authorise** the Minister of Finance to make drafting changes to the policy document prior to its public release;

Report backs

38. **invite** the Ministers of Finance and Land Information to report back to Cabinet Economic Growth and Infrastructure Committee by 31 August 2010 with:

    38.1. an assessment of whether the fees charged to overseas investors are correctly set to fund the Overseas Investment Office to assess applications in a reasonable timeframe;

    38.2. an evaluation of how the changes to the screening regime have affected application numbers, assessment times, the operation of the new sensitive land test, and feedback from law firms on the changes from an investor's perspective.

Hon Bill English
Minister of Finance

Date:

Annex 1: Compliance cost summary

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.

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 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

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

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 on past investments 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.