THE TREASURY
Kaitohutohu Kaupapa Rawa

Review of the overseas investment screening regime

REGULATORY IMPACT STATEMENT

December 2009

New Zealand Government

AGENCY DISCLOSURE STATEMENT

This Regulatory Impact Statement has been prepared by the Treasury. It provides an analysis of options to simplify the regime and reduce compliance costs while ensuring that the most sensitive New Zealand assets are adequately protected. The review has taken the broad structure of the regime as a given (for example the existence of a benefit test for sensitive land investment), and has looked at how parts of the regime can be improved and simplified.

The review has considered how to improve the overseas investment screening regime by assessing the parts that create the highest costs for investors. The procedure for screening investments in significant business assets and sensitive land has been assessed as providing the largest potential for improvement. Fishing quota screening has not been considered because the low number of quota applications means the potential for realising large gains in practice is low.

The Terms of Reference for the review were limited to considering simplifications to the current screening regime and not alternatives to the regime, or whether a regime is necessary. A fuller analysis would consider whether a screening regime is the most effective way of addressing concerns about overseas investment and whether the design of the regime is consistent with the Government's overall economic objectives.

A further caveat is that both the qualitative and quantitative assessment of the impact of any changes are subject to a number of uncertainties and the actual impact will vary across the different application types and their complexity.

The policy options are not likely to have significant effects that the Government has said will require a particularly strong case before regulation is considered. In fact the proposals are designed to reduce such effects in the current screening regime:

- *impose additional costs on businesses.* In general the proposals are expected to reduce, rather than increase, costs for businesses and investors. The only exception is the substantial harm test, which is arguably an improvement on the current strategic assets test, but will still retain some potential for uncertainty for investors.

- *impair private property rights, market competition, or the incentives on businesses to innovate and invest.* The proposals are expected to improve incentives on businesses to invest by reducing barriers to investment and strengthening private property rights.

- *override fundamental common law principles (as referenced in Chapter 3 of the Legislation Advisory Committee Guidelines)*. The proposals are expected to more fully align the Act with these principles, for example the principles that "property will not be expropriated without full compensation" and "all are treated equally under the law".

Nic Blakeley, Acting Manager, International, The Treasury

Signature: Date:

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EXECUTIVE SUMMARY

Motivation for the review

The Overseas Investment Act is being reviewed as part of the Government's regulatory reform programme. Regulatory reform is a key part of the Government's agenda and the review programme aims to ensure that regulation does not inhibit businesses from innovating, investing, creating jobs and earning higher profits.

New Zealand relies on overseas investment to provide local businesses with capital to expand and to bring in new technology and skills from offshore. The flow of overseas investment into New Zealand totalled $27 billion for the year ended March 2008, with a net outflow of $9 billion in 2008/09.[1] New Zealand is competing more than ever with a wide range of countries for overseas capital. It is therefore particularly important that our investment screening regime does not deter valuable investment that would help the New Zealand economy grow and recover more quickly from recession.

At the same time it is important to recognise that overseas investment in sensitive assets can raise community concerns, such as loss of ownership value and concerns about investors reducing public access and usage of land that has been traditionally provided. The screening regime can therefore be used to provide oversight of investments in sensitive assets to ensure that these concerns are adequately addressed.

The key objective of the review is to simplify the regime and reduce compliance costs while ensuring that the most sensitive New Zealand assets are adequately protected.

Problem definition

The overseas investment screening regime may be imposing unnecessary costs on investors and deterring or delaying investment as a result. There are three main characteristics of the current regime that are likely to be causing this problem:

- ***Complexity and cost of applications.*** Investment applications have become more complex since 2005 when the scope of the Act was widened and the criteria used to assess land applications increased from 11 to 27. As a result the time and cost of assessing and preparing applications to invest has increased. Complex applications can fill multiple folders as investors try to address the wide range of factors considered. Depending on the complexity of the application, preparation costs can exceed $200,000 and the time to go through the screening process can be in the order of 3 months. Additional cost is created by screening some investments that are not likely to be sensitive.

[1] Statistics New Zealand, *Balance of Payments and International Investment Position: Year ended 31 March 2009.*

For example, the sensitivity of land adjoining local parks and reserves is not immediately apparent.

- ***Uncertainty.*** The screening regime is acting as a deterrent to some investors because of the uncertainty it creates. Uncertainty is created in two ways. The first is the ability to change factors used to assess investments at short notice. The second is the wide discretion Ministers have to impose conditions on sensitive land investments. Ministers can determine which factors are relevant and whether they have been 'adequately' addressed by the investor.

- ***Cost of conditions.*** The conditions imposed on sensitive land investments can be costly to comply with. Some conditions go well above what a domestic investor may be required to do. Examples include requirements to construct walking tracks and to make donations to research organisations. On the other hand, these conditions can create additional benefits for New Zealand that would not have otherwise been achieved.

It is not possible to determine the extent to which investments are not occurring because of the regime, but there is anecdotal evidence to show that some investors are frustrated by the regime and delaying or stopping investment activities as a result.

Review approach

This review has focused on the most complex parts of the screening regime in order to seek changes that will have the biggest impact in practice. Sensitive land applications make up 85% of all applications received since 2005 and are the most costly to prepare and assess. Investments in significant business assets make up most of the remaining applications and the review will consider whether this part of the regime can be simplified. The review has not assessed the fishing quota screening regime which has had only one investment since 2005 and therefore any changes are likely to have a limited impact in practical terms.

Options and impacts

The table on the following pages sets out the range of options considered in this review and their expected impacts. The impacts have been assessed against the criteria outlined in the table below which have been developed to assess the impact of the options against the objectives of the review. Where possible a quantitative assessment of the impact is provided. Otherwise a qualitative assessment has been used. A rating of 'high' means the proposal is likely to have a large or significant impact, a 'medium' rating indicates a moderate impact, and a 'low' rating indicates a small or no impact.

Change in compliance costs	Impact on investor certainty	Impact on protections	FTA impacts	Risks
Will the proposal reduce the time and cost of preparing and assessing investment applications?	Will the proposal improve certainty for investors?	Will the proposal reduce the protections provided in the current screening regime?	Will the proposal affect current or future Free Trade Agreement obligations?	Does the proposal create risks, such as avoidance, or implementation difficulties?

	Change in compliance costs	Impact on investor certainty	Impact on protections	FTA impacts	Risks
Definition of an overseas person – Section 3					
Raise the 25% threshold to 40%	Low - 4 fewer applications p.a. savings between $150,000 and $900,000.	Low - does not impact	Medium - large minority stakes held by one overseas person would avoid screening.	Medium - could not be reversed in future for our FTA partners	Low- A relatively straightforward change to implement.
Introduce a dual threshold	Low - 4 fewer applications p.a. Savings between $150,000 and $900,000	Low - does not impact	Low - Firms that are no longer screened are unlikely to have significant overseas control.	Medium - could not be reversed in future for our FTA partners.	High - avoidance risk if no associate test applied but such a test very difficult to implement.
Introduce additional exemptions	Medium – 7-10 fewer applications p.a. Savings between $200,000 and $1.8m. Application fee up to $15,000 per exemption, monitoring fee approx $10,000 p.a.	Medium - Exempt investors are no longer subject to review.	Low - Fewer transactions reviewed, but exempted firms similar to NZ firms.	Low - exemptions could not be reversed for FTA partners, but would only apply to a minimal number of investors.	Low – avoidance risks mitigated by placing conditions on exemptions.
Business assets: hurdle – Section 5					
Increase screening threshold to $150 million	Low - around 4 fewer applications p.a. with compliance cost savings of around $100,000 pa.	Low – does not impact	Low - Fewer (but less sensitive) are subject to review.	Medium - could not be reversed for FTA partners. [*Withheld - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements].*	Low - straightforward change to implement and no obvious avoidance risks.
Increase screening threshold to $200 million	Low - around 7 fewer applications per year. Savings of around $200,000 pa.	Low – does not impact	Low - Fewer (but less sensitive) assets are subject to review.	Medium - could not be reversed for FTA partners. [*Withheld - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements].*	Low - straightforward change to implement and no obvious avoidance risks.
Remove screening based on total assets	Low - Around 4 fewer applications per year. Savings of around $100,000 pa	Low – does not impact	Low - Fewer transactions are subject to review, however these firms are not 'sensitive'.	Medium - The increase in threshold could not be reversed for our FTA partners.	High - significant risk of avoidance and could not be reversed in future.
Sensitive land: scope – Section 6					
Increase non-urban land area threshold to 10ha	Medium - 10 fewer applications p.a. year with compliance cost savings in the order of $1.7m	Low – does not impact	Low - Reduced ability to screen small land purchases.	Medium - could not be reversed for FTA partners.	Low - straight forward to implement.
Remove screening for commercial/industrial sites in rural areas	Low - approximately 2-3 fewer applications per year.	Low - consistent treatment of these sites may improve understanding of the regime.	Medium – reduced screening of some sites which may be sensitive.	Medium - could not be reversed for FTA partners.	Low – may have smaller impact than expected.
Remove local parks and reserves from screening	Medium - up to 16 fewer applications per year, compliance cost savings around $2.8 million	Medium – better clarity over whether the land is sensitive.	Low – non-screened land unlikely to be sensitive.	Medium - could not be reversed for FTA partners.	Low - some local parks and reserves may be considered sensitive.

Apply an area threshold to the size of parks/ reserves	Medium - Up to 16 fewer applications per year with cost savings in the order of $2.8 million	Medium - better clarity over whether the land is sensitive.	Low - land adjoining large local parks and reserves still screened.	Medium - could not be reversed for FTA partners.	Low – land adjoining large local parks still screened.
Sensitive land: hurdle – Section 7					
Simplified benefit test	Medium - assessment effort reduced by 8% and preparation effort reduced by 15-20%	Medium - Uncertainty over if existing benefits can be counted is removed. Uncertainty remains over Ministers ability to weight factors on a case by case basis.	Low - test covers the same issues as the current test but without requirement to show "substantial and identifiable" benefit for non-urban land.	Low – NZ able to alter the factors (both upwards and downwards) used to assess investments in sensitive land.	Low - proposal could have less impact on compliance costs than expected due to similarity to status quo.
Targeted benefit test (core environ./social factors)	Medium - assessment effort reduced by 15% and preparation effort reduced by 30-35%	Medium - if factors are not relevant, they do not need to be addressed.	Medium - Ministerial discretion over economic factors removed, consideration of environmental and social factors retained.	Low – NZ able to alter the factors (both upwards and downwards) used to assess investments in sensitive land.	Low - proposal could have less impact on compliance costs than expected.
Narrow benefit test (walking access only)	High – assessment effort reduced by 20% and preparation effort reduced by 35-40%	High - uncertainly is removed, other than the level of walking access that will be required by Ministers.	High - Ministerial discretion across removed apart from providing 'adequate' walking access.	Low - NZ able to alter the factors used to assess investments in sensitive land.	High - may raise concerns that there is insufficient oversight being applied to overseas investment.
Remove offer-back requirement for riverbed	High - assessment effort reduced by 90% and preparation effort reduced by 20%	Medium - uncertainty over whether the Crown will accept the offer of riverbed is removed.	Medium - ownership is one way of providing public access; loss of ownership value.	Low - NZ able to alter the criteria/factors used to assess investments in sensitive land.	Medium - concerns about the loss of ownership value.
Remove offer-back requirement entirely	High – assessment effort reduced by 90% and preparation effort reduced by 20-25%	Medium - Uncertainty over whether the Crown will accept the offer of special land removed.	Medium - The main loss is the value attributed to ownership of the bed.	Low - NZ able to alter the criteria/factors used to assess investments in sensitive land.	Medium - concerns about the loss of ownership value.
Special land: process – Section 8					
Set of simplifying changes	Medium – assessment effort reduced by 40% and preparation effort reduced by 5-10%	Medium - the proposals should significantly improve clarity of the special land process.	Low - the proposals are intended to have no impact on the policy intent of the special land process.	Low - The proposals are intended to have no impact on the policy intent.	Low - proposals could have less impact on compliance costs than expected.
Policy change by regulation – Section 9					
Remove the ability to add factors by regulation	Low - no direct impact.	High - significant improvement in certainty as assessment factors will not change at short notice.	Medium - loss of Ministerial flexibility to react quickly to particular investments.	Low - New Zealand has reserved the ability to alter the factors used to assess investments in sensitive assets.	Low - future investment may raise concerns that the benefit test cannot address. Mitigated by the substantial harm test.
Add requirement to consult with relevant parties	Low - No direct impact.	Low - Improved transparency, but changes may still occur at short notice.	Medium - Risk that the consultation will be limited and not cover all interested parties.	Low - New Zealand has reserved the ability to alter the factors used to assess investments in sensitive assets.	Medium - the consultation requirement creates some loss of flexibility, but changes can still be made quickly.

Exempt any current applications from changes	Low - No direct impact.	Medium – More certainty for investors with applications underway, but not future investors.	Medium - Ministerial flexibility is reduced for applications already underway, but changes can still be made quickly.	Low - New Zealand has reserved the ability to alter the factors used to assess investments in sensitive assets.	Medium - Regulations could still be enacted that change the intent of the Act.
Strategic assets – Section 10					
Remove strategic assets factor and do not replace it	Low – The investor impact is more directly related to certainty than costs.	High – removes uncertainty over strategic asset definition.	Medium - ability to consider 'strategic' sectors reduced - legislative change required.	Low - NZ reserved the ability to alter the factors used to assess investments in sensitive assets.	Medium - a future application may raise concerns that the benefit test cannot address.
Defined strategic assets test	Low - the investor impact is more directly related to certainty than costs.	Medium - tightly specified test is more certain.	Medium - Ministerial flexibility limited with a tight definition.	Low - NZ reserved the ability to alter the factors used to assess investments in sensitive assets.	High - difficult to design a test that provides an adequate balance between investor certainty and Ministerial flexibility.
Substantial harm test	Low - the investor impact is more directly related to certainty than costs.	Medium - more certainty than the status quo but still allows for interpretation by Ministers.	Low - the test would increase protections compared to the current test.	Low - NZ reserved the ability to alter the factors used to assess investments in sensitive assets.	Medium – may be seen as a de-liberalising measure, high hurdle for use.
Sovereign Wealth Funds – Section 11					
Additional screening criteria for SWFs	Medium - Addressing the new factors will create some additional cost for Government investors but it is difficult to say how big they are.	Low - The new factors would not improve certainty and may create uncertainty depending on how they are applied.	Low - The test would increase protections compared to the status quo.	Medium - could be seen as counter to NZ's obligations not to introduce new classes of investments that are screened.	Medium – possible retaliation against NZ government investors. May be unnecessary given lack of evidence of problem.
Maintain current business threshold for SWFs	Low - The status quo would continue to apply for SWF investments.	Low - The status quo would continue to apply for SWF investments.	Low - The test would increase protections relative to raising the threshold for all investments.	Medium - could be seen as counter to NZ's obligations not to introduce new classes of investments that are screened.	Low - possible retaliation against NZ government investors. May be unnecessary given lack of evidence of problem.
Assets Already In Overseas Ownership – Section 12					
Remove screening if an investor is increasing investment in existing asset	Medium - approximately 17 fewer applications p.a. with compliance cost savings of between $500,000 and $3 million	Low - not applicable.	Low - some transactions are no longer screened, but screening provides little additional benefit	Medium - an exemption will be irreversible for our FTA partners.	Medium - public concerns may arise about investors moving from minority to majority stakes without screening.
Remove screening where asset is sold from one overseas person to another	High – approx 26 fewer applications p.a., cost savings between $800,000 and $5 million	Low – no impact.	High - new investor not assessed for character and acumen.	Medium - This change will be irreversible for our FTA partners.	High - risk of asset being sold to 'good' investor, then resold to investor with character concerns.

Key tradeoffs

The fundamental trade-off between the options outlined above is between certainty for investors and flexibility for Ministers to address concerns about overseas investment. The more specific and objective the screening regime is made, the more certainty investors have about how their applications will be assessed. On the other hand, this certainty for investors means that Ministers have less flexibility to address New Zealander's concerns about overseas investment. It can be difficult to fully specify in advance what New Zealanders will consider a sensitive investment and the types of concerns that it will raise. Therefore a flexible regime provides Ministers with the ability to address societal concerns on a case by case basis.

Implementation and review

The policy proposals in this document will require amendments to the Overseas Investment Act 2005 and the Overseas Investment Regulations 2005.

Subject to Cabinet agreement, a Bill will be introduced into Parliament in early to mid 2010 to progress the changes. The Finance and Expenditure Select Committee will seek submissions and deliberate on the bill. Interested members of the public will be able to have input into the review through the Select Committee process.

The impact of any changes will be reviewed six months after they have come into effect. Further consideration will be given on how to manage any applications that are made in the transition between the current Act and any amended Act.

Consultation and feedback

This review has been led by Treasury, in consultation with Land Information New Zealand and the Overseas Investment Office. The following agencies were consulted in the preparation of this Regulatory Impact Statement:

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.

A Technical Reference Group made up of five senior members of law firms who frequently deal with the overseas investment applications was also established to assist with the review. The Group has assisted with assessing the impact of the review proposals on investors and provided suggestions on areas of the screening regime that could be improved.

A large amount of feedback was received on the review proposals and a significant number of comments have been incorporated into this RIS. Views on the proposals ranged from strong opposition, to agreement and to suggestions that they do not go far

enough. The most proposals that attracted the most debate were the changes to the sensitive land benefit test, the offer of special land to the Crown and the substantial harm test.

The feedback has led to a number of changes to the RIS. For example, the simplified benefits test was developed in response to concerns that the targeted and narrow benefits tests were too far removed from the status quo. A proposal to remove the requirement to offer farm land on the open market before sale to an overseas person, and changes to the purpose of the Act have also been removed because feedback indicated they would have little impact.

1 INTRODUCTION

1.1 Overseas investments and its effects

What is overseas investment?

1.1 Overseas investment occurs when an overseas person purchases an interest in New Zealand assets, including property, securities or intangible assets. Statistics New Zealand distinguishes between the following types of overseas investment in New Zealand:

- *Direct:* Investments that are made to acquire a lasting interest in an enterprise located in an economy, the investor's purpose being to have a *significant influence* (defined as at least 10% ownership) in the management of the enterprise.
- *Portfolio:* Investments in long-term bonds and corporate equities such as shares where the level of equity ownership by the investor is less than 10%.
- *Other:* Other investment comprises all capital transactions not included in direct investment, portfolio investment or reserves, e.g., foreign exchange assets and liabilities of banks; loans; deposits and short term bills and bonds.

What are the main benefits of overseas investment?

- *Provision of additional capital.* Foreign investment allows domestic investment to exceed domestic saving and therefore provides business with additional capital to expand their operations. The economic literature suggests higher investment financed by overseas investment increases national incomes and output.[2] In New Zealand it has been estimated that overseas investment lifted national income by $5.9 billion between 1995 and 2005, or $2,600 on a per worker basis.[3] The counterargument is that foreign saving is not a perfect substitute for domestic saving and that high external debt makes New Zealand vulnerable to external shocks.

- *Foreign-owned firms are generally more productive than domestic firms*. Empirical studies have found that foreign-owned firms can have higher productivity and better management practices than domestic firms due to knowledge transfers.[4] However, this could in part be due to foreign investors investing in relatively better performing firms.

- *Spill-over benefits.* Aside from the direct benefit of additional capital, overseas investment can provide spill-over benefits to the local economy in a number of ways. The most commonly identified sources of spill-overs are:[5]

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[2] The Contribution of Foreign Borrowing to the New Zealand Economy: Treasury Working Paper 08/03
[3] ibid
[4] International Connections and Productivity: Making Globalisation Work for New Zealand, New Zealand Treasury Productivity Paper 09/01
[5] ibid

- *competition* – the entry of foreign firms may incentivise domestic firms to become more efficient in order to remain competitive.
- *demonstration effects* – domestic firms may imitate products/processes of foreign firms through observation and reverse engineering.
- *forward and backward linkages* – foreign firms may have an incentive to assist firms they source inputs from to improve their production standards.

1.2 The size of these benefits is likely to vary depending on the type of investment and how well the domestic firm is able to absorb new ideas and techniques. For example, some of these benefits may be more apparent where the investment involves business operations and less relevant where it involves only the sale of land.

What are the main concerns about overseas investment?

- *Profits going offshore.* An overseas owner may repatriate a portion of the returns earned from their investment back to their home country. This outflow of funds can raise concerns on the grounds that the profits may have been retained and reinvested in New Zealand if the firm was locally owned. However, the sale price should reflect the value of the expected future profits, and this capital can be recycled into other productive investments in the economy.

- *Loss of ownership value.* For some New Zealanders simply knowing that a particular asset is no longer in New Zealand ownership can create a welfare loss. For example, the proposed sale of Nicks Head Station to an overseas investor in 2002 raised opposition from a number of groups.[6] It is important to note however, that concerns around public access and usage can be addressed without requiring public ownership of the land.

- *Overseas investors may not share the same values as domestic investors.* A domestic owner may be happy to allow the public to walk across their land or to use rivers or lakes on their land, particularly where this access has been traditionally provided. An overseas investor may not be aware of these customs, place the same value on allowing public access and usage or know of New Zealand legislation that protects sensitive features. However an appropriate response could be to create general policies relating to access or the protection of significant sites to ensure protection regardless of the nationality of the owner.

- *Non-commercial motivations.* Foreign investors may have ulterior or malevolent motives that could jeopardise national security interests. However examples of this occurring are difficult to find and the best response may be to ensure that legislation governing the ongoing operations of businesses is sufficiently robust to address these concerns.

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[6] The Historic Places Trust was concerned about the sale as "*this area is of great significance to our country's history and our national identity, as a place that has very special significance to Maori and Pakeha alike*" http://www.historic.org.nz/news/media_releases/2002_06_27.html

- *Hollowing out.* Foreign ownership may make it more likely that part or all of the firm will be moved offshore, resulting in lower economic activity in New Zealand. However shifting operations offshore is not exclusive to foreign owned firms and is done by New Zealand owned firms if it is in the best interests of the business.

1.3 It is not possible to quantify in monetary terms the costs that these concerns create, however they can result in a welfare loss for certain sections of the public.

1.2 Intent and description of the regime

1.4 The screening regime is based on the view that in general, foreign investment is in New Zealand's national interest, because of the benefits it provides. However, in a subset of cases where investments concern sensitive assets, the concerns outlined above could be sufficiently high so as to outweigh these benefits.

1.5 The screening regime is therefore used to ensure that these concerns are adequately addressed. Allowing all overseas investment to occur with no oversight would be considered undesirable by sections of the community because it could create real and potentially significant costs.

1.6 In response to these concerns the government has implemented a range of policies that affect the entry and ongoing activity of overseas investors in New Zealand.

General legislation

1.7 Like domestic investors and businesses, overseas investors are subject to all New Zealand legislation once they are operating here. Legislation such as the Resource Management Act, the Companies Act and the Corporations (Investigation and Management) Act affect the ongoing operations of businesses in New Zealand. The problems these Acts are designed to address, such as land use or environmental protection, are not specific to the nationality of the owner of a business.

1.8 Beyond these general protections, the government has established some specific policies to deal with specific concerns about a subset of overseas investment.

Specific interventions

1.9 The government has put in place specific restrictions to address possible concerns about overseas investment in certain companies or industries.

- *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 (the Minister of Finance).
- *Air New Zealand.* Non-New Zealand nationals may not own more than 10% of voting rights without Kiwi Shareholder consent.

- *Banking sector.* Banks with significant operations in New Zealand must be locally incorporated *[withheld - maintain the effective conduct of public affairs through the free and frank expression of opinions]*

Investment screening

1.10 For sensitive assets, prior approval is required before an overseas investor may take an ownership or control interest in those assets. The Overseas Investment Act 2005 requires that investors must go through a screening process before completing an investment. The Act requires that overseas persons obtain consent for investment in:

- *sensitive land* (for example 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.*

1.11 The criteria that an investor must meet before their investment is approved differ according to category of investment. In all cases the investor needs to demonstrate that they have business experience and acumen; financial commitment to the investment; and that they are of good character.

1.12 For sensitive land, the investor must also show that the investment will benefit New Zealand; and for fishing quota the investment must be in the national interest.

1.13 Whether an investment in sensitive land is of benefit to New Zealand is assessed against a range of factors including:

- whether the investment creates jobs, new technology or business skills, increased exports, greater efficiency and productivity; and
- whether there are adequate mechanisms for protecting the environment, flora and fauna, walking access and historic heritage.

1.14 Ministers are able to impose conditions on investments to ensure that the above factors are adequately addressed. In this sense, it is Ministers who are acting on behalf of the public to address their concerns about investment.

1.15 The screening regime helps to offset the concerns raised about investment in sensitive assets. For example concern about the loss of ownership value cannot be fully addressed unless overseas ownership is prohibited, but the screening regime can be used to assess whether an investment should proceed and if so, whether conditions are required to ensure that community concerns are addressed. Conditions relating to social and environmental factors can be applied to try to offset the loss of ownership value.

1.16 In effect, the regime allows Ministers to balance between New Zealanders' concerns about investment and the economic benefits it provides. Ministers are able to exercise the powers in the Act to address New Zealanders concerns – for example maintaining adequate walking access. It can be difficult to fully specify

in advance what New Zealanders will consider a "sensitive investment" and the types of concerns that it will raise. Therefore the screening regime provides Ministers with a degree of flexibility to address societal concerns on a case by case basis.

2005 amendments

1.17 In 2005 the Overseas Investment Act was enacted after the completion of a review of the previous Act. The review aimed to provide greater protection to sites of special historical, cultural or environmental significance. Significant changes to the screening regime included:

- Ministers are now able to consider a wider range of factors when assessing the benefit of an investment in sensitive land; in particular a number of social and environmental factors were added.
- Investments in non-urban land greater than 5 hectares must provide "substantial and identifiable" benefit to New Zealand.
- Foreshore, seabed, lakebed and river bed must be offered to the Crown before it can be sold to an overseas investor.

1.3 Objective of the review

1.18 The key objective of the review is to simplify the regime and reduce compliance costs while ensuring that the most sensitive New Zealand assets are adequately protected. The Terms of Reference for the review make it clear that the Government wishes to maintain a screening regime to address concerns about overseas investment in sensitive assets, but that improvements can be made to its operation.[7]

1.19 The motivation for the review arose out of concerns that some parts of the current screening regime are unnecessarily complex and costly and valuable investment is being deterred as a result (as discussed in section 2). The changes to the screening regime made in 2005 allowed for more oversight and control by Ministers but also increased complexity and cost.

1.20 The Government has made it clear that a screening regime is necessary to ensure that public concerns about investments in sensitive assets are adequately addressed. However, where there are opportunities to simplify and reduce the cost of going through the screening process, the Government has stated that it wishes to ensure that improvements are made.

1.21 There is a generic risk with all the options that they may not be seen by overseas investors as going far enough. However it is important to balance openness against public concern about investment in sensitive assets.

[7] Terms of Reference for the Overseas Investment Act review

1.22 The criteria that will be used to assess the impact of any proposals to simplify the screening regime are:

Criteria	Impact	Assessment
Change in compliance costs	High	The proposal will result in a large reduction in the time to prepare and assess an application (therefore reducing the likelihood of the regime deterring/delaying investment).
	Medium	The proposal will result in a moderate reduction in the time to prepare and assess an application.
	Low	The proposal will have little or no impact on the time taken to prepare and assess applications.
Impact on investor certainty	High	The proposal will significantly improve certainty of process or outcomes for investors (therefore reducing the likelihood of the regime deterring/delaying investment).
	Medium	The proposal will moderately improve certainty of process or outcomes for investors.
	Low	The proposal will have little or no impact on certainty of process or outcomes for investors.
Impact on protections	High	The proposal will substantially reduce the ability of Ministers to impose additional requirements, above that of domestic investors, on overseas investments in sensitive assets.
	Medium	The proposal will moderately reduce the ability of Ministers to impose additional requirements, above that of domestic investors, on overseas investments in sensitive assets.
	Low	The proposal will have little or no impact on the ability of Ministers to impose additional requirements, above that of domestic investors, on overseas investments in sensitive assets.
FTA impacts	High	The proposals will have a significant impact on the negotiation of new, or our obligations under existing, Free Trade Agreements.
	Medium	The proposals will have a moderate impact on the negotiation of new, or our obligations under existing, Free Trade Agreements.
	Low	The proposal will have little or no impact on the negotiation of new, or our obligations under existing, Free Trade Agreements.
Risks	High	The proposals raise significant avoidance, implementation or other risks.
	Medium	The proposals raise some moderate avoidance, implementation or other risks.
	Low	The proposals raise no or little avoidance, implementation or other risks.

1.23 For each of the above criteria, a qualitative assessment will be given and where possible a quantitative assessment made.

1.24 The scope of the review will exclude the fishing quota screening regime which has had only one investment since 2005 and therefore any changes are likely to have a limited impact in terms of improving simplicity. The lack of applications in this area could however be an indication that the current restrictions are acting as a deterrent to investment. Feedback from the Technical Reference Group has suggested that there are cases where the screening regime has deterred investment in fishing quota. This issue could be considered in a future review.

1.4 Interaction with international obligations

1.25 In reviewing the Act, it is important to consider New Zealand's international obligations, such as those already made in Free Trade Agreements, (FTAs) or may make in the course of current or future FTA negotiations. In agreements such as the P4 agreement[8] and the WTO Global Agreement on Trade in Services (GATS) New Zealand has reserved the right to make changes (both more or less restrictive) to the *criteria* that are used to assess investment applications. However New Zealand is not able to add additional *categories* to the investments subject to screening, or to expand the scope of the existing categories. In other words screening cannot be extended beyond significant business assets, sensitive land and fishing quota where New Zealand has only committed to screening investments in those categories in international agreements.

1.26 In addition, in the P4 agreement New Zealand has committed not to 'roll-back' any liberalising changes it makes to the screening regime in future through the inclusion of a "ratchet" provision. This provision "locks in" (i.e. creates a binding commitment between New Zealand and the P4 partners) future unilateral liberalisation of the New Zealand overseas investment regime. For example if the business screening threshold were to be increased from $100 million, it could not subsequently be reduced back to $100 million for those FTA partners. For our other FTA partner countries, our commitments are either significantly below our current threshold or well above it meaning unilateral changes would not be 'locked-in'.

[8] Members are New Zealand, Chile, Singapore and Brunei Darussalam

2 CURRENT OPERATION OF THE REGIME

2.1 This section describes how the current regime is operating in terms of the number and value of applications, complexity, processing times, and how it is perceived by investors in order to assess whether there is scope for improvement.

2.1 Operational statistics

2.2 The charts on the following page summarise key statistics relating to the operation of the regime, which are discussed subsequently in further detail.

Number of Applications

2.3 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.[9]

2.4 The following table and figure details the breakdown of applications:

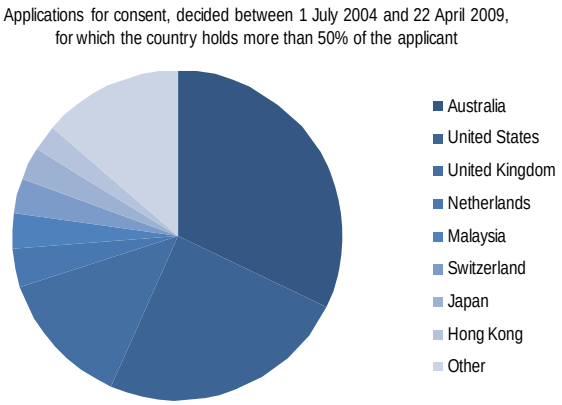
Table 1: Decisions on overseas investment applications, August 2002 – August 2008

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

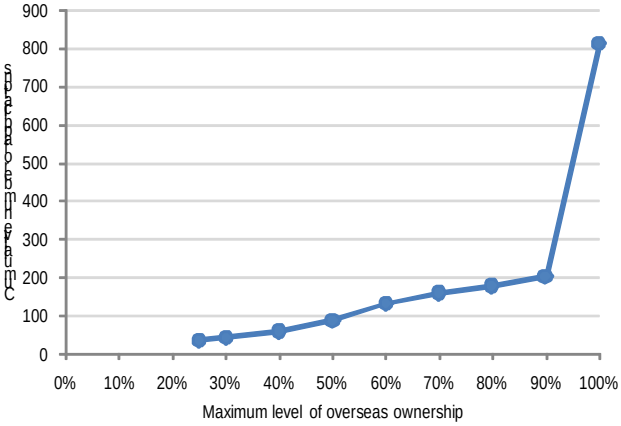
Source: Overseas Investment Office

[9] 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.

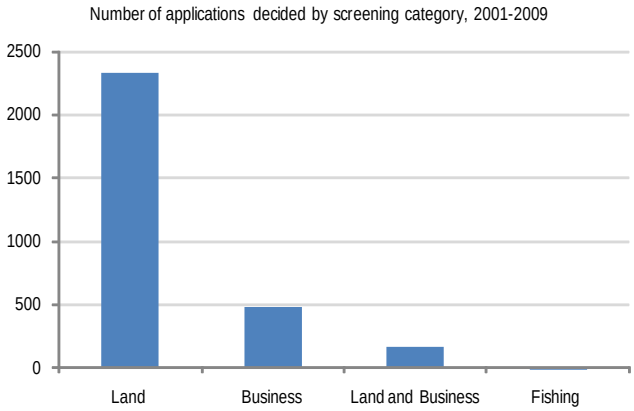
Most applicants are from Australia, the US and the UK…



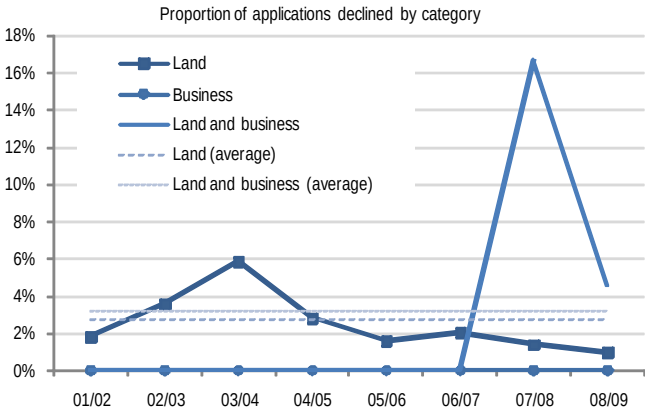
…and generally have a high degree of overseas ownership.



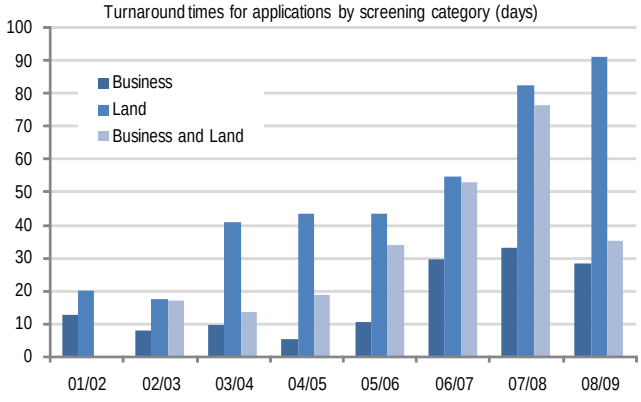
The vast majority of applications involve land…



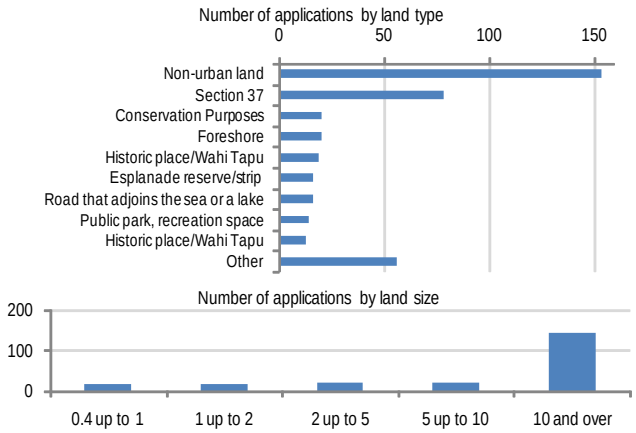
…and the only applications declined involve land.



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



Land applications cover a range of sensitivities and sizes.



Source: Overseas Investment Office

2.5 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 are no significant problems with the operation of the Act. However the approval rate also 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. A further consideration is the number of applications which are withdrawn before the assessment process is completed. 10% of all applications received by the Office are either lapsed, withdrawn or do not require consent. A number of these applications have been withdrawn because the investor does not consider that they will be successful in gaining consent.

2.2 Costs of the screening regime

Complexity of applications

2.6 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. Under the pre-2005 legislation there were 11 criteria and factors that were considered when assessing an investment in sensitive land. The current Act has 27 criteria and factors. 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. The current Act extended this requirement to cover all non-urban land over 5 hectares.

2.7 The increased complexity and scope of the Act increased costs for investors in terms of understanding the Act and preparing investment applications, as anecdotal evidence from legal firms indicates: complex applications take several weeks to prepare and each application can fill multiple folders.[10]

Application assessment times

2.8 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.[11] Application times have since reduced considerably due to a drop in application numbers and an increase the number of staff assessing applications, funded by higher application fees. It is possible that further improvements could be made with additional resources. However higher fees mean that to some extent, time costs are reduced at the expense of increasing monetary costs for investors. Simplifying the Act (reducing complexity and

[10] Simpson Grierson (March 2009), *FYI Corporate Advisory*

[11] 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.

scope) would help to make an absolute reduction in costs for investors. Additional increases in fees have therefore not been considered in this review.

Uncertainty

2.9 The current Act has two main sources of uncertainty. The first source is the ability to alter the factors used to assess investments in sensitive land by regulation and potentially at short notice. Uncertainty is created if the factors for assessing an investment are changed partway through the application process.

2.10 The second source of uncertainty is created by the discretion Ministers have when determining whether an investment in sensitive land will benefit New Zealand. Investors face uncertainty over whether they have provided sufficient benefit across the range of economic, environmental and social factors used to assess benefit. Minsters are able to determine the relevance and weighting of each factor on a case by case basis and whether the investor has adequately addressed these factors.

Compliance cost quantification

2.11 As noted above, investors face a range of costs when going through the screening regime. These costs will vary depending 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 requires the investor to provide improved walking access will be significantly more complex and costly to prepare and comply with than a business application.

2.12 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**

Time costs	Business applications	Land applications**
Time to prepare application	~5 days	3-6 weeks
Time to assess application^	Up to 40 working days	Up to 50 working days
Dollar costs	**Business applications**	**Land applications****
Application fees	$13,000	$19,000-22,000
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

2.13 The above table does not include cost of delays while applications are prepared and considered. These costs can be significant as investors and vendors have to

put their business plans on hold and can increase the longer an application takes to prepare and assess. Examples include hedging investment capital against exchange rate risk and the cost of borrowing.

Costs of conditions imposed

2.14 In addition to the above costs, compliance costs are created by conditions imposed on an investment in order to gain consent. The most costly conditions are imposed on sensitive land applications, where the range of factors considered provides wide scope for conditions. Some 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 create additional benefits for New Zealand, they also impose costs for investors. Some examples of the conditions imposed are outlined below:

- Construct a 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.
- Agree not to subdivide the land.

2.3 Benefits gained from screening

2.15 While the conditions outlined above create costs for investors, the other side of the coin is that they create benefits that may have otherwise not been achieved without screening.

2.16 The ability to impose conditions on overseas investments in sensitive land can deliver environmental and social benefits such as the protection of indigenous vegetation or improved public walking access. As the cost of complying with these conditions falls on the investor, the benefits are achieved without any cost to government. These conditions cannot be imposed on domestic investors. The case study below outlines an example of the benefits that have been achieved in previous investments.

[withheld - protect the commercial position of the person who supplied the information

2.4 Impact on investment

2.17 At a theoretical level it is reasonable to assume that the existence of an investment screening regime could deter overseas investment, simply because it imposes an additional transaction cost. The actual size of any deterrence effect will depend on the nature of the screening regime. It is also important to remember that there are a number of other factors which influence New Zealand's attractiveness as an investment destination, such as other government policies and awareness of investment opportunities in New Zealand.

2.18 There is some empirical evidence to suggest that screening regimes do act as a barrier to overseas investment. The OECD has estimated that the level of investment into New Zealand would have been around 30% higher across the 1990s if we had reduced restrictions to the level of the United Kingdom (the most open in the OECD).[12] Similar results were found for Australia, Canada and the United States.

2.19 There is also anecdotal evidence to suggest that our screening regime has acted as a disincentive or barrier to overseas investors who might invest in New Zealand. It is difficult to determine how large this effect is but feedback from law firms *[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 has completely deterred investors from investing in New Zealand, and some are even actively discouraging other investors from considering investing in New Zealand.

2.20 *[withheld - 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. The case studies below provide some examples of how the Act has deterred investment.

[12] OECD 2003, The Influence of Policies on Trade and Foreign Direct Investment

Case study: Contact Energy Ltd

Contact Energy regularly needs to acquire land for electricity generation purposes that is defined as sensitive under the Overseas Investment Act (usually non-urban land exceeding 5 hectares). The time and cost of both preparing and awaiting assessment of applications to invest in such land is substantial for Contact. For example in the last year and a half (January 2008-June 2009), Contact made six applications for consent. Each of those applications was approximately 15 pages with another 200 pages of supporting documentation. The time required for Contact to prepare and finalise these applications was at least six weeks and the assessment time ranged from 8 to 22 weeks. This means a conservative estimate of the total lead time for seeking consent is 14 to 28 weeks.

Contact's majority shareholder, Origin Energy (Australia), was also recently required to apply for consent to increase its shareholding in Contact in order to participate in a profit distribution plan (the initial distribution resulted in an increase of only 0.06%). As part of the consent application, Origin was required to provide land data, maps and certificates in relation to over 200 Contact properties.

Source: Contact Energy Ltd

Case study: McDonald's Restaurants Ltd

McDonald's recently announced plans to open thirty new restaurants over the next three years. McDonald's was incorporated in New Zealand in November 1975. Despite 80 per cent of its restaurants being franchised by local business men and women, and a 30 year presence in New Zealand, due to its ownership structure, McDonald's is considered an overseas person for the purposes of the Overseas Investment Act. The requirement to seek consent before making an investment in sensitive assets has created compliance costs for the company and has resulted in investments not going ahead.

A recent example was a proposal to develop a new restaurant site in the North Island. As the proposed restaurant site adjoined a reserve, it was considered sensitive land under the Overseas Investment Act and consent was required before the investment could go ahead. While the vendors were supportive of the purchase, they were not prepared to wait for McDonald's to obtain consent under the Act, because of the length of the application process and the uncertainty over the outcome. McDonald's was also deterred from making an application due to the additional cost, potential delays, and the amount of information required for the consent application.

As a result, McDonald's decided not to purchase the site and the restaurant for the area will not be built. The restaurant was estimated to have contributed around $400,000 to local suppliers and producers and have created 60 full-time jobs as well as other employment for suppliers and contractors.

Source: McDonald's Restaurants (NZ) Ltd

Case study: AMP Capital Investors (NZ) Ltd

AMP New Zealand is an overseas person under the Overseas Investment Act and almost all investment transactions require due diligence to assess whether consent is required. All direct land transactions require careful consideration of whether the land is considered sensitive which generally involves acquiring a certificate as to the land's status from an agent or legal advisor. The size of the investments undertaken by AMP also results in regular consideration under the 'significant business assets' test.

The requirement to seek consent raises a number of problems for AMP:

- *an investment offer will be conditional on receiving consent*, which puts AMP at a significant disadvantage to an unconditional offer from a non-overseas person, in some cases even where the price offered is at a premium to the competing bid;
- *capital raising is made difficult* because the timeframe for seeking consent means that there is a long period of risk and uncertainty for the offshore investor, thereby increasing the cost of capital;
- *fund withdrawals by New Zealanders increase the relative proportion of overseas ownership* which complicates the withdrawal process;
- *the regime is very complex*, and applies to a range of commercial, retail and industrial properties and a variety of securities transactions that have no direct relationship with the underlying investment. Although consent will almost certainly be received, the delays and uncertainty over the extent of the delays create the disadvantage.

One consequence of these problems is that AMP spends a considerable amount on legal advice and land consultants to determine whether the screening regime applies, and to prepare applications. The screening regime is also one factor that is a deterrent for AMP offering investors the opportunity to invest in the rural economy.

Source: AMP Capital Investors (NZ) Ltd

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

2.5 International comparisons

OECD's FDI Regulatory Restrictiveness Index

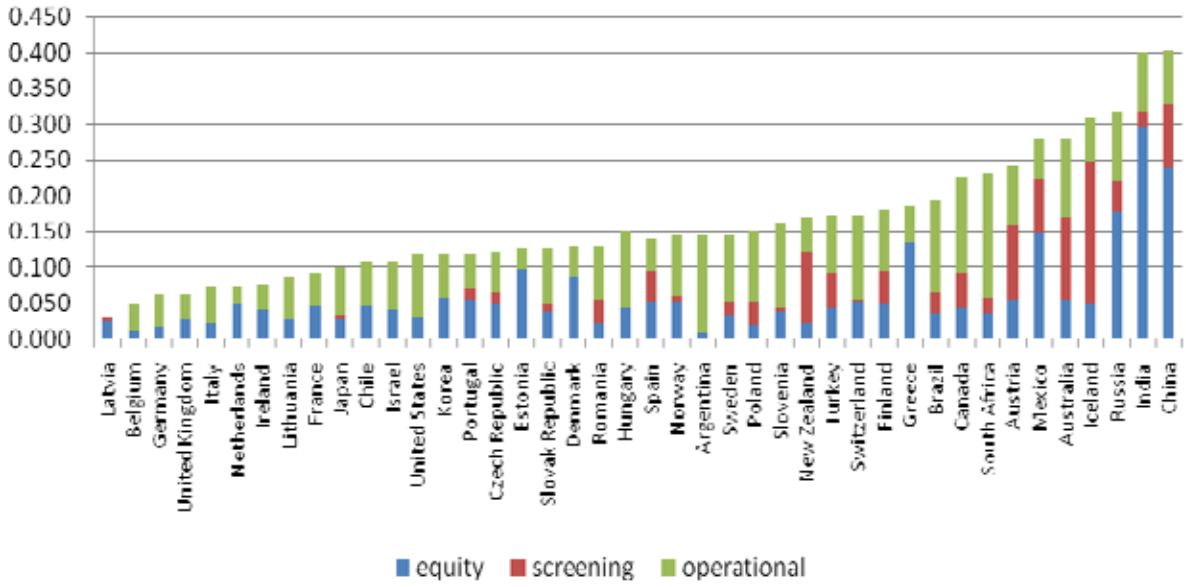
2.22 The OECD's Foreign Direct Investment (FDI) Regulatory Restrictiveness Index measures the extent to which countries treat foreign investors differently from nationals.[13] The index assesses the extent of equity restrictions, screening requirements, and operational restrictions such as constraints on foreigners

[13] *OECD International Investment Perspectives* (2006) p.135-151

managing or working in companies. The index allows for the comparison of New Zealand's overseas investment regime with other countries.

2.23 The graph below shows that New Zealand ranks 15th most restrictive out of the 42 ranked countries (and 10th in the OECD). New Zealand's score 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. Also of note is that only around half of the countries surveyed have a formal screening regime.

Figure 1: FDI Regulatory Restrictiveness by type of restriction



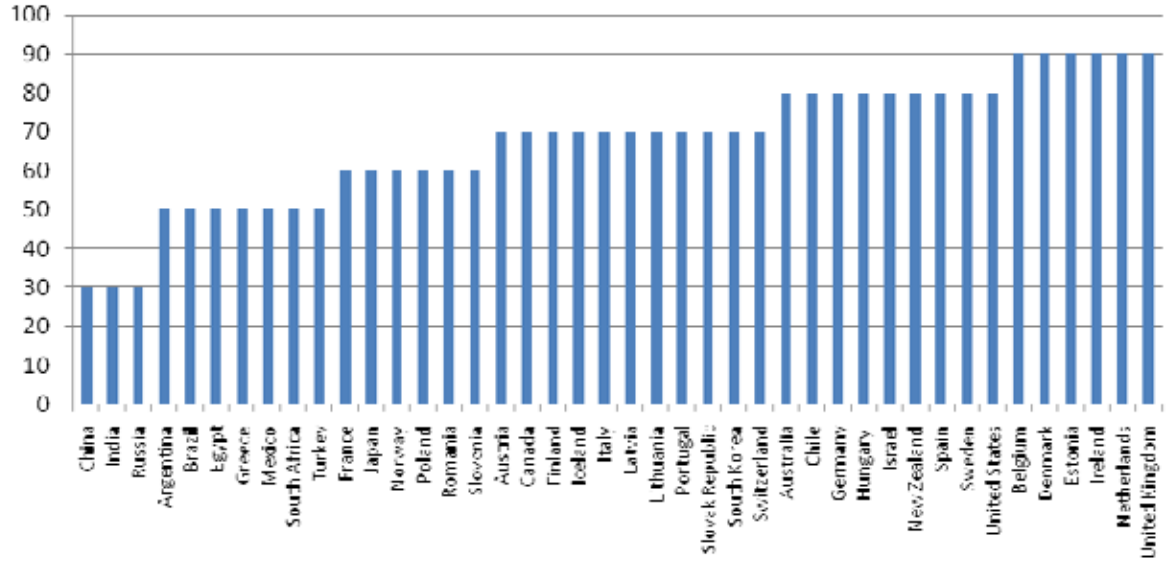
2.24 It is important to note that the index assesses the potential restrictiveness of investment regulations and not the extent to which restrictions are used. As a result part of the reason for New Zealand's position is the potential for the screening regime to be restrictive and it does not consider the high approval rate for investment applications.

2.25 Acknowledging the limitations, the OECD index is useful in showing that a number of countries do not operate a formal screening regime and that the scope of our regime is relatively wide.

Index of Economic Freedom

2.26 The Heritage Foundation produces an Index of Economic Freedom which can also be used to compare New Zealand's investment freedom with other countries. On this measure, New Zealand scored well at 80, compared with an average over all countries of 48.8. Figure 3 shows how this compares with the 41 other countries analysed in the OECD study above.

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



2.27 The Heritage Foundation noted that New Zealand encourages foreign investment in most sectors, does not discriminate against foreign buyers, but does limit foreign ownership of Air New Zealand and Telecom New Zealand. They also noted that in general, regulations and bureaucracy are efficient and transparent and land and real estate purchases are subject to strong restrictions.

2.28 The Heritage Foundation's assessment of investment 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. However the methodology for the study is less clear than the OECD Index.

World Economic Forum Enabling Trade Report

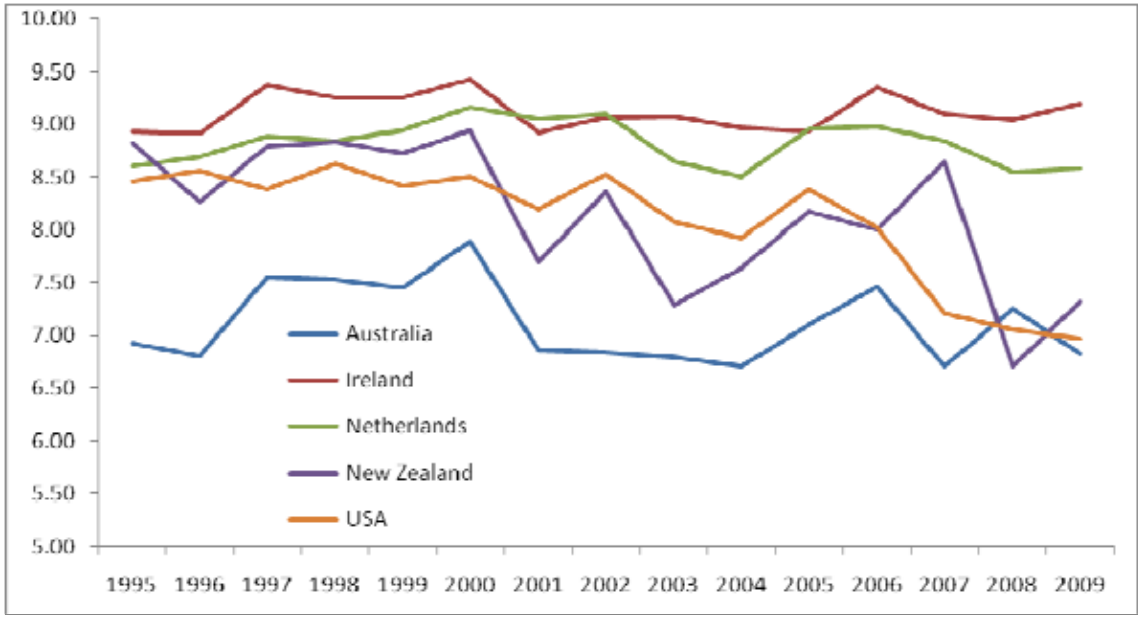
2.29 The World Economic Forum's Enabling Trade report includes a survey based assessment of a country's openness to foreign participation. New Zealand's rankings and scores are summarised in the table below, and compared with the top performers in the survey. The scores can range between 1 and 7, with 7 being least restrictive and 1 very restrictive.

Factor	Ranking/121	Score	Top performer	Score
Ease of hiring foreign labour	55	4.8	UAE	6.1
Prevalence of foreign ownership	22	5.8	Hong Kong	6.7
Business impact of rules on FDI	56	5.3	Ireland	6.7
Capital controls	14	6.0	Hong Kong	6.6

2.30 New Zealand's ranking in terms of the business impact of FDI rules is relatively poor at 56 out of 121.

IMD World Competitiveness Yearbook

2.31 The IMD, a Swiss business school, publishes an annual report which includes a survey based measure of how free foreign investors are to acquire control in domestic companies.



2.32 New Zealand's score dipped in 2008, possibly due to the Auckland Airport decision. The table also shows that there is room for New Zealand to improve relative to other small global players (Ireland, the Netherlands) which do better than on this measure.

2.6 Conclusion

2.33 The following conclusions can be drawn from the above discussion:

- The complexity and cost associated with going through the screening regime has increased since 2005.
- The most complex application types are sensitive land investments, which take the longest to assess, are the most costly to prepare, and have the most costly conditions to comply with.
- At the same time the changes also allowed a wider range of conditions to be imposed on investments in order to create additional benefits.
- New Zealand has a relatively restrictive screening regime compared to other OECD countries, at least in law, and a number of countries do not have any formal investment screening.
- The current screening regime is likely to be deterring some investment, but it is difficult to estimate the size of this effect.

3 DEFINTION OF AN OVERSEAS PERSON

3.1 Status Quo

3.1 An overseas person is broadly defined in the Overseas Investment Act[14] 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 where overseas persons: own or control 25% or more of the body corporate's securities; have the power to control the composition of 25% or more of the governing body; or have the right to exercise 25% or more of the voting power at a meeting of the body corporate, or;
- a partnership, trust or unit trust where 25% or more of the partners or members are overseas persons or an overseas person or persons have a beneficial interest in or entitlement to 25% or more of the assets.

3.2 Exemptions from screening are currently provided for:

- *specific types of investment* for example transactions which only result in temporary overseas ownership or an overseas person acquiring securities etc as a result of division of relationship property;
- *portfolio investors,* enabling overseas companies to invest in New Zealand companies without this investment contributing towards whether the New Zealand company is considered an overseas person; and
- *New Zealand controlled persons*, enabling a company that is an overseas person as defined in the Act, but clearly in "New Zealand hands", to invest in New Zealand without requiring consent.

3.2 Potential problem and discussion

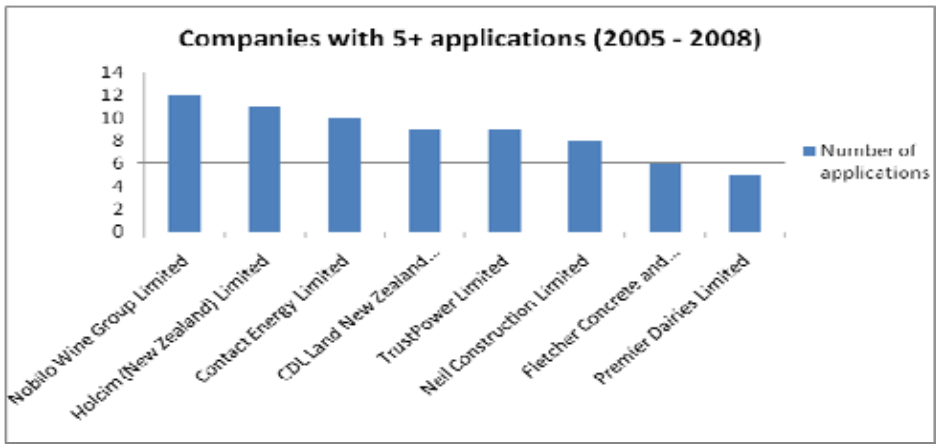
3.3 The Capital Market Development Taskforce, law firms who act for investors, and affected investors have raised concerns that the definition of an overseas person is capturing too many investors. The current threshold means that firms with majority New Zealand control but widely held minority foreign ownership/control are treated as overseas persons and must seek consent each time they invest in sensitive assets. In the first quarter of 2009, around nine of the top 40 firms listed on the NZX had between 25% and 50% overseas ownership. A further 8 had majority overseas ownership. OIO data shows that 11% of investment applications since 2004 where from firms with minority overseas ownership and

[14] Section 7 of the Act provides the full definition.

that most of these firms had no single overseas person owning 25% or more of the firm. The vast majority (75%) of applications were from firms with 90% or more overseas ownership.

Level of overseas ownership/control	Number of applications	Applications where one overseas person owned >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	

3.4 In addition a number of firms have been subject to screening multiple times in recent years. The graph below shows the firms which have applied five or more times over the last four years (not including subsidiaries).[15]



3.5 As noted in section one, a key concern about overseas investment is that overseas investors may act in a way that is inconsistent with New Zealand's best interests or domestic norms. As a general principle then, the Act should focus on screening firms that may act outside of New Zealand's interests.

3.6 The screening regime however, may be screening firms that are likely to be acting in the same way as domestic firms. Where a firm has dispersed, minority overseas ownership it is likely to be more difficult for the overseas persons to exert influence. As a consequence of this dispersed ownership, the domestic

[15] Note that TrustPower has applied for exemption and was added to the list of New Zealand controlled persons on 19 June 2008. TrustPower is included for completeness purposes and as an example of an investor who has sought exemption due to the high compliance costs of multiple applications.

investors are likely to have greater influence over the firm's operations. If the overseas ownership is relatively concentrated, for example by one person owning 25% of the firm, then that person is more likely to be able to exercise control.

3.7 Where an investor has strong links to New Zealand the likelihood of them either not being aware of domestic norms or acting contrary to them is low as it is unlikely to be in their interest to take actions that may damage profitability. Examples of these links would be having previous investment approved, length of operations in New Zealand, and local incorporation, listing and headquartering. The more integrated the firm is into the New Zealand economy, the more likely it is to behave in the same way to a domestically owned firm.

3.8 The review is therefore investigating options to avoid screening firms that are likely to act similarly to domestic firms.

3.3 Options

3.9 The following options have been developed to address the problems of firms with dispersed minority overseas control and repeat investors with strong links to New Zealand being screened:

Raise the 25% threshold

3.10 To avoid the problem of firms with minority overseas control being screened, the 25% threshold which determines whether a firm is an overseas person could be lifted. Lifiting the threshold to 40% would have reduced application numbers by 24 between 2004 and 2009, or an average of around 4 applications per year.

3.11 To assist with considering what may be an appropriate threshold for determining control, the table below provides examples of thresholds in other legislation.

	Definition
Reserve Bank Act	This Act uses both 10% and 25% when defining 'significant influence', in relation to a registered bank: 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. This definition only applies to one person, rather than a group with 10% or 25% control.
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.
Takeovers Code	Regulates takeover transactions at a threshold of 20% of voting rights in the target company.
Australian screening regime	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.

Canadian screening regime	An entity where non Canadians own 50% or more of the voting interests is considered an overseas person.[16]
International Monetary Fund	The IMF uses a 10% threshold when distinguishing between portfolio investment and foreign direct investment.

3.12 The main downside of this option is that it does not account for cases where there is a high level of ownership held by one overseas person. For example a firm that was 30% controlled by one overseas person would not be subject to screening, but this level of control by one person is likely to provide influence over how the business operates. From the above table it appears that a higher threshold, such as 40%, would not be consistent with other approaches to determining control.

3.13 The table below outlines the impact of this option against the criteria discussed in section one.

Criteria	Impact	Assessment
Change in compliance costs	Low	Around 4 fewer applications per year reducing compliance costs by between $150,000 and $900,000 pa.
Impact on certainty/predictability	Low	Does not impact
Impact on protections	Medium	Firms with a large minority stake held by one overseas person would avoid screening when that person is likely to have influence over the firms operations.
FTA impacts	Medium	This change could not be reversed in future for our FTA partners
Risks	Low	A relatively straightforward change to implement.

Introduce a dual threshold

3.14 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.

3.15 Firms with overseas ownership/control of 25% or more by **one** overseas person would be considered overseas persons, because this level of ownership by one person is likely to provide influence over the firm. A firm 40% or more controlled by **two or more** overseas persons would also be considered an overseas person.

3.16 Such a system has the advantage of recognising that dispersed ownership is less likely to result in control. For example under this option a firm with 26 overseas persons each controlling 1% of the voting rights would not be considered an overseas person. Under the status quo this firm would be considered an overseas person as the total level of overseas ownership exceeds 25%.

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

3.17 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 controlled 15% of a firm, the firm would not be considered an overseas person, unless an associate test were applied. If firms were required to identify shareholders who are associated, this option is likely to be unworkable because it may be difficult for a firm to know the relationship between all its shareholders.

3.18 The table below outlines the impact of this option against the criteria discussed in section one.

Criteria	Impact	Assessment
Change in compliance costs	Low	Around 4 fewer applications per year reducing compliance costs by between $150,000 and $900,000 pa.
Impact on certainty/predictability	Low	Does not impact.
Impact on protections	Low	Firms that are no longer screened are unlikely to have significant control by overseas persons.
FTA impacts	Medium	This change could not be reversed in future for our FTA partners.
Risks	High	Risk of avoidance is high if no associate test is applied. If an associate test is applied, it will be very difficult to implement.

Introduce additional exemptions

3.19 A further option would be to introduce exemptions from screening for a wider range of firms, rather than changing the definition of an overseas person in the Act.

3.20 The Act currently includes exemptions for a variety of purposes. We see three principles that could be used to guide when exemptions may be warranted:

- *Technical changes of little policy interest* – some transactions are captured through technicalities that mean that they are required to apply for consent. However, many of these transactions do not create policy concerns. Exempting these transaction reduces scrutiny that Ministers have but this does not have significant effects on the operation of the regime overall. The current exemption for some specific types of investment is built on this principle.
- *The investor is technically "in New Zealand hands"* – On closer examination of the ownership and control of some firms currently defined as overseas persons, it can be demonstrated that the investor is controlled by New Zealanders. Under New Zealand ownership or control, they are judged less likely to act contrary to New Zealand interests and screening is not considered necessary. The current exemptions for portfolio investors and New Zealand controlled persons are based on this principle.

3.21 *Unlikely to act outside of New Zealand's interests* – One major concern with foreign investment is that a foreigner will act contrary to New Zealand interests once an asset is purchased. However, if an investor has shown benefit multiple times with past investments, and can prove strong links to New Zealand, the

likelihood of them either not being aware of domestic norms or acting contrary to them is low.

3.22 The review has identified two areas that are not currently covered by existing exemptions but that are consistent with the principles above.

3.23 The first is companies with strong links to New Zealand. Exemptions could be provided for firms that meet certain criteria: local incorporation, dispersed overseas shareholding, New Zealand control of the Board, length of operations in New Zealand, locally headquartered, NZX listed, and product is wholly produced and consumed in New Zealand. Companies would have also had to have been through the screening regime at least once to ensure that they have history of being able to prove that they provide benefit to New Zealand.

3.24 The second is transactions where the underlying owners are New Zealanders but are made through overseas-owned trustee companies and investment funds such as Portfiolio Investment Entities. In these transactions, New Zealanders are the ulimate benefical owners of the investment activity, but an overseas person may control the trust which undertakes the investment.

3.25 Implementation of the New Zealand linked repeat investor exemption would significantly reduce compliance costs for a small number of companies. At the most, this would result in a 9.5% reduction in applications per year, if all the repeat investors qualified for exemption.

3.26 The main risk of introducing new exemptions is the risk of evasion if investors structure themselves so that they meet the criteria. However, these risks can be mitigated through well specified criteria, case-by-case consideration of exemptions and review and revocation mechanisms. Each company and subsidiaries of that company would need to apply separately for exemption so there would be no flow down benefits to subsidiaries if their parent company was exempted, or vice versa.

3.27 The main risk of an exemption for transactions where New Zealanders are the unerlying beneficial owners is that there may be practical difficulties in identifying the beneficial owners. As a consequence the practical effect of the exemption may be lower than expected.

3.28 Applications for exemptions would be need to be made by investors to the Overseas Investment Office to address the risks of evasion. Applications would be made at the investors cost – current exemption application fees range between $11,000 and $15,000. Ongoing monitoring fees are approximately $10,000 per annum.

3.29 The table below summarises the impact of the exemption option against the criteria outlined in section one.

Criteria	Impact	Assessment
Change in compliance costs	Medium	7-10 fewer applications per year with compliance cost savings of between $200,000 and $1.8 million. One-off costs of around $11,000-15,000 per exemption application and monitoring costs of around $10,000 p.a.
Impact on	Medium	Exempt investors are no longer subject to screening.

certainty/predictability		
Impact on protections	Low	Fewer transactions are subject to screening, however it is unlikely the exempted firms and transactions are unlikely to raise concerns because of their links to New Zealand, or New Zealanders are the beneficial owners.
FTA impacts	Low	Exemptions could not be reversed for FTA partners, but given that this exemption would only apply to a small number of investors the risks remain low.
Risks	Low	Risks of avoidance are mitigated by basing exemptions on a certain ownership structure and requiring regular review. The key risk of the exemption for transactions for trustee companies is that it may be less effective than expected.

3.4 Summary

3.30 When coming to a view on the preferred option for changes to who is considered an overseas person, the key considerations are:

- the extent to which increasing a single threshold for ownership or control will reduce oversight of investments from firms with substantial overseas ownership;
- the additional complexities that may be created by a dual threshold; and
- whether repeat investors with strong links to New Zealand are likely to act in a similar way to New Zealand controlled firms.

3.31 The table below summarises the impact of the three options:

Criteria	Increase the 25% threshold to 40%	Introduce a dual threshold	Introduce new exemptions
Change in compliance costs	Low	Low	Medium
Impact on certainty/predictability	Low	Low	Medium
Impact on protections	Medium	Low	Low
FTA impacts	Medium	Medium	Low
Risks	Low	High	Low

4 SIGNIFICANT BUSINESS ASSETS: SCOPE

4.1 Status Quo

4.1 In broad terms an investment in significant business assets is an investment:

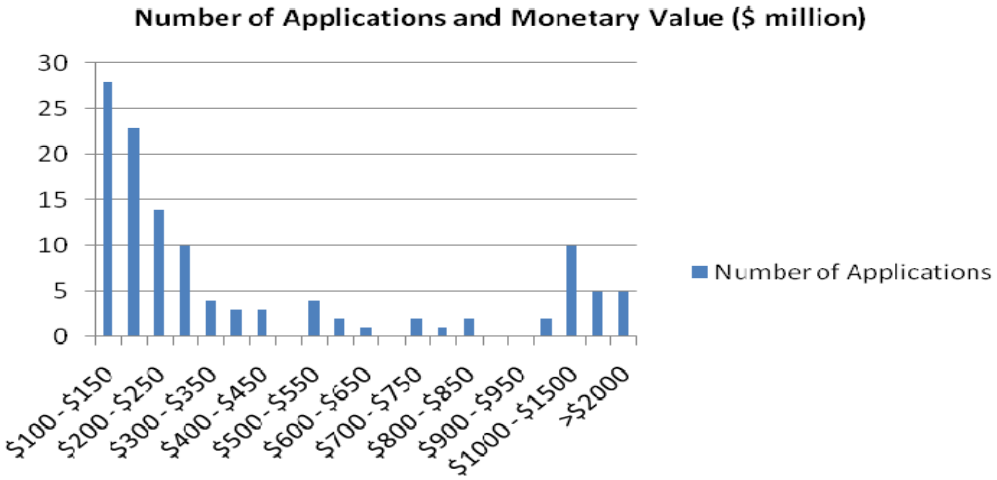
- in an *existing business*, where *both* (i) the share is 25% or more *and* (ii) *either* the value of that share is over $100 million, *or* the assets of the target investment are more than $100 million;
- in a *new business*, where the value of the new business is over $100 million; or
- in *property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

4.2 Potential problem and discussion

4.2 In general there appear to be no significant problems with the scope of screening for business assets. These applications are relatively straightforward to prepare and assess, and no business-only applications have been declined since 1984.

4.3 That said, the review will examine whether the current monetary threshold of $100 million is capturing investments in genuinely significant businesses. Screening creates compliance costs for investors, even if they are low. To the extent that screening of non-sensitive assets is reduced, compliance costs are also reduced.

4.4 The chart below shows that a large proportion of business applications fall within the $100-$200 million range. Given that most fall in this range, the review will look in more detail at the types of firms with assets within this grouping.



4.5 The table below outlines the New Zealand firms with total assets worth between $100 and $200 million.[17] Rows highlighted in green indicate that the firm is majority overseas owned and blue rows indicate the firm is a cooperative or government owned. If an overseas investor purchases more than 25% of these firms, that transaction will be subject to screening.

Company	Asset value ($000)	Company	Asset value ($000)
Skellerup Holdings	194,039	Winstone Pulp International	138,823
Onesource Holdings NZ	191,169	Siemens (NZ)	138,378
Holden New Zealand	187,943	Alcatel-Lucent New Zealand	136,502
Smiths City Group	186,414	Multiplex Constructions	133,508
Briscoe Group	180,389	Airways Corporation of NZ	133,425
Rakon	174,444	Open Country Cheese Company	131,873
ZESPRI Group	172,547	Nestle New Zealand	130,482
GlaxoSmithKline NZ	164,926	Wahn Investments	128,567
ProvencoCadmus	162,495	Allied Foods (NZ)	127,507
Avon Pacific Holdings	162,110	ITW New Zealand	125,091
Spotless Services (NZ)	159,445	3M New Zealand	122,354
Chubb New Zealand	159,079	NZ Plumbers' Merchants	121,885
Bridgestone New Zealand	157,630	Lion Nathan Wines and Spirits	118,436
Opus International Consultants	156,813	Combined Rural Traders Society	114,067
General Cable Holdings NZ	156,184	Restaurant Brands New Zealand	112,969
Mitsubishi Motors New Zealand	155,944	Wesfarmers Industrial and Safety Holdings	111,938
Market Gardeners	151,667	Redeal	111,101
Whitcoulls Holdings	151,355	Aperio Group	109,881
Tech Pacific Holdings (NZ)	150,606	Armourguard Security	104,976
ACP Media	146,727	Flight Centre (NZ)	104,418
Mitre 10 New Zealand	143,003	New Zealand Investment Holdings	100,648
PMP (NZ)	142,606		

4.6 The table shows that vast majority of firms with assets between $100 million and $200 million are already overseas owned. As a result overseas investment into these firms may be less sensitive. In particular where these firms are wholly owned subsidiaries of multinational firms, it is difficult to argue that a change in the ownership of that multinational would raise significant concerns.

4.3 Options

4.7 The discussion below outlines options to potentially reduce screening of non-sensitive business assets. The option of completely removing the business screening process has not been considered because doing so would remove a

[17] New Zealand Management Magazine, December 2008, Vol. 55, Issue 11

significant part of the screening regime which is outside of the Terms of Reference of the review. Significant business assets are one of the three categories of sensitive assets that are screened, and its complete removal would therefore be a substantial change to the structure of the regime.

Increase screening threshold to $150 million

4.8 Increasing the screening threshold to $150 million is one option to avoid screening investments that may not be sensitive. This option would mean around four fewer business applications per year with resulting compliance costs reductions. Given that most companies in this range are local subsidiaries or majority overseas owned, the argument that they are sensitive is reduced.

4.9 On the other hand, making fewer firms subject to screening may raise concern if these firms are considered to be sensitive assets. A key impact of increasing the threshold is that it would be "locked in" for some of New Zealand's FTA partners and could not be reversed. *[Withheld - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements]*.

4.10 The key impacts of this proposal are outlined in the table below.

Criteria	Impact	Assessment
Change in compliance costs	Low	Around 4 fewer applications per year with compliance cost savings of around $100,000 pa.
Impact on certainty/predictability	Low	Does not impact.
Impact on protections	Low	Fewer transactions are subject to review, however it is arguable that these firms are not 'sensitive'.
FTA impacts	Medium	The increase in threshold could not be reversed for some of our FTA partners. *[Withheld - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements].*
Risks	Low	This would be a relatively straightforward change to implement and raises no obvious avoidance risks.

Increase screening threshold to $200 million

4.11 A further option is to increase the threshold to $200 million. This would have the effect of reducing business applications by around seven per year, with resulting compliance cost reductions. This proposal would have similar benefits and downsides to those discussed in the above option.

4.12 The key impacts of this proposal are outlined in the table below.

Criteria	Impact	Assessment
Change in compliance costs	Low	Around 7 fewer applications per year with compliance cost savings of around $200,000.
Impact on certainty/predictability	Low	Does not impact.
Impact on protections	Low	Fewer transactions are subject to review, however it is arguable that these firms are not 'sensitive'.
FTA impacts	Medium	The increase in threshold could not be reversed for some of our FTA partners. *[Withheld - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements]*.
Risks	Low	This would be a relatively straightforward change to implement and raises no obvious avoidance risks.

Remove screening based on total assets

4.13 As noted earlier, investments are screened if an overseas person purchases 25% or more of a business with assets of greater than $100 million, or the consideration paid for the transaction exceeds $100 million. The first part of this test means that an investor could be spending well *less* than $100 million and still be screened. For example if they purchased 25% of a firm with assets of $100 million, they may be spending $25 million, or less depending on the value of equity. As a result some relatively small transactions can be caught by the Act.

4.14 To avoid this problem, the reference to screening based on total assets could be removed. The result would be that an investment would have to have a consideration of more than $100 million to be screened.

4.15 The main downside of this option however is that it may create avoidance risks as investors may be able to structure transactions to avoid paying $100 million directly. The likelihood of this avoidance occurring is not clear, but the change would be irreversible due to our FTA commitments, making it difficult to address avoidance if it became an issue in future. This option would also make it difficult assess international transactions where the New Zealand business is a small part of the overall deal. Often in these transactions the consideration paid for the New Zealand part of the deal is not explicitly separated out, so having reference to total assets makes it clear whether the transaction is captured or not.

4.16 The key impacts of this proposal are outlined in the table below.

Criteria	Impact	Assessment
Change in compliance costs	Low	Around 4 fewer applications per year with compliance cost savings of around $100,000 pa
Impact on certainty/predictability	Low	Does not impact.
Impact on protections	Low	Fewer transactions are subject to review, however it is arguable that these firms are not 'sensitive'.
FTA impacts	Medium	The increase in threshold could not be reversed for some of our FTA partners. *[Withheld - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements]*.
Risks	High	There is a significant risk of avoidance and the irreversibility of the change would make it difficult to address this risk in future.

4.4 Summary

4.17 The three main judgements to consider when assessing whether to increase 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's compliance cost.* Screening investments has both a time and financial cost to investors. A higher threshold would reduce compliance costs for investors who are no longer screened. The judgement here is how much these costs influence the attractiveness of New Zealand as an investment destination.

4.18 The table below summarises the impact of the three options discussed above.

Criteria	Increase screening threshold to $150m	Increase screening threshold to $200m	Remove screening based on total assets
Change in compliance costs	Low	Low	Low
Impact on certainty/predictability	Low	Low	Low
Impact on protections	Low	Low	Low
FTA impacts	Medium	Medium	Medium
Risks	Low	Low	High

5 SIGNIFICANT BUSINESS ASSETS: HURDLE

5.1 Status Quo

5.1 Investors in significant business assets must show that they:

- have relevant business acumen
- have demonstrated a financial commitment to New Zealand
- are of good character, and
- are not ineligible from obtaining an exemption or permit under the Immigration Act 1987.

5.2 These criteria target the investor's suitability to invest in New Zealand and are assessed as follows:

- *Business acumen.* The OIO requires the investor to have the practical knowledge and ability relevant to the investment they intend to make, for example experience in the same industry and type of investment;
- *Financial commitment.* The OIO seeks evidence to show that the investor has committed resources to the investment such as securing an advance or loan to undertake the investment.
- *Good character.* This criterion takes into account any offences and contraventions of the law by the investor and any other matters that may adversely reflect on the investor's fitness to make the investment. Persons who have been imprisoned for serious offences, subject to a removal order, deported, involved in terrorism, or who are likely to commit drug offences, do not qualify to invest in New Zealand.

5.2 Potential problem and discussion

5.3 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, no business only investment applications have been declined in the last 25 years.

5.4 The current criteria for assessing overseas investments in significant business assets appear to be working well and there is no evidence that they are a unnecessarily delaying investments. As a result there are no obvious grounds for investigating improvements to these criteria.

6 SENSITIVE LAND: SCOPE

Status Quo

6.1. Sensitive land is broadly defined in the Overseas Investment Act as[18]:

Land that is or includes this type of land...	...and exceeds
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)	-
Land that adjoins...	**...and exceeds**
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

Potential problem and discussion

6.2. The review is investigating whether it is possible to refine the scope of sensitive land to avoid screening investments that may not be considered sensitive. Where non-sensitive investments are screened, it creates delays for valuable investments into New Zealand.

6.3. The table below shows the distribution of applications across the various types of sensitive land and that the most common applications are in the categories of non-urban land or land adjoining local parks and reserves.

Type of land[19]	Number of Applications*	Proportion of Applications (%)*
Includes - Non-urban land exceeding 5 hectares	153	37.8%
Adjoins – Local parks and reserves	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%

[18] Refer to Schedule 1 of the Act for a full description.

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

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

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%

6.4. Given that applications most commonly fall within either non-urban land or land adjoining parks and reserves, the review will examine whether these categories are capturing only sensitive types of land.

Non-urban land

6.5. 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 that is both:

i) in an urban area, and

ii) used for commercial, industrial, or residential purposes,

6.6. The current definition of non-urban land gives rise to two potential problems:

- *Definition of non-urban land:* The current definition includes land that is used for commercial/industrial or residential purposes and is located outside of an urban area. This presents an inconsistency as these types of land would not be screened if they are located in urban areas. Given that these types of land are not considered sensitive in urban areas there may be a case to remove them from screening in non-urban areas. On the other hand commercial sites such as tourist lodges and sawmills in rural areas could include sensitive features. In addition, determining whether land is urban can be difficult, as, especially on the boundary between urban and non-urban areas. Land zoning does not always make a clear distinction between urban and non-urban areas.
- *Area threshold:* The area threshold at which non-urban land purchases are screened may be set too low. For example, it is not clear why small lifestyles blocks should be considered sensitive. The table below shows that the large majority of non-urban land applications have exceeded the 30 ha threshold over the past two

years. Increasing the threshold to 10 hectares would reduce land applications by around 12%. The table below indicates the land area of the 154 non-urban land applications over the past two years.

Land Area (Ha)	Number of non-urban land applications
< 5 *	8
5 - 10	19
10 - 15	9
15 - 20	9
20 - 25	7
25 - 30	3
30 +	96
Total	154

* These investments were screened because of other sensitivities eg adjoining foreshore.

Local parks and reserves

6.7. The Act requires the OIO to keep a list of reserves, parks and other sensitive areas, land adjoining which, is screened under the Act.[20] The current list 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;
- 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 land; and
- National Parks.

6.8. Anecdotal examples of investments being screened because the land adjoins a local sports field have been the catalyst for the review to consider whether it is appropriate for this list to include local parks and reserves. A recent example was Fletcher Building requiring approval to acquiring a lease for a Placemakers Store because of an adjoining park. On one hand, it is not clear what concerns would be raised by an investor purchasing this kind of property. Part of the justification for screening adjoining land is that it may be used to provide public access but playgrounds and sports fields are already likely to have access provided. However larger local parks could hold higher conservation values, and the adjoining land may be considered important for conservation purposes. The inclusion of land adjoining National Parks has greater justification as it is more likely to be sensitive because of the conservation value of the park and potentially for public access reasons.

6.9. The use of the list also creates some uncertainty over whether the adjoining land is subject to screening. The list includes some criteria as to which parks should be included, for example parks which provide public access to natural and physical

[20] See section 37 of the Act for a full description.

resources or historic heritage, but does not name individual parks. However the criteria can be interpreted in different ways which leads to some investors applying for consent without being sure if they are subject to the regime.

6.10. It is worth noting that the Act separately screens land which adjoins regional parks, esplanade reserves/strips that adjoins the sea or a lake, any scientific, scenic, historic or nature reserve, lakebed, recreation reserves that adjoins the sea or a lake, land subject to a heritage order and land that is a Maori reservation and adjoins the sea or a lake.

Options – non-urban land

6.11. The following options have been developed in order to address the problems associated with the screening of non-urban land. The option of completely removing sensitive land from the Act has not been considered because doing so would remove a significant part of the screening regime which is outside of the Terms of Reference of the review. Sensitive land is one of the three categories of sensitive assets that are screened, and its complete removal would therefore be a substantial change to the structure of the regime.

Increase area threshold

6.12. The current threshold for non-urban land is set relatively low at 5ha when the compared to the majority of applications being over 30 ha.[21] Increasing the threshold to 10ha would avoid screening smaller lifestyle blocks that are more likely to be used for residential purposes, but ensure that large purchases of non-urban land continue to be screened. 2002 data from Statistics New Zealand states that the average sheep farm size was 554ha, dairy farm: 146ha, forestry block: 481ha, and horticulture block: 18.4ha.[22] Small lifestyle blocks used for residential purposes and that are not sensitive for any other reason (such as adjoining foreshore) are unlikely to raise significant sensitivities. Relative to large farm blocks, they are less likely to have features that the Act protects such as walking access, indigenous vegetation and heritage areas.

6.13. The downside of increasing the threshold is the loss of oversight over smaller investments in non-urban land. In addition, this change could not be reversed in future because of commitments New Zealand has made in some free trade agreements to only make liberalising changes to the screening regime.

6.14. The table below outlines the impact of this change.

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[21] Note that smaller thresholds apply to land adjoining/including foreshore, reserves etc. These thresholds are not proposed to change.

[22] 2002 data from Statistics New Zealand states that the average sheep farm size was 554ha, dairy farm: 146ha, forestry block: 481ha and horticulture block: 18.4ha.

Criteria	Impact	Assessment
Change in compliance costs	Medium	Approximately 10 fewer applications per year with compliance cost savings in the order of $1.7 million pa
Impact on certainty/predictability	Low	No significant impact expected.
Impact on protections	Low	Some reduction in the ability to screen small land purchases, but large purchases remain subject to safeguards.
FTA impacts	Medium	This change could not be reversed for some FTA partner countries where New Zealand has committed only to reduce investment barriers and not reverse any changes.
Risks	Low	The area threshold change is relatively straight forward to implement and is unlikely to have unintended effects.

Remove screening for commercial/industrial sites in rural areas

6.15. Given that commercial and industrial sites are not screened when located in urban areas, it is arguable that they should also not be screened if they are located in non-urban areas. This proposal would require a change to the definition of non-urban land. Any other non-urban land such as farmland, forestry or residential would still be subject to screening.

6.16. On the downside, removing these sites from screening means less oversight of investments into commercial and industrial sites which may have some sensitive features. For example, a tourist lodge may include land that is traditionally used for walking access. In addition, this change could not be reversed in future because of commitments New Zealand has made in some free trade agreements to only make liberalising changes to the screening regime.

6.17. The table below outlines the impact of this option.

Criteria	Impact	Assessment
Change in compliance costs	Low	There have been 50 non-urban land applications in the last two years which did not include farmland. It is not possible to tell how many of these would no longer be screened as many of them would include forestry or other rural land. If 10% of these applications are for commercial/industrial sites, this change would reduce applications by around 2-3 per year.
Impact on certainty/predictability	Low	Consistent treatment of these sites may improve investor certainty.
Impact on protections	Medium	Some reduction in the ability to screen land purchases which may be sensitive sites.
FTA impacts	Medium	Could not be reversed for investments from some FTA partner countries where New Zealand has committed only to reduce investment barriers and not reverse any changes.
Risks	Low	The change may have less impact than expected, depending on how many applications are only commercial/industrial sites in non-urban areas.

Options – local parks and reserves

6.18. The following options have been developed in order to address the problems created by the screening of land adjoining local parks and reserves:

Remove local parks and reserves from screening

6.19. Under this option, land that adjoins local parks and reserves would no longer be subject to screening. This option would avoid investments in land being screened simply because they adjoin a local park, which is less likely to be sensitive than land adjoining larger Regional or National parks. Screening for land adjoining National Parks, Wildlife Reserves and government purpose reserves used for wildlife management would be retained because the adjoining land may be particularly important for access or conservation purposes.

6.20. The downside of this option is that it would mean land adjoining large local parks and reserves would not be screened, for example land adjoining botanic gardens or reserves such as Otari-Wilton bush in Wellington. In addition, this change could not be reversed in future because of commitments New Zealand has made in some free trade agreements to only make liberalising changes to the screening regime.

6.21. The table below outlines the impact of this proposal.

Criteria	Impact	Assessment
Change in compliance costs	Medium	Up to 16 fewer applications per year with compliance cost savings around $2.8 million
Impact on certainty/predictability	Medium	Improved certainty as investors no longer face uncertainty over whether the land is subject to screening.
Impact on protections	Low	Some reduction in the ability to screen investments, in particular land adjoining large local parks and reserves (eg botanic gardens) would not be subject to screening.
FTA impacts	Medium	This change could not be reversed for some FTA partner countries in where New Zealand has committed only to reduce investment barriers and not reverse any changes.
Risks	Low	There may be some local parks and reserves that are considered to be of equal sensitivity to regional parks.

Apply an area threshold to the size of parks and reserves

6.22. Under this option land would not be subject to screening because of the adjoining local park or a reserve, unless that park or reserve was greater than 80 hectares. Applying an area threshold will avoid screening land adjoining sports fields for example, but would still provide for screening of land adjoining large local parks. Some examples of local parks and reserves are outlined below.

Park	Size
Otari Wilton Bush – Wellington	100ha
Wellington Botanic Gardens	25ha
Karori Sanctuary – Wellington	252ha
Pukekura Park – New Plymouth	52ha
The Esplanade – Palmerston North	19ha
Auckland Botanic Gardens	64ha
Wither Hills Farm Park - Blenheim	1100ha

6.23. As with the above options, this option would mean remove oversight for land adjoining smaller local parks and reserves and could also not be reversed in future.

6.24. The table below outlines the impact of this option.

Criteria	Impact	Assessment
Change in compliance costs	Medium	Up to 16 fewer applications per year with compliance cost savings in the order of $2.8 depending on area threshold employed. Data on the size of the adjoining park is not collected.
Impact on certainty/predictability	Medium	Improved certainty as investors no longer face uncertainty over whether the land is subject to screening.
Impact on protections	Low	Some reduction in the ability to screen investments, however land adjoining large local parks and reserves (e.g. botanic gardens) would still be screened.
FTA impacts	Medium	This change could not be reversed for investments from some FTA partner countries where New Zealand has committed only to reduce investment barriers and not reverse any changes.
Risks	Low	There may be some small local parks and reserves that are considered to sensitive and not screened.

Summary

6.25. The key judgements when considering changes to the scope of sensitive land are:

- *Sensitivity of site.* Do the applications that would no longer be screened involve land that would be considered sensitive? For example in the case of land adjoining local parks and reserves, what would make that adjoining land sensitive?
- *Compliance cost savings.* The proposals could create some significant savings in terms of compliance costs for investors.
- *Irreversibility.* The changes could not be reversed in future for investors from some countries with which we have FTAs.

6.26. The table below summarises the impact of the options discussed above.

Criteria	Increase non-urban land threshold to 10ha	Remove screening for commercial/industrial sites in rural areas	Remove local parks and reserves from screening	Apply an area threshold to local parks and reserves
Change in compliance costs	Medium	Low	Medium	Medium
Impact on certainty/predictability	Low	Low	Medium	Medium
Impact on protections	Low	Medium	Low	Low
FTA impacts	Medium	Medium	Medium	Medium
Risks	Low	Low	Low	Low

7 SENSITIVE LAND: HURDLE

7.1 Status Quo

7.1 As with the business screening hurdle, to gain consent to invest in sensitive land, an investor must meet the investor test of business experience and acumen, have financial commitment and be of good character.

7.2 In addition the investor must show:

- that the investment, will, or is likely to, benefit New Zealand; [23]
- 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, that the farm land or has been offered for sale on the open market.

7.3 The following factors are used to assess whether the investment will benefit New Zealand:

Economic factors	Whether the overseas investment will, or is likely to, result in: • 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.
Environmental factors	Whether there are or will be adequate mechanisms in place for protecting or enhancing: • existing areas of significant indigenous vegetation and significant habitats of indigenous fauna, for example, any 1 or more of the following: • 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.

[23] The investor is exempted from proving benefit, if they are ordinarily resident in New Zealand or intending to reside in New Zealand indefinitely.

Social factors	Whether there are or will be adequate mechanisms in place for providing, protecting, or improving walking access to: • 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. 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: • 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. 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.
Other factors	Whether the overseas investment, or the granting of the application for consent, will, or is likely to: • 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. Whether the overseas person: • 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. Whether refusing the application for consent will, or is likely to: • adversely affect New Zealand's image overseas or its trade or international relations • result in New Zealand breaching any of its international obligations.

7.4 The Minister of Finance and the Minister for Land Information must consider all of the above factors to determine which are relevant and then decide whether an overseas investment will benefit New Zealand. If the land includes non-urban land exceeding 5 hectares, Ministers must also determine whether the benefits will, or are likely to be, substantial and identifiable. Ministers can use their discretion with respect to the relative importance of those factors.

7.5 In order for the Overseas Investment Office to consider an application and advise Ministers on how it should be decided, investors must address each of the factors to determine whether they are relevant or not. Investors must also present an investment plan that generally includes:

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) if applicable, detail on and conservation plans for indigenous vegetation/fauna, wildlife, historic heritage and walking access and ways of protecting these features; 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).

7.2 Potential problem and discussion

Land hurdle

7.6 The current benefit test for investments in sensitive land has the advantage of allowing Ministers to consider a wide range of factors to show and to require a high level of 'benefit' before the investment may proceed. However it is also contributing to the high time and monetary costs of preparing investment applications discussed in section 2 for the following reasons:

- *Number of factors considered.* The large number of factors that must all be addressed means that a significant amount of time is required to prepare and assess applications. Complex applications can fill a number of ring binders.
- *Height of hurdle.* The requirement to show "substantial and identifiable" benefit in the case of non-urban land is a somewhat higher threshold for investors to pass. This requirement can be difficult to meet if the investor is seeking to increase their ownership share in an asset or when the asset is being sold from one overseas investor to another, because it can be difficult to show *additional* substantial and identifiable benefits with each investment. The substantial and identifiable criterion is also difficult to meet if the benefits will not be realised for a number of years, for example with some forestry investments, as the benefits are less certain.
- *Uncertainty over weighting.* Uncertainty is created as Ministers are able to determine the relative importance of each factor in the benefit test, and the level of benefit that must be provided.
- *Possible duplication.* It is possible that some of the factors considered in the benefit test may be addressed in other legislation that provides protection regardless of whether the investor is overseas or domestic. For example the Resource Management Act and the Conservation Act provide some, but not necessarily the same, protections for wildlife and controls over land use.

7.7 The requirement for the investor to also meet the investor test that is applied to investments in significant business assets does not appear to be causing particular problems.

7.8 The question therefore is whether an alternative formulation of the benefit test could provide adequate protections but with lower compliance costs.

Offer of special land

7.9 Where the relevant land includes special land (foreshore, seabed, lakebed or riverbed), these parts of the land must be offered to the Crown. Special land has been a factor in approximately 9% of sensitive land applications in the past two years.

7.10 The main advantage of this requirement is that it provides the Crown with the ability to own these types of land. This may be considered desirable if a high value is placed on ownership value itself. It may also be a way of clarifying uncertainty over the Crown ownership of some riverbeds. As discussed below, ownership does not necessarily provide for public access and usage.

7.11 The review has found that the requirement to offer special land also raises three significant issues discussed below.

7.12 The complicated and costly process creates commercial duress. The process for offering special land envisages that the land would be surveyed and valued before the Crown makes a decision on whether to acquire the land. The OIO estimates that the survey process would likely take at least six months, followed by several months to determine the valuation. The cost and time required to undertake this process is such that it has never been followed. Instead the land is offered to the Crown at no cost, to avoid delays and fast-track the sale. Investors and vendors are in effect being placed under significant commercial duress with the Crown benefiting by acquiring the land without cost. Offering special land imposes a particular burden on industries for which access to or across waterways is an integral part of business, such as forestry and electricity generation.

7.13 The burden to offer the land falls on the existing owner, rather than the overseas investor. It is the current owner who potentially receives a lower sale price if the land's value is reduced by removing the special land, and may act as a disincentive for existing owners to sell to an overseas person. The process imposes a burden on New Zealanders which is inconsistent with the purpose of the Act, which makes it a privilege for overseas persons to acquire sensitive New Zealand land.

7.14 More fundamentally, the review has found that Crown ownership does not necessarily provide for public access or usage. In the case of river and lakebed, ownership by the Crown does not currently extend to any adjoining land or the water above the bed. As a result, Crown ownership does not provide for public access to or usage of the river or lake. These rights have been negotiated through other parts of the approval process as discussed in the case study below. Proposed changes to the special land offer process in the following section will allow for Crown ownership of the water, which would allow for public usage.

Case Study: Poronui Station

As discussed in section two, sale of Poronui Station resulted in a number of benefits, such as an easement to provide access for hunters and anglers. It is important to recognise that these benefits were achieved quite separately from the Crown's decision to acquire the riverbeds running through the Station. Other conditions of consent were used to ensure that adequate walking access and vegetation protection was provided.

Source: Overseas Investment Office

7.15 In response to the problems raised above, the review is considering whether to the requirement to offer special land to the Crown should be retained.

7.3 Options – benefit test

7.16 The following options have been developed to address the problems raised above regarding the land hurdle. The option of completely removing the benefit test has not been considered because the test is the main part of the sensitive land screening process and doing so would remove a significant part of the screening regime which is outside of the Terms of Reference of the review.

Simplified benefit test

7.17 The current benefit test could be simplified by reducing the number of factors used to assess benefit. The main advantage of this approach would be to reduce the time and cost of preparing and assessing an application as fewer factors must be addressed.

7.18 The table below outlines the factors that Ministers would assess benefit against under the simplified benefits test. Overall they are relatively similar to the current factors. The key difference is that a number of the factors have been aggregated. A further difference is that the requirement to show "substantial and identifiable" benefit in the case of non-urban land would be removed. This would have the advantage of reducing the hurdle to be met in a subset of investments and provide consistency of assessment across all types of sensitive land. However this change would reduce Ministers ability to require additional benefit in these cases.

Economic factors	Whether the overseas investment will, or is likely to, result in: • economic benefits to New Zealand including but not limited to: the introduction of new technology or skills, increasing efficiency or productivity, and retaining jobs
Environmental factors	Whether there will be adequate mechanisms in place for protecting or enhancing: • areas of significant indigenous vegetation • significant habitats of indigenous fauna and 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

Social factors	Whether there will be adequate mechanisms in place for: • maintaining or enhancing walking access to or across the relevant land; • protecting or enhancing historic heritage within the relevant land
Other factors	Whether: • declining the application for consent will, or is likely to, adversely affect New Zealand's image overseas as an investment destination or its trade or international relations • the overseas investment will, or is likely to, result in further investment in New Zealand, enhance the ongoing viability of other overseas investments in New Zealand, or the investment is from an overseas investor who has previously undertaken investments of benefit to New Zealand • whether the overseas investment will, or is likely to, result in other consequential benefits to New Zealand If the relevant land is or includes farm land that land has been offered for sale on the open market accordance with regulations.

7.19 As with the current test, Ministers may determine the relative importance to be given to each relevant factor. Importantly however, it will be made explicit that Ministers may consider that the maintenance of the status quo can contribute to benefit. The current test implies that the status quo can be sufficient, for example "there are or will be adequate mechanisms to…", but it has caused confusion in the past.

7.20 As discussed in section 10, a substantial harm test is also proposed to apply to investments in sensitive land. The issue of special land is also discussed separately in the following section.

7.21 Given that this test covers largely the same factors as the current test, there is a risk that its impact on investors' compliance costs may be smaller than expected. There will be some reduction because the current test requires that all factors are addressed. Therefore by reducing them there will be some reduction in work required from investors.

7.22 The table below outlines the estimated impact of the proposed simplified test against the criteria outlined in section 2.

Criteria	Impact	Assessment
Change in compliance costs	Medium	The OIO estimates that this option would reduce the time taken to assess applications by roughly 8%, although this will vary by application type. Effort required to prepare applications is expected to drop by roughly 15-20%.
Impact on certainty/predictability	Medium	Uncertainty over whether the status quo applies is removed. Uncertainty remains over Ministers' ability to determine the relative importance of each factor.
Impact on protections	Low	The test covers the same issues as the current test and does not reduce ability to impose conditions. Removing the requirement to show "substantial and identifiable" benefit in the case of non-urban land reduces the ability to require additional benefit in a subset of applications.
FTA impacts	Low	In FTAs to date New Zealand has reserved the right to alter the factors (both upwards or downwards) used to assess investments in sensitive land.
Risks	Low	The main risk is that the proposal will have less impact on compliance costs than expected because of its similarity to the current test. The proposal is unlikely to create other risks such as avoidance.

Targeted benefit test (core environmental and social factors)

7.23 A further alternative would be to reduce the number and types of factors considered in the benefit test. A benefit test targeted at environmental and social factors would address concerns about whether an investor would share the same values as a domestic investor, as discussed in section one. For example Ministers would be able to assess whether adequate protection is provided for historic areas and walking access.

7.24 The key change from the simplified test is that it would not consider the economic benefit of an investment. It can be argued that it is not necessary to require investors to show economic benefits because they are inherent in the investment itself. The first benefit is the provision of new capital into the economy. The sale price should reflect the value of the expected future profits of the assets, and this capital can be recycled into other productive investments in the economy. Economic benefits are also likely to occur because the transaction is conducted on a commercial basis which incentivises the investor to make the best use of the asset and maximise the return as would be the case for a domestic investor. Thirdly, concerns about 'poor' behaviour by investors are likely to apply regardless of whether they are New Zealand or overseas based. As a result legislation like the Resource Management and Companies Acts apply regardless of the nationality of the investor.

7.25 On the other hand the requirement to show economic benefit is one of the least complex parts of the current benefit test so its removal is likely to have a small impact. In addition its removal means that Ministers may no longer have discretion to impose conditions on investments relating to employment, exports and new technology.

7.26 The table below outlines the factors that Ministers would assess benefit against under the targeted benefit test. The relevant Ministers must be satisfied that the

overseas investment will, or is likely to, benefit New Zealand on the basis that, where appropriate and practicable:

Environmental factors	• there are or is likely to be adequate mechanisms in place for protecting or enhancing areas of significant indigenous vegetation; • there are or is likely to be adequate mechanisms in place for protecting or enhancing significant habitats of indigenous fauna and 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;
Social factors	• there are or is likely to be adequate mechanisms in place for maintaining or enhancing walking access; • there are or is likely to be adequate mechanisms in place for protecting or enhancing historic heritage within the relevant land; and • if the relevant land is or includes farm land that land has been offered for sale on the open market accordance with regulations.

7.27 If any of the above factors are not relevant the investor would not be assessed against them. The investor test would continue to apply.

7.28 As discussed in section 10, a substantial harm test is also proposed to apply to investments in sensitive land. The issue of special land is also discussed separately in the following section.

7.29 The table below outlines the estimated impact of the targeted benefit test against the criteria outlined in section two.

Criteria	Impact	Assessment
Change in compliance costs	Medium	The OIO estimates that the reduction in factors will reduce the time taken to assess applications by roughly 15%, although this will vary by application. Effort required to prepare applications is expected to drop by roughly 30-35%.
Impact on certainty/predictability	Medium	If any of the factors are not relevant, they do not need to be addressed. No requirement to provide 'extra' benefits elsewhere to compensate.
Impact on protections	Medium	Ministerial discretion and oversight of economic benefits is removed, but ability to consider environmental and social factors is retained.
FTA impacts	Low	In FTAs to date New Zealand has reserved the right to alter the criteria/factors (both upwards and downwards) used to assess investments in sensitive land.
Risks	Low	The main risk is that the proposal has less impact on compliance costs than expected because economic factors are the least complex part of the current test. The proposal is unlikely to create other risks such as avoidance.

Narrow benefit test (walking access only)

7.30 A further alternative of the benefit test would be to require investors to identify any sensitive features on the relevant land and acknowledge any obligations they have to protect them under other legislation. As shown in the table below, these sites would mirror the contents of the current benefit test. Ministers would have discretion only over the provision of adequate public walking access.

7.31 Under this option investors would follow the process in the table below:

Identification process	Identify any sensitive features on the relevant land from the following: • indigenous vegetation and fauna • 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 and acknowledge any obligations they have to protect these features in accordance with New Zealand law.
Discretionary factors	Demonstrate that there are, or is likely to 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.

7.32 This option would have the advantage of considerably reducing the complexity of the screening regime for investors as they would largely be complying with similar requirements as that of domestic investors. The identification process would make investors aware of sensitive features that will be of significance to New Zealanders and the relevant laws in place to protect them.

7.33 Relying on other legislation to protect sensitive features could be justified on the grounds that these features are worthy of protection regardless of the nationality of the owner. Specific legislation should be strong enough to protect the relevant features. It is important to note however, that legislation such as the Walking Access, Conservation, Historic Places and the Resource Management Acts provide for both regulatory and voluntary protections but may not capture all sensitive features which require protection. Relying on these pieces of legislation alone could see relatively less protection achieved and would mean that Ministers do not have the ability to impose additional conditions to protect these features.

7.16 The key downside of this option is that it significantly reduces Ministerial discretion to impose conditions on overseas investors, over and above what domestic investors must comply with. While the identification process is not required of domestic investors, it does not provide Ministers with additional discretion to impose conditions regarding the protection of these features. Discretion remains over walking access as it can be argued that New Zealand's tradition of allowing public access across land means that discretion is required to ensure investors meet domestic norms.

7.17 The table below outlines the estimated impact of the proposed simplified test against the criteria outlined in section two.

Criteria	Impact	Assessment
Change in compliance costs	High	The OIO estimates that the reduction in factors will reduce the time taken to assess applications by roughly 20%, although this will vary by application type. Effort required to prepare applications is expected to drop by roughly 35-40%.
Impact on certainty/predictability	High	Uncertainty over what conditions would be imposed is removed, other than the level of walking access that will be required by Ministers.
Impact on protections	High	Ministerial discretion and oversight across most factors is removed, with discretion remaining only over walking access. Investors must still comply with the same requirements of domestic investors and identify all sensitive sites on the land.
FTA impacts	Low	In FTAs to date New Zealand has reserved the right to alter the criteria/factors (both upwards and downwards) used to assess investments in sensitive land.
Risks	High	Loss of ability to impose a wider range of conditions may raise concerns that there is insufficient oversight being applied to overseas investment.

7.4 Summary

7.18 In choosing between the above options, the key consideration is the extent to which overseas investors should be required to meet higher standards than domestic investors and the resulting compliance effort created for investors. An important consideration is the extent to which the nationality of investor raises concerns over how they will behave in relation to sensitive features and whether protections over and above those of domestic investors are required.

7.19 The table below summarises the impacts of the three options above:

Criteria	Simplified benefit test	Targeted benefit test	Narrow benefit test
Change in compliance costs	Medium – 8% reduction in assessment effort. 25-30% reduction in preparation effort	Medium – 15% reduction in assessment effort. 30-35% reduction in preparation effort	High – 20% reduction in assessment effort 35-40% reduction in preparation effort
Impact on certainty/predictability	Medium	Medium	High
Impact on protections	Low	Medium	High
FTA impacts	Low	Low	Low
Risks	Low	Low	High

7.20 The following examples illustrate the practical difference between the three options.

Example study 1: Sawmill

An overseas person makes an application to buy 20 hectares of farm land in the central North Island to build a sawmill. The land does not include indigenous vegetation or wildlife. There is a small wahi tapu site in one corner of the property which is significant for the local community.

	Status quo	Simplified overall benefit test	Targeted benefit test	Narrow benefits test
Investor test	• Investor must be of good character, have relevant business experience and financial commitment.	• Investor must be of good character, have relevant business experience and financial commitment	• Investor must be of good character, have relevant business experience and financial commitment	• Investor must be of good character, have relevant business experience and financial commitment
Benefit test	• Must show 'substantial and identifiable' benefit across 20 factors: -Investment is likely to create 50 new jobs and introduce new technology to NZ. -Investor must agree to protect the wahi tapu site and provide walking access.	• Must show benefit across 8 factors: -Investment is likely to create 50 new jobs and introduce new technology to NZ. -Investor must agree to protect the wahi tapu site and provide walking access.	• Must show benefit by meeting, where relevant, four environmental and social factors: -Vegetation and wildlife factors are not relevant. -Investor must agree to adequately protect the wahi tapu site and provide walking access to it.	• Investor must identify the significant feature (wahi tapu) and acknowledge any obligations they have to protect it. • Investor must agree to provide public walking access to the site.
Comparison with status quo	N/A	Same, other than substantial and identifiable requirement.	Economic benefits not assessed.	Little discretion to impose requirements above that of what local investors must meet.

Example 2: Lifestyle property

An overseas person makes an application to buy a 1 hectare residential property adjoining the foreshore as a holiday home. There are no indigenous vegetation, wildlife or heritage sites on the property and the public has access to the beach via public walkways.

	Status quo	Simplified overall benefit test	Targeted benefit test	Narrow benefit test
Investor test	• Investor must be of good character, have relevant business experience and financial commitment.	• Investor must be of good character, have relevant business experience and financial commitment	• Investor must be of good character, have relevant business experience and financial commitment	• Investor must be of good character, have relevant business experience and financial commitment
Benefit test	• Must show benefit across 20 factors • Because the investor is not able to show benefit across the economic, environmental, social or other factors, they are asked to contribute $50,000 to a local community group.	• Must show benefit across 8 factors • Because the investor is not able to show benefit across the economic, environmental, social or other factors, they are asked to contribute $50,000 to a local community group.	• Must show benefit by meeting, where relevant, four environmental and social factors • None of the factors are relevant – application approved	• No significant features are identified on the site and walking access is not a relevant consideration.
Comparison with status quo	• N/A	• Same, other than substantial and identifiable requirement.	• Economic benefits not assessed. As no factors are relevant, not required to provide additional benefit.	• As no factors are relevant, not required to provide additional benefit.

7.5 Options – special land

7.21 The following options have been developed to address the problems raised above regarding the land hurdle. In addition section eight discusses how the current procedure could be simplified.

Remove offer-back requirement for riverbed

7.22 The screening regime could be simplified by removing the requirement to offer riverbed to the Crown, but retain the offer procedure for other types of special land. Riverbed is the most common type of special land to be offered to the Crown making up almost all special land applications. Riverbed is also the most complex and costly type of special land to assess because of the high costs of the survey and valuation, uncertainties over whether the Crown already owns the bed and the uncertain application of common law ownership rights to the centre line of the river. In addition benefits achieved by ownership, such as public access and usage, can be achieved under the simplified or targeted benefits test

outlined above which allow for conditions to be imposed relating to walking access and trout and salmon habitat protection.

7.23 On the other hand, simply knowing that riverbed is in Crown ownership may have some benefit purely in terms of ownership value. Crown ownership of riverbeds is one way of providing benefits such as access the bed for fishing and other recreational activities. Public ownership also allows for active management of the bed, (e.g. pest control). Riverbed could potentially also be used in Treaty Settlement negotiations. However, this is largely a consequential benefit given that the land can only be used if the land happens to be sold to an overseas investor, and is likely to cover only part of a river.

7.24 The table below outlines the impact of removing the requirement to offer riverbed to the Crown:

Criteria	Impact	Assessment
Change in compliance costs	High	Riverbed offers are some of the most complex applications to assess. The OIO estimates that removing this requirement will reduce assessment effort by 90% for applications involving special land. Application preparation effort is expected to drop by roughly 20%.
Impact on certainty/predictability	Medium	Uncertainty over whether the Crown will accept the offer of riverbed is removed.
Impact on protections	Medium	Riverbed ownership provides only limited public access/usage – this is generally achieved under other parts of the benefit test. The main loss is the value attributed to the ownership of the bed.
FTA impacts	Low	In FTAs to date New Zealand has reserved the right to alter the criteria/factors (both upwards and downwards) used to assess investments in sensitive land.
Risks	Medium	There may be public concerns about the loss of ownership value if riverbeds are not offered to the Crown.

Remove offer-back requirement entirely

7.25 A further option would be to remove the requirement to offer any special land to the Crown. This option would mean that foreshore, seabed, lakebed and riverbed would not need to be offered. The main advantage of this option is that it would completely remove all the problems related to the offer back procedure thereby reducing compliance costs for investors.

7.26 On the other hand, the additional impact of this option on compliance costs relative to the above option will be small because riverbed offers make up all the cases where the Crown has exercised its right to take the special land. In addition, ownership of land such as foreshore and seabed may be viewed as particularly important given its significance to New Zealanders.

Criteria	Impact	Assessment
Change in compliance costs	High	Total impact is high as the OIO estimates that removing this requirement will reduce assessment effort by 90% for applications involving special land. The marginal difference compared to removing riverbed only is low because riverbeds make up almost all special land applications. Application preparation effort is expected to drop by roughly 20-25%.
Impact on certainty/predictability	Medium	Uncertainty over whether the Crown will accept the offer of special land is removed.
Impact on protections	Medium	The main loss is the value attributed purely to ownership of the bed. Land ownership does not provide for public access or usage which are achieved under the benefit test.
FTA impacts	Low	In FTAs to date New Zealand has reserved the right to alter the criteria/factors (both upwards and downwards) used to assess investments in sensitive land.
Risks	Medium	There may be public concerns about the loss of ownership value if special land is not offered to the Crown.

7.6 Summary

7.27 In choosing between the above options the key trade off is between the value placed simply on the ownership of foreshore, seabed, lakebed and riverbed, and the complexity and compliance costs the offer back procedure requires. If ownership is highly valued in itself, the offer back procedure should be retained. If ownership value is less significant in the case of riverbeds, the option of removing these should be chosen. Finally if ownership value of all types of special land is low, the procedure can be removed entirely.

7.28 The table below summarises the impacts of the two options above:

Criteria	Remove riverbed offer back	Remove offer back entirely
Change in compliance costs	High – 90% reduction in assessment effort. 20% reduction in preparation effort	High – 90% reduction in assessment effort but little marginal change relative to removing riverbed only. 20-25% reduction in preparation effort
Impact on certainty/predictability	Medium	Medium
Impact on protections	Medium	Medium
FTA impacts	Low	Low
Risks	Medium	Medium.

8 SPECIAL LAND PROCESS

8.1 Status Quo

8.1 One factor used in determining benefit for investments in sensitive land is: if the relevant land is or includes 'special land' (i.e. foreshore, seabed, or bed of a river or lake), whether that special land has been offered to the Crown in accordance with regulations.

8.2 This provision was introduced in the legislative changes in 2005 and the process is set out in detail in the Overseas Investment Regulations 2005. Broadly, the process involves:

- identifying that the land to be sold to an overseas persons is or includes special land;
- formally offering the land to the Crown, and the Crown then accepting or waiving the offer (potentially including surveying and valuing the land); and
- legally transferring the land into Crown ownership.

8.2 Potential problem and discussion

8.3 As discussed in section seven, the special land process generally adds a relatively large amount of additional compliance cost to the screening process for the vendor, purchaser, and the Overseas Investment Office.

8.4 The question of whether special land should be required to be offered to the Crown as part of the sensitive land test is considered in section seven. This section considers only the design of the process, taking the broad policy intent as given. In particular, this section explores whether the compliance costs associated with the process are greater than necessary to achieve the policy intent.

8.5 The special land process has caused a number of frustrations, such as:

- numerous complaints from law firms representing overseas investors, highlighting the lack of clear process;
- *[Withheld -maintain professional legal privilege]*
- administrative difficulties for the Overseas Investment Office in implementing the provisions, to the extent that no accepted special land has been formally conveyed to the Crown.

8.6 Many of the difficulties stem from a lack of clarity and certainty in the current legislation, increasing compliance costs because resolving the uncertainty tends to take time. The broad areas of difficulty are:

- *definitions of special land* – it is sometimes unclear whether particular land is captured, based on the characteristics of the land (e.g. if a river is adjacent, but not on, the land's title) or the application (e.g. if the land is only leasehold and therefore not actually owned by the vendor);

- *offering and accepting the land* – the basis on which Ministers make their decision to accept or waive is not clearly specified, and timeframes and what happens in some situations (e.g. the Crown does not accept within the specified time limit) are not covered; and

- *transferring the land to the Crown* – the process by which the land is vested in Crown ownership is not specified (creating administrative difficulties).

8.3 Options

8.7 A number of changes have been identified that would resolve many of these uncertainties, as summarised in the three tables below. All of these changes are intended to be consistent with the current policy intent. The changes are essentially independent, so a decision on whether or not to proceed with the change could be made for each one.

Definitions of special land

Issue	Problem	Proposal
Definition of 'special land'	The definitions are spread across different parts of the Act and Regulations, potentially creating uncertainty.	All definitions should appear in the Act.
Land with an adjoining bed	It is unclear if the land is captured if it is not part of the title, but the owner has presumed ownership under Common Law. The Ministerial directive letter has specified that such land should be included.	Define special land in the Act to include any interest in adjoining land owned by *ad medium filum*.
Water/air/etc. above the river or lake bed	Acquiring river and lake bed only involves the physical bed, not the water, air, etc. above the bed, in contrast to the provisions for foreshore and seabed. Access issues (part of the policy intent) are more closely related to the water.	Define 'bed' in the Act to be consistent with the definition of 'foreshore and seabed'.
Movable beds	The Act is silent on whether beds will be fixed in place at the time of the offer back, but waterways naturally gradually shift over time.	Clarify that the exact location of the bed will move over time.

Issue	Problem	Proposal
Artificially widened rivers	A river of less than 3 metres that is artificially widened (e.g. for irrigation) is captured.	Exclude from the definition natural rivers that have been artificially widened to exceed 3 metres.
Interest less than freehold	The presumption is that the Crown will take full ownership, but the investment could be much less than a freehold interest (e.g. leasehold, or a small proportion of freehold). It is legally questionable whether an offer could occur in such circumstances.	Limit the offer back process to situations where the interest is 50% or more of freehold land.

Offering and accepting special land

Issue	Problem	Proposal
Criteria for the Crown to accept/waive	The criteria used by Ministers are not specified in the Act or Regulations, but do appear in the Ministerial directive letter.	Define the relevant criteria for decision-making in the Act.
Time limit lapsed	The situation is not covered where the Crown does not accept or waive the offer within the 30-day limit.	Specify that failure to respond will mean the offer automatically lapses.
Fit with existing Crown rights	Accepting or waiving an offer to acquire land could imply that the Crown has waived any ownership rights it may have under other legislation.	Specify that any acceptance or waiver is without prejudice to any existing Crown ownership rights.
Requirement to survey for valuation	The owner can specify that the Crown must arrange a survey to value the land. In many cases, surveying may not assist valuation, and is just costly and time consuming.	Give the Crown a choice whether to survey the land to establish its value or to allow the public valuer to determine the best method for valuation.

Transferring the land to the Crown

Issue	Problem	Proposal
Protecting agreements where the land is not on the title	Situations where the special land is not on the title (e.g. adjoining river bed) create a potential problem in protecting the agreement, given the delay between consent and transfer.	Specify that the Crown may caveat the transfer of land title with the agreement to transfer special land to the Crown.
Administration of lakebed and riverbed acquired	The Act currently does not specify that lakebed and riverbed acquired will be governed by the Land Act, as is the case for other similar cases, creating administrative difficulties.	Specify that any lakebed or riverbed acquired will become Crown Land under the Land Act.
Vesting of the land in the Crown	There are no provisions to aid the conveyance of accepted lakebed or riverbed to the Crown, and standard methods are potentially costly and problematic.	Create an automatic vesting provision, without the need for a separate instrument of conveyance.

Issue	Problem	Proposal
Creation of separate parcels of non-special land	The special land process is exempt from the subdivision provisions in the Resource Management Act. But if the Crown acquires special land, separate parcels of non-special land could be created that could potentially be disposed of separately, which may be contrary to local district planning rules.	Specify that if separate parcels of land are created from removal of special land, the parcels are unable to be disposed of separately, without agreement of the territorial authority.

8.8 The overall impact of the above set of proposals is summarised below:

Criteria	Impact	Assessment
Change in compliance costs	Medium	The OIO estimates that the proposals will reduce the time taken to assess applications involving special land by roughly 40% on average. Application preparation effort is expected to reduce by around 5%
Impact on certainty/predictability	Medium	The proposals should provide significantly greater clarity of the process involved in offering special land to the Crown.
Impact on protections	Low	The proposals are intended to have no impact on the policy intent of the special land process.
FTA impacts	Low	The proposals are intended to have no impact on the policy intent and therefore no impact on international obligations.
Risks	Low	The main risk is that the proposals will have less impact on compliance costs than expected. The proposals are unlikely to create other risks such as avoidance.

9 POLICY CHANGE BY REGULATION

9.1 Status Quo

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

9.2 Potential problem and discussion

9.2 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.

9.3 After the addition of this factor, a complaint was made to the Regulations Review Committee. The complaint was made on five grounds, including that the regulation made some unusual or unexpected use of the powers conferred by the statute and that it contained matters more appropriate for parliamentary enactment. [24]

9.4 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". It also recommended amending the Overseas Investment Act to remove the ability to add to the factors by regulation or add a requirement to consult with relevant parties.

9.5 The review identified two problems arising 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.

[24] 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.

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 subject a much lower level of scrutiny than a change made legislatively.

9.3 Options

9.6 In order to address the problems outlined above, the review has developed the following options:

Remove the ability to add factors by regulation

9.7 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.

9.8 A draw-back of this option is 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.

9.9 The table below outlines the estimated impact of the proposed simplified test against the criteria outlined in section two.

Criteria	Impact	Assessment
Change in compliance costs	Low	No direct impact.
Impact on investor certainty	High	Significant improvement in certainty as assessment factors will not change at short notice.
Impact on protections	Medium	Loss of Ministerial flexibility to react quickly to particular investments. Changes can still occur but only via legislation.
FTA impacts	Low	New Zealand has reserved the ability to alter the factors used to assess investments in sensitive assets.
Risks	Low	Risk that a future investment may raise concerns that the benefit test cannot address. This is mitigated by the substantial harm test discussed in section 10.

Add a requirement to consult with relevant parties

9.10 Ministers could be required to consult with relevant/involved parties before adding 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.

9.11 It may however be practically difficult to implement this option, as there are likely to be different views on what is adequate consultation and to determine who should be consulted.

9.12 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. However it would not necessarily improve investor certainty as it does not prevent changes from being made at short notice.

9.13 The table below outlines the estimated impact of the proposed simplified test against the criteria outlined in section two.

Criteria	Impact	Assessment
Change in compliance costs	Low	No direct impact.
Impact on investor certainty	Low	Improved transparency, but changes may still occur at short notice.
Impact on protections	Medium	The consultation requirement creates some loss of flexibility, but changes can still be made quickly.
FTA impacts	Low	New Zealand has reserved the ability to alter the factors used to assess investments in sensitive assets.
Risks	Medium	Risk that the consultation will be limited and not cover all interested parties.

Exempt any applications under consideration from the effect of regulation changes

9.14 The Act could require that any changed factors cannot apply to applications already submitted to the OIO. Thus the existing 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.

9.15 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.

9.16 Again 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.

9.17 The table below outlines the estimated impact of the proposed simplified test against the criteria outlined in section two.

Criteria	Impact	Assessment
Change in compliance costs	Low	No direct impact.
Impact on investor certainty	Medium	Investors with applications in progress would have more certainty, but future investors may still be impacted by changes made at short notice.
Impact on protections	Medium	Ministerial flexibility is reduced for applications already underway, but changes can still be made quickly.
FTA impacts	Low	New Zealand has reserved the ability to alter the factors used to assess investments in sensitive assets.
Risks	Medium	Regulations could still be enacted that change the intent of the Act.

9.4 Summary

9.18 The key trade-off across the options is between the amount of discretion available to Ministers to react quickly to a particular investment, and the level of certainty provided to investors about the 'rules of the game'. If Ministerial flexibility is highly valued then the status quo or simply adding a requirement to consult would deliver this. If investor certainty is considered highly important then the complete removal of the ability to change factors by regulation should be favoured.

9.19 The table below summarises the options and their impacts:

Criteria	Remove regulation making power	Require consultation	Exempt pending applications
Change in compliance costs	Low	Low	Low
Impact on certainty/predictability	High	Low	Medium
Impact on protections	Medium	Medium	Medium
FTA impacts	Low	Low	Low
Risks	Low	Medium	Medium

10 STRATEGIC ASSETS

10.1 Status Quo

10.1 When assessing whether an investment in sensitive land is likely to benefit New Zealand, one of the factors Ministers may consider is *whether the investment will, or is likely to, assist New Zealand to maintain New Zealand control of strategically important infrastructure on sensitive land.*

10.2 Potential problem and discussion

10.2 There are two main problems with the status quo:

- ***Regulatory uncertainty.*** There is 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.

- ***Narrow 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.

10.3 The effect that introducing the new regulation at short notice had on investor confidence is discussed in section nine.

10.4 Standing back from problems with the existing restrictions on strategic assets, the prior question is: does the screening regime need to have some form of backstop power to decline investments in extreme circumstances, over and above generic screening for significant business assets and sensitive land?

10.5 Many other jurisdictions have some ability to decline investments where they are expected to threaten the national interest or national security. For example Australia, the United States, Canada, Germany, and Japan all have some form of power to decline investments where they threaten national security or the national interest.

10.6 The key advantage of having this ability in a New Zealand context is that it provides the government with extra flexibility to react in circumstances where an investment may have significant negative effects that are not able to be addressed by the standard screening process. The downside of having this ability is that it can create uncertainty for investors if the grounds for its use are not well defined. In addition, as discussed in section one there is a range of other existing policies targeted at overseas investment in specific sectors.

10.7 The OECD has developed guidelines to assist with the development of national security type powers as summarised below. These are useful principles to keep in mind when considering if and how to create such a power.

- *Non-discrimination.* In general governments should rely on general measures which apply to both domestic and overseas investors. Where such measures are deemed inadequate to protect national security, measures taken with respect to individual investments should be based on the specific circumstances of the individual investment which poses a risk to national security.
- *Transparency/predictability.* While sensitive information should remain confidential, the objectives of any national security policies and the process for review should be as transparent as possible so as to increase predictability for investors.
- *Regulatory proportionality.* Restrictions on investments should not be greater than needed to protect national security and they should be avoided when other existing measures can address national security concerns.
- *Accountability.* There should be appropriate procedures for internal government oversight, parliamentary oversight, judicial review, and important decisions (including decisions to block an investment) should be taken at high levels of government.

10.3 Options

Remove strategic assets factor and do not replace it

10.8 It can be argued that explicit coverage of strategic assets or national interest/security provisions is not be required within the overseas investment regime.

- *Existing restrictions.* As noted in section one, 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.

- *Difficult to design anything additional.* The complexities of designing specific provisions for strategic assets mean that they are likely to create a potentially large degree of regulatory uncertainty for investors. For example it would be difficult to explicitly define what a strategic asset is, to come up with a comprehensive list of these assets, or to determine what tests would have to be met before an investment could proceed.

10.9 As noted above, the main downside of removing this ability risks Ministers being unable to decline an investment in circumstances where the existing benefit test was unable to adequately address the concerns raised.

10.10 The table below outlines the expected impacts of this option:

Criteria	Impact	Assessment
Change in compliance costs	Low	The investor impact is more directly related to certainty.
Impact on investor certainty	High	Investors would have greater certainty over how their investments would be assessed as they would be subject to the benefit test only.
Impact on protections	Medium	Ministers ability to easily consider concerns about investments in 'strategic' sectors is limited. Legislative change would be required to introduce new factors.
FTA impacts	Low	New Zealand has reserved the right to alter the factors used to assess investments in sensitive assets so new factors could be introduced in future.
Risks	Medium	The key risk is that a future application raises concerns that the benefit test cannot address.

Defined strategic assets test

10.11 An alternative to the current strategic assets factor would be to develop a more refined test that provides more certainty to investors about how strategic assets are defined and what test will be applied to them.

10.12 There are a number of parameters to consider when designing a test for strategic assets. 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	• a relatively broad definition (e.g. simply "strategically important infrastructure") • a narrow definition (e.g. specific businesses).
Sectors	• all sectors • specific sector(s) (e.g. infrastructure) • specific sub-sector(s) (e.g. airports)
Nature of restriction	• simple ownership restrictions (e.g. maximum 49.9% overseas ownership, or no overseas ownership at all) • restrictions related more to control by a small number of overseas investors (e.g. 25.0% by any one investor).
Extent of the restriction	• a net benefit test • explicit ownership restrictions
Location in the regime	• separate class of assets • part of screening for significant business assets • part of screening for sensitive land

10.13 A core consideration within these options is the degree of specificity given to strategic assets. 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. It is likely to be difficult to tightly specify the businesses that are 'strategic'. Furthermore naming specific companies is likely to affect their share price or valuation and may concern existing foreign owners (where relevant).

10.14 A better specified strategic assets test would have the advantage of providing greater certainty for investors. However this would restrict Ministerial flexibility and it is likely that the types of assets considered to be strategic will change over time.

10.15 The table below sets out the impacts of a more tightly defined strategic assets test.

Criteria	Impact	Assessment
Change in compliance costs	Low	The investor impact is more directly related to certainty.
Impact on investor certainty	Medium	A tightly specified test would make it clearer what strategic assets were. However being considered a strategic asset is likely to affect a firm's value and raise concerns for existing overseas owners.
Impact on protections	Medium	Depending on how tightly strategic assets are defined, Ministerial flexibility to react in unforeseen circumstances will be limited.
FTA impacts	Low	New Zealand has reserved the right to alter the factors used to assess investments in sensitive assets so new factors could be introduced in future.
Risks	High	The implementation of such a test is a difficult balance between investor certainty and Ministerial flexibility. In practice it is likely to be very difficult to design a test that provides an adequate balance between the two.

Substantial harm test

10.16 A further option would be to add a new test to the existing classes of investments that are screened that allowed Ministers to decline an investment where, in their view, it would or is likely to, result in substantial harm to New Zealand by threatening public order, public health and safety, or essential security interests.

10.17 Such a test would be in line with approaches by other countries that have the ability to decline investments for security reasons (details outlined in Annex E). The advantage of this approach is that it provides Ministers with the ability to decline an investment in what will probably be rare circumstances where the benefit test does not address concerns.

10.18 The disadvantage is that it could create uncertainty for investors because of the ambiguity over what the terms in the test mean. To help offset this uncertainty, the key terms could be defined as outlined below. While they are not precise definitions, they provide an indication of the scale of the concerns that would be raised before the test is used.

- *Threats to public order* means: *investments that would damage the functioning of society or threaten the political or economic survival of the state.*

- *Threats to public health and safety* means: *investments that would severely damage the health and safety of the New Zealand public, or a section of the public.*

- *Threats to essential security interests means: investments that would threaten economic capacity that is critical for New Zealand's economic well-being; actions taken in time or war, or armed conflict, or other emergency in international relations; actions respecting the non-proliferation of weapons of mass destruction; actions relating to the production of arms and ammunition.*

10.19 The test would in effect be an addition to the factors considered when assessing investments in sensitive land or significant business assets. Consistent with current Ministerial responsibilities it would be exercised by the Minister of Finance in the case of significant business assets and the Ministers of Finance and Land Information in the case of sensitive land.

10.20 Given the potentially wide scope of the test, conditions on its usage would help to reassure investors about how it will be used, thus increasing transparency and predictability of its application. However, imposing conditions on the application of the test has the downside of limiting Ministerial flexibility and potentially increasing the grounds on which a decision can be challenged. The conditions on the application of the test and reasons for their use are listed below:

a) *The Minister must have credible evidence to show that in the Minister's view, the investment is likely to create substantial harm.* This requirement will help to offset concerns about the test being used in trivial circumstances. However what is credible will be determined by the Minister.

b) *The Minister must consider whether the substantial harm that may be posed by the investment can be addressed under other legislation.* This requirement will signal that the test will only be used in circumstances where other legislation cannot address concerns. For example concerns about how the investor may behave in future could be better addressed by legislation that covers the ongoing behaviour of an investor such as the Companies Act. The screening regime only considers the investment at point of entry.

c) *The Minister must have regard to whether its use will breach any of New Zealand's international obligations.* This requirement will ensure that international obligations such as World Trade Organisation (WTO), OECD Codes and other regional and bilateral obligations are considered before the test is used.

d) *The Minister must follow due process as set out in regulations.* To provide more guidance to investors on how the test would be implemented the regulations would set out time limits for consideration, how the Ministers are to be advised of applications that may raise concerns of substantial harm.

e) *The Minister must table a summary of the reasons for the use of this criterion in the House as soon as practicable after making the decision.* This requirement addresses the OECD principle of transparency and will ensure investors are aware of why a decision was taken, at least at a high level.

10.21 *[Withheld - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements]*. Both domestic and international litigation risks could be reduced through good process, including for example a requirement to notify an investor early that the test is likely to be applied.

10.22 The expected impact of this proposal is outlined in the table below.

Criteria	Impact	Assessment
Change in compliance costs	Low	The investor impact is more directly related to certainty.
Impact on investor certainty	Medium	The test arguably provides more certainty than the status quo by defining key terms and outlining how the test would be applied. However it still has a wide scope and the definitions leave room for interpretation by Ministers.
Impact on protections	Low	The test would increase protections compared to the current strategic assets test as it covers both business and land investments and not just infrastructure assets.
FTA impacts	Low	New Zealand has reserved the ability to alter the factors used to assess investments in sensitive assets so new factors could be introduced in future.
Risks	Medium	There is a risk that our trading partners will see this as a regressive measure that goes against our commitments not to introduce additional types of investment screening. Risk that the hurdle for the use of the test may be too high to address all the circumstances in which it could be used.

10.4 Summary

10.23 The key trade-offs to be made in relation to strategic assets or providing an ability to decline investments due to concerns that cannot be addressed under the existing screening process are:

- How likely is it that there will be investments that raise concerns that cannot be addressed under the current screening regime, and that the concerns will only relate to overseas investors (not domestic investors)? If there is a risk the standard provisions of the regime will not be sufficient in an unexpected circumstances, some form of reserve test may be required.

- Investor certainty and Ministerial flexibility. To the extent that definitions and caveats can be provided on the use of any new test, investor certainty is improved, but at the cost of lower flexibility for Ministers.

10.24 A summary of the impact of the options is outlined below:

Criteria	Remove strategic asset test	Defined strategic asset test	Substantial harm test
Change in compliance costs	Low	Low	Low
Impact on certainty/predictability	High	Medium	Medium
Impact on protections	Medium	Medium	Low
FTA impacts	Low	Low	Low
Risks	Medium	High	Medium

11 SOVEREIGN WEALTH FUNDS

11.1 Status Quo

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

> *"…special purpose investment funds or arrangements, owned by the general government and created 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. 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."*

11.2 New Zealand does not have any *specific* screening procedures that target investments from Sovereign Wealth Funds. Investments from SWFs will be screened in the same way as other investments if they fall within the categories of investments described in the Overseas Investment Act.

11.2 Potential problem and discussion

Increased prevalence

11.3 SWFs have grown in value and their assets are estimated to total around $US3 trillion. While this is small compared to the value of global managed funds of around $60 trillion, the IMF projects that foreign assets held under SWF management could reach $US6-10 trillion by 2013.[25] SWF growth is partly linked to growth in international reserves and strong earnings on commodities such as oil.

11.4 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

[25] IMF (2008), *Sovereign Wealth Funds – A Work Agenda*.
McKinsey Global Institute (2009), *The New Power Brokers*.

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

11.5 There has been an increasing level of debate on the benefits and risks associated with cross border sovereign investment as the size of these investors has grown. 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

11.1 The fact that SWFs are government owned overseas investors 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. In fact the the evidence suggests that SWFs are generally passive and long-term investors with no desire to impact company decisions by actively using their voting rights. 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.[26]

11.2 On the other hand, while there may be no sign to date of non-commercial behaviour from Sovereign Wealth Funds, it does not rule out it occurring in future. A key concern is that as the size of these funds grows, the impact of any non-commercial behaviour, if it occurs, will be bigger.

11.3 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

[26] IMF (2008)

information can help allay fears about the intentions and motivations of SWFs. A number of governments already publish this information.

11.4 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 shown by investments in troubled financial companies in late 2008 and early 2009.

International responses

OECD

11.5 In June 2008, 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:[27]

- 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

11.6 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

[27] OECD (2008) *Sovereign Wealth Funds and Recipient Countries – Working together to maintain and expand freedom of investment*

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.

IMF guiding principles for Sovereign Funds

11.7 In response to 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.

11.3 Options

Screening for SWF investments

11.8 If there is concern that SWFs may operate in a non commercial manner, additional factors could be added to the screening regime to test:

- 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 SWF investment (or other best practice guidelines); and

- that the SWF regularly publishes information on their performance and operating intentions.

11.9 The key aim of these criteria would be to address concerns that the SWF is influenced by political or other motivations. This option could be described as a precautionary approach which provides flexibility in case SWF investments raise concerns in the future.

11.10 On the downside, introducing additional criteria could signal that New Zealand is less open to SWF investments at a time when these investors are becoming an important source of capital. Furthermore given the lack of evidence to suggest that SWFs are investing non-commercially, new criteria could be creating unnecessary barriers and constraints on investment.

11.11 A further consideration is that New Zealand has government owned organisations which invest offshore, and that any additional barriers placed on to overseas funds could be reciprocated if they were seen as discriminatory. In addition, although these factors could be added to the existing investor test, there is a risk that the change is viewed as a protectionist measure that is counter to our international obligations.

11.12 The table below outlines the expected impact of this option:

Criteria	Impact	Assessment
Change in compliance costs	Medium	Addressing the new factors will create some additional cost for Government investors but it is difficult to say how big this will be.
Impact on investor certainty	Low	The new factors would not improve certainty and have the potential create uncertainty depending on how they are applied.
Impact on protections	Low	The test would increase protections compared to the status quo.
FTA impacts	Medium	The new factors could be seen as counter to our obligations not to introduce new classes of investments that are subject to screening.
Risks	Medium	Small risk that investments by New Zealand government investors will face additional barriers if the new factors are considered discriminatory by other countries. May create unnecessary barriers and deterrent given lack of evidence of a problem.

Maintain current business threshold for SWF investments

11.13 An alternative option would be to retain the current screening threshold for investments by SWFs into significant business assets. The current threshold of $100 million could be retained for SWF investments and any increases would only apply to non-governmental investors. The threshold could not be lowered for SWFs investments from some countries because of our FTA commitments, but they could be exempted from future increases.

11.14 The advantage of this approach would be to ensure that SWFs investments receive a higher level of scrutiny in future than investments from other investors. It would not mean that a different test is applied to these investments, simply that the level at which the investments are considered sensitive is lower.

11.15 On the downside, this option may result in unnecessary screening of investments that are not sensitive given the lack of evidence that SWF's are investing non-commercially.

11.16 The table below outlines the expected impact of this option:

Criteria	Impact	Assessment
Change in compliance costs	Low	The status quo would continue to apply for SWF investments into significant business assets.
Impact on investor certainty	Low	The status quo would continue to apply for SWF investments into significant business assets.
Impact on protections	Low	The test would increase protections relative to raising the threshold for all investments.
FTA impacts	Medium	The new factors could be seen as counter to our obligations not to introduce new classes of investments that are subject to screening.
Risks	Low	Small risk that investments by New Zealand government investors will face additional barriers if a separate threshold is considered discriminatory by other countries. May create an unnecessary deterrent given lack of evidence of a problem.

11.4 Summary

11.17 In coming to a view on the preferred option, the key considerations are:

- *The level of concern about future risk.* Non-commercial behaviour has not been observed by SWFs to date, and there are steps underway to improve the transparency of these funds in future. However the predicted growth of SWFs in future may suggest a taking precautionary approach and applying additional measures in the event that growing SWF influence is misused.

- *Protections provided by existing regime.* The current screening regime does provide a degree of oversight for SWF investors. For example an assessment of 'good character' could take into account any criminal activities and 'business acumen' could potentially incorporate aspects of commerciality. If included, a substantial harm test would provide further protection, and domestic legislation such as the Companies and Corporations (Investigation and Management) Acts regulate the general operation of businesses operating in New Zealand.

- *International response.* Any additional measures implemented by New Zealand risk being viewed as protectionist and may be counterproductive to New Zealand's SWFs if the result is an increase in protection worldwide.

11.18 The table below summarises the impacts of the two options discussed above.

Criteria	New criteria for SWF investors	Maintain screening threshold at $100m
Change in compliance costs	Medium	Low
Impact on certainty/predictability	Low	Low
Impact on protections	Low	Low
FTA impacts	Medium	Medium
Risks	Medium	Low

12 ASSETS ALREADY IN OVERSEAS OWNERSHIP

12.1 Status Quo

12.1 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.

12.2 Potential problem and discussion

12.2 The review is examining whether it is necessary to screen both types of transactions noted above.

Increase in level of existing ownership/control of asset

12.3 In general the Act seeks to ensure that investments in sensitive land will create benefit to New Zealand investors in business assets and sensitive land are of good character and have sufficient business acumen.

12.4 Where an investor has already been granted consent to invest in a sensitive asset, their character and acumen will have been assessed, and they will have shown benefit if sensitive land is included. If these issues are reassessed on taking a greater share in the same asset, it seems unlikely that the result will be any different to the first assessment. If the investor is the same, their character and acumen assessment should provide the same result. If the investor has already satisfied the requirement to show benefit, it becomes harder to show additional benefit with each increase in ownership stake.

12.5 However the current requirement to gain consent to increase an ownership stake does have the advantage of ensuring if the structure of the overseas person changes, their character and acumen is re-assessed. For example if the overseas person was a body corporate and the board or shareholders of that company changed significantly. There may also be a perception that an investment should be screened if the investor is moving from a minority to a controlling (greater than 50%) stake in the asset.

Sale of an asset from one overseas person to another

12.6 It can be difficult for an overseas investor to show that their investment will create benefit if they are purchasing the asset from another investor that has already demonstrated this. For example the previous investor may have already provided walking access, expanded output or created jobs. The ability to create additional benefit may therefore be limited.

12.7 However this issue will can be addressed by clarifying that maintaining the status quo can be sufficient to provide benefit as discussed in section seven. In addition concerns about the character and business acumen of the new investor are likely to be relevant.

12.3 Options

Remove screening if an investor is increasing investment in an existing asset

12.8 Given that the result of screening an investor when they are seeking to increase their stake in an existing asset is unlikely to change, these types of transactions could be exempted from screening. The advantage of this option would be to reduce compliance costs for investors who have already been through the screening regime.

12.9 On the other hand, there may be concerns about an overseas person moving from a minority to a majority stake in a business without additional screening. There is also some risk that an investor's character may change in future and exempting them from screening would mean that these changes are not assessed. However this is a general risk with the screening regime as it only assesses an investor and investment at a point in time, and does not consider change over time.

Criteria	Impact	Assessment
Change in compliance costs	Medium	Approximately 16 fewer applications per year with compliance cost savings of between $470,000 and $2.5 million
Impact on investor certainty	Low	Not applicable.
Impact on protections	Low	Although some transactions are no longer screened, the screening is of little value
FTA impacts	Medium	An exemption may be irreversible for our FTA partners.
Risks	Medium	Public concerns about investors moving from minority to majority stakes without screening. If the overseas person's character has 'changed' since the last assessment this will not be picked up.

Remove screening if an asset is sold from one overseas person to another

12.10 To address the difficulty of an investor having to show additional benefit when they are purchasing an asset from another overseas person, screening could be

removed, for these transactions. This option would however mean that the new investors character and business acumen are not assessed.

12.11 The impact of this option is outlined below:

Criteria	Impact	Assessment
Change in compliance costs	High	Around 25 applications would no longer be screened per annum with compliance cost savings of $800,000 to $5 million pa.
Impact on investor certainty	Low	Not applicable
Impact on protections	High	The new investor would not be assessed for good character and business acumen.
FTA impacts	Medium	This change may be irreversible for our FTA partners.
Risks	High	Concerns could be raised about the non-screening of asset sales once they have left New Zealand ownership. Avoidance risks could be created if an asset was sold to a holding company with a good reputation and then resold to an overseas person with character concerns.

12.4 Summary

12.12 In coming to a view on the first option the key considerations are the compliance costs caused by screening increases in existing ownership shares and any concerns raised by moving from a minority to a majority stake without screening. On the second option the key considerations are whether the difficulties of showing additional benefit can be addressed in other ways and whether the loss of ability to screen new investors for character and acumen is significant.

12.13 The table below summarises the impact of both options:

Criteria	Remove screening for increases in an existing asset	Remove screening for sales from one overseas person to another
Change in compliance costs	Medium	High
Impact on certainty/predictability	Low	Low
Impact on protections	Low	High
FTA impacts	Medium	Medium
Risks	Medium	High

13 IMPLEMENTATION AND REVIEW

The policy proposals will require amendments to the Overseas Investment Act 2005 and the Overseas Investment Regulations 2005.

A Bill will be introduced into Parliament in early or mid 2010 with any changes agreed by Cabinet. The Finance and Expenditure Select Committee will seek submissions and deliberate on the bill. Interested members of the public will be able to have input into the review through the Select Committee process.

It is expected that applications made before any changes have come into effect will be considered on the basis of the current screening regime. Applications made after changes have come into effect will be assessed on the basis of the new screening regime.

Given that some of the options would remove the need to screen some investments, or reduce the requirements they need to meet, there is the potential for some investors to delay making investments until the new regime is in place. For example an investor planning to purchase a 8 hectare section of non-urban land may delay the investment if the option of increasing the threshold from 5 hectares to 10 hectares is chosen.

Further consideration will be given to how to manage any transitional applications. For example one issue to consider is whether investors with applications underway should have the option of transferring to any amended screening regime. This would be one way of managing the risk that investors withdraw pending applications to have them considered under a different regime.

An evaluation of the effectiveness of the changes to the screening regime will be made six months after any legislation has come into effect. 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.

14 CONSULTATION AND FEEBACK

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 Regulatory Impact Statement:

> 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.

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: http://www.treasury.govt.nz/publications/informationreleases/overseasinvestment/review2009

15 SUMMARY OF FEEDBACK

The table below outlines the main issues raised through consultation and how they have been addressed.

Issue	Comment/Concern	How addressed
Interaction with the fishing quota screening regime	Earlier 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.	Analysis now includes this as a 'risk' of this option.
	An earlier 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.
Sensitive land - scope	Removing land adjoining local parks and reserves from screening risks leaving out local parks that may have similar values to regional parks.	An option to retain land adjoining local parks over a certain area threshold has been included. National Parks and Wildlife reserves have been included.
	Remove screening for land that *adjoins* land with heritage sites/heritage orders/ wahi tapu areas would reduce protections. The setting of a historic place is important and changes to sites adjacent to historic places can impact on heritage values. This change would also have little or no impact as the land is likely to be caught by other sensitivities.	This proposal has been removed.
Sensitive land hurdle	The option where investors must 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 now requires investors only to acknowledge their obligations under these pieces of legislation
	That the OIA should not be used to pursue other policy objectives which can be achieved with legislation that covers domestic and overseas investors.	There are options that would significantly reduce the amount of discretion available to Ministers.
	An assessment of economic benefits is important to ensure that overseas investment will deliver economic benefit to New Zealand.	A simplified benefits test has been developed which includes economic benefits.

Issue	Comment/Concern	How addressed
[Withheld - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements].		
Changing the purpose statement.	Altering the purpose is unlikely to have a practical effect on the application of the Act.	While work was undertaken to assess possible options for a revised purpose, the proposal to change the purpose statement has been dropped because of the low impact.
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. The requirement does not create large costs for investors.	This proposal has been removed.
Sovereign Wealth Funds	Sovereign Wealth Fund investors may have non-commercial motivations that would be counter to New Zealand's national interest.	Options that would provide additional screening of SWF investments have been included.
Strategic assets	The substantial harm test is too high a threshold for practical use.	The test has been amended to include economic interests. The hurdle is high to ensure that it is used only when other parts of the regime cannot address the concerns.
	The substantial harm test could be applied with little justification and its use could damage New Zealand's reputation as a place to invest.	Conditions around the use of the test have been developed to provide transparency over its use and to try and clarify the circumstances in which it will be used.
	The substantial harm test should be exercised by a range of Ministers.	The Minister for Land Information has been added to the test. Ministers are explicitly permitted to consult with other Ministers.
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 without re-screening.	This risk is noted in the paper. The investor has already passed a test targeted at their *usage* 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 *another* 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.	This risk is noted in the paper. Concerns about good character and awareness of sensitive features on land are still relevant when an asset moves from one overseas owner to another.

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, the impact is likely to be small or because changes could raise significant avoidance risks. 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;
- 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.

ANNEX A: TERMS OF REFERENCE

Problem definition

1. New Zealand's overseas investment screening regime influences the attractiveness of New Zealand as an investment destination. In the current economic environment, access to foreign capital is particularly important and we need to ensure that the screening regime does not unnecessarily deter or prevent initial and ongoing foreign investment. There is scope to improve the design and implementation of the current screening regime to ensure that it provides clarity, certainty and predictability for investors; ensures efficient processing of investment applications; minimises compliance costs associated with applications for subsequent investments; targets relevant concerns about foreign investments and ensures positive outcomes for the New Zealand economy.

Objectives

2. The objective of this review 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.

Coverage

3. The review will consider the following issues:

a. how the purpose of the Overseas Investment Act 2005 (the Act) can be restated to better reflect the importance of foreign investment to New Zealand's economic growth;

b. how the screening thresholds for investments in significant business assets and sensitive land can be adjusted to ensure they promote the initial and ongoing flow of investment into New Zealand;

c. how the type and scope of land defined as sensitive under the Act can be refined to ensure that only land of particular significance or importance to New Zealand is screened;

d. how the tests that initial and ongoing investments must meet for consent to be granted under the Act, and the factors for determining benefit to New Zealand, can be altered to avoid deterring valuable investments and to minimise compliance costs;

e. whether the current regulation making powers in the Act should be repealed;

f. other matters as considered appropriate by the Minister of Finance, Minister for Land Information and Minister for Regulatory Reform.

General

4. The Minister for Land Information will lead the day to day work on the review of the overseas investment screening regime (the Act and the Overseas Investment Regulations 2005). The Treasury will support and provide policy advice to the Minister for Land Information in this role. The Overseas Investment Office will provide support for the review, consistent with its role as the agency with responsibility for operational matters relating to overseas investment screening.

5. A Technical Reference Group will be established to advise officials on the practicality of any amendments to the Act and to provide suggestions on other improvements that can be made to the Act. The Group will be made up of senior legal practitioners with expertise in applying the Act. The Group will be appointed by the Minister for Land Information. A separate Terms of Reference for the Group is attached.

Timeframes

6. Cabinet agreement to any recommendations arising from the review will be sought by the end of June 2009. The timing of any necessary legislation will be determined by the government.

Other

7. I am confident that review will deliver a feasible set of options for reform and recommendations that will:

be the minimum necessary to achieve its objectives, having assessed costs, benefits and risks;

be as generic and as simple as the sector allows;

use self-regulatory approaches where appropriate;

be appropriately durable, predictable and adaptable;

where appropriate accord with international best practice being mindful of our commitment to a single economic market with Australia;

minimise compliance costs imposed; and

aim to minimise adverse impacts on:

i. innovation and investments;

ii. competition;

iii. individual responsibility (with appropriate risk balance); and

iv. property rights.

ANNEX B: FOREIGN INVESTMENT AND NATONAL ACCOUNTS

Two related arguments are often made for why overseas investment may not be in New Zealand's interest:

- Overseas investment aggravates the current account deficit. Reducing overseas investment would reduce the current account deficit.
- Overseas investment results in profits going offshore, showing up in the current account. This amount is lost earnings for New Zealanders.

In Treasury's view, both of these arguments have significant shortcomings.

The impact of any particular investment on the current account is not obvious.

When the investment relates to the purchase of new capital, overseas investment increases the overall amount of investment that occurs in the New Zealand economy. The overall impact on the current account will be influenced by which sectors the investment occurs in and the returns generated on the investment. Investment in the export sector (or import-competing sector) has the potential to grow New Zealand's net exports and hence reduce the current account deficit.

When the investment relates to the purchase of existing capital assets by overseas investors, at least some of the return generated by these assets will accrue to the overseas investors and hence impact on the investment income deficit. However, overseas investors will be required to pay for their purchases and hence there is the opportunity for New Zealand firms to pay off debt (much of it owed to overseas people) and/or increase their investments abroad. In the case that overseas-denominated debt is paid down, this portion of debt will no longer generate income for overseas people. In the case that New Zealand investment abroad is increased, New Zealand will receive higher income from abroad.

The overall impact on the current account deficit will therefore depend on the type of investment and the returns earned, both in New Zealand and abroad.

The flow of profits is the wrong measure to focus on.

In aggregate, greater overseas ownership generally increases the gap between GDP (economic activity that occurs in New Zealand) and GNI (income accrued to New Zealanders).[28] However, the gap per se should not matter for policy. Rather, the relevant question is whether the gap results in lower long-term real incomes for New

[28] New Zealand is among the groups of countries where the level of GNI is somewhat lower than GDP, but it does not significantly change the relative ranking when compared with other OECD countries. The difference between New Zealand's GDP and GNI growth over the last twenty years is very small.

Zealanders (i.e. long-term GNI). Overseas investment brings a number of benefits that are highly likely to increase long-term real incomes.

Empirical evidence suggests capital inflows have boosted New Zealand incomes.

A Treasury working paper[29] investigated the impact of overseas investment on net national income and estimated that capital inflows increased income per worker by $3,000 (in 2007 dollars) cumulatively between 1988 and 2006. That is, national income is increased by overseas investment after allowing for return to investors. (The main caveat is that this estimate captures first round effects only, rather than a general equilibrium model.)

Any sale to an overseas person should take into account future profit streams.

When an overseas person makes a New Zealand investment, that sale should take into account the future flow of profit stream, in the same way that the share price of a listed company should reflect future cash flows. What New Zealanders then do with the proceeds is up to them. The starting point should be that New Zealanders are making choices that maximise their own welfare, whether that is by investing in another venture domestically, investing offshore, consumption, or a mix of these.

Deliberately reducing overseas investment would mean reducing growth.

The counterfactual to lower overseas investment is often assumed to be that everything else is the same, except New Zealand owns more of its assets. But domestic investment is, by definition, made up of domestic saving and overseas saving. Since domestic investment is currently greater than domestic saving, the correct counterfactual is lower domestic investment, and therefore lower economic growth. Deliberately reducing overseas investment would therefore mean reducing New Zealanders' living standards.

Overseas equity investment is better from a vulnerability perspective than debt.

Overseas investment can come in the form of either debt or equity – equity is preferable from an economic vulnerability point of view since it is harder to reverse quickly. The Overseas Investment Act only screens direct equity investment, and direct equity investment makes up only about 17% of total (gross) overseas investment in New Zealand – the remainder is largely debt.

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[29]Anthony Makin, Wei Zhang and Grant Scobie, "The Contribution of Foreign Borrowing to the New Zealand Economy," Treasury working paper 08/03, http://www.treasury.govt.nz/publications/research-policy/wp/2008/08-03/

ANNEX C: OTHER RELEVANT POLICY

A number of other changes to government policy have been recently made which are relevant when considering changes to the Overseas Investment Act:

- **Business Migrants.** The government recently announced changes to the Business Migrant Scheme in order to attract more valuable migrants. The Business Migrant Scheme aims to attract financial capital to local firms or government by providing residence to people who wish to make a significant financial contribution to New Zealand's economy. The changes do not affect the application of the Overseas Investment Act, which will continue to apply if the migrant wishes to invest in sensitive assets.

- *[*Withheld - *maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*.

- **Administrative and regulatory improvements to the screening regime.** A number of minor improvements to the screening regime have already been made. These changes include additional exemptions for minor and technical transactions, a new delegation and directive letter and increased fees to support the faster processing of applications.

- **Free Trade Agreement links.** As discussed in section one, some of the proposed changes could impact on current and future FTAs.

ANNEX D: NOTE ON COMPLIANCE COST CALCULATIONS

Where possible this review has estimated the value of compliance cost reductions for each option. The cost of preparing and assessing applications is outlined in section two of this report, based on information from the OIO and law firms.

The calculations of compliance cost savings are based on the mid points of the figures provided by the OIO and law firms. It should be acknowledged that these figures can be subject to significant variation, depending on the complexity of the application and particularly for sensitive land applications. Therefore the compliance cost reduction estimates should be viewed as rough estimates and indicative only.

The compliance cost estimates also only take into account monetary costs of preparing an application. Other savings, such as time that can be diverted from application preparations to core business activities and reduced cost of delays to business activities, will occur, but have not been quantified.

ANNEX E: OTHER APPROACHES TO NATIONAL INTEREST/NATIONAL SECURITY

Australia	• 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 s/he considers that an investment in these areas is not in the "national interest" then s/he can reject the application.
United States	• President can suspend or prohibit any foreign acquisition, merger, or takeover of a U.S. company that s/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/she must also consider that existing legislation does not provide adequate safeguards to protect national security.
United Kingdom	• 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 is 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	• 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 the 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	• 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 Minster 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.
Canada	• Canada has recently introduced a national interest test that allows the relevant Minister to review an investment on national security grounds.