

## Treasury Report: Overseas Investment Review - draft full policy document

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|--------------|--------------|-------------------|------------|
| <b>Date:</b> | 23 June 2009 | <b>Report No:</b> | T2009/1529 |
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### Action Sought

|  | <b>Action Sought</b>  | <b>Deadline</b> |
|--|---|-----------------|
| Minister of Finance<br>(Hon Bill English)          | <b>Discuss</b> the contents of this report at your meeting with officials at 10.00am on Friday 26 June.<br><br><b>Indicate</b> any changes you would like made to the draft policy document before consultation with departments and the Technical Reference Group. | 26 June 2009    |
| Associate Minister of Finance<br>(Hon Simon Power) | <b>Note</b> the contents of this report.  | 26 June 2009    |

### Contact for Telephone Discussion (if required)

| <b>Name</b>          | <b>Position</b>               | <b>Telephone</b>     |                      | <b>1st Contact</b> |
|----------------------|-------------------------------|----------------------|----------------------|--------------------|
| [withheld – privacy] | Analyst, International        | [withheld – privacy] | [withheld – privacy] | ✓                  |
| Nic Blakeley         | Acting Manager, International | [withheld – privacy] | [withheld – privacy] |                    |

### Minister of Finance's Office Actions (if required)

**Refer** a copy of this report to the Minister for Land Information.

Enclosure: Yes (**Draft policy document for OIA review: 1268418**)

## Treasury Report: Overseas Investment Review - draft full policy document

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### Executive Summary

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You are meeting with Treasury, Land Information New Zealand, and the Overseas Investment Office at 10am on Friday 26 June to discuss the overseas investment review.

#### **The policy document now covers the full set of issues.**

The attached draft policy document includes analysis and initial recommendations for all the issues to be considered in the review. Subject to your comments, the draft will be circulated to government agencies and the Technical Reference Group for comment. We expect some of the recommendations will change based on consultation, particularly in relation to the practical workability of some of the proposed changes.

#### **The draft proposed changes would make significant improvements.**

The overall estimated impact of the review is summarised in the table below:

|                       | Significant business assets   | Sensitive land   |
|-----------------------|---|--|
| <b>Scope changes</b>  | <ul style="list-style-type: none"> <li>Better targeted screening threshold, reducing applications by around 40% (based on historical data)</li> </ul> | <ul style="list-style-type: none"> <li>Better targeted scope, reducing applications by around 20% (based on historical data)</li> </ul>  |
| <b>Hurdle changes</b> | <ul style="list-style-type: none"> <li>No change</li> </ul>   | <ul style="list-style-type: none"> <li>Significantly simpler and more predictable test for investors.</li> <li>No uncertainty around treatment of strategic assets</li> <li>No complexity around offering special land to the Crown</li> </ul> |

#### **The most significant proposed changes are to sensitive land and strategic assets, but practical workability of the land change needs testing through consultation.**

The most significant proposed recommendation in the review is to establish an objective-based test for sensitive land, where investors must show that they have complied with relevant domestic legislation such as the Walking Access Act, the Historic Places Act and the Conservation Act. Under such a test, concerns about public access, for example, are still addressed, but by showing compliance with domestic legislation, rather than any additional hurdle for overseas investors to meet. This recommendation in particular requires further consideration as part of the consultation process to test that it will be workable in practice.

The review also proposes that the existing screening regime and foreign ownership limits for certain companies provide sufficient protection, without additional provision for strategic assets. Removing this provision will improve investor certainty and confidence.

Other recommendations will make useful improvements, but trade-offs could be made with changes to sensitive land screening and strategic assets. For example, concerns about relying on the existing screening process to cover strategic assets could be reduced by proposing a smaller, or no, increase to the business screening threshold.

## Recommended Action

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We recommend that you:

- a **indicate**, at your meeting with officials on Friday 26 June, any changes you would like made to the draft policy document before consultation with departments and the Technical Reference Group;
- c **refer** a copy of this report to the Minister for Land Information.

*Yes/no.*

**Nic Blakeley**

Acting Manager, International  
for Secretary to the Treasury

Hon Bill English

**Minister of Finance**

## **Treasury Report: Overseas Investment Review - initial recommendations**

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### **Purpose of Report**

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1. This report seeks your comments on the draft findings of the Overseas Investment Act review before consultation with departments and the Technical Reference Group.

### **Analysis**

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2. You are meeting with officials from Treasury, Land Information New Zealand (LINZ), and the Overseas Investment Office (OIO) at 10.00am on Friday 26 June to discuss the overall recommendations arising from the review of the Overseas Investment Act.
3. We have drafted a policy document that contains all the relevant analysis and recommendations in a form to be publicly released after Cabinet has made decisions. The current draft of the policy document is attached to this report. You have previously seen the first phase of this document (T2009/1095 refers), but it now covers all the issues to be addressed in the review.

### **Summary of draft recommendations**

4. The table on the following two pages outlines all the issues considered in the review and the review's draft recommendations. It also provides an assessment of the impact of each recommendation against the three objectives stated in the policy document – to ensure that the screening regime is: well targeted at community concerns; simple; and predictable. Where possible, the impact on the number of applications is also given, however these numbers are approximate only, because applications can often fall within more than one category of sensitive land. Consultation on these recommendations with departments and the Technical Reference Group is required, in particular to assess whether they will be workable in practice.

### **Our view of the recommendations**

5. The terms of reference for the review were aimed at reducing the complexity of the screening regime while retaining protection for sensitive assets. Within these bounds, we consider that the changes proposed to the screening regime will result in significant improvements by simplifying the screening process and removing a number of less significant transactions from screening altogether.
6. We consider that the highest priority area for reform is the sensitive land screening process because it is the source of the biggest problems with the current regime. We also consider the removal of any specific provisions for strategic assets represents a significant improvement that will improve investor certainty. The other recommendations in the review will make useful improvements but in our view are relatively less important than the sensitive land and strategic asset changes.
7. Our first best advice remains not screening overseas investment at all, on the basis that domestic policies that affect overseas and domestic investors equally are likely to be much better targeted at underlying problems. However, we are cognisant of strong public sentiment on overseas investment and we think policy stability over time is important to provide certainty to investors. We would see a relatively liberal regime that is stable over time as preferable to greater openness that was reversed in the future. We think the changes proposed in this review strike a reasonable balance.

| Issue                         | Status Quo  | Draft Recommendation  | Impact  |
|-------------------------------|---|---|---|
| Purpose of the Act            | <i>To acknowledge that it is a privilege for overseas persons to own or control sensitive New Zealand assets.</i>     | <i>To maintain an open and welcoming stance towards foreign investment generally, while providing safeguards for investments in sensitive assets by overseas persons.</i>   | <ul style="list-style-type: none"> <li>• <b>Well targeted.</b> The new purpose will allow the Act to be implemented and interpreted in a way that recognises the importance of investment while protecting sensitive assets.</li> </ul> |
| Definition of overseas person | A firm that is 25% or more overseas owned/controlled by one or more overseas persons is subject to the Act.           | Recognise the difference between widely dispersed and concentrated foreign control by using a dual threshold: Firms that are 25% or more controlled by <i>one</i> overseas person or 40% or more controlled by <i>two or more</i> overseas persons. | <ul style="list-style-type: none"> <li>• <b>Well targeted</b> as fewer majority New Zealand controlled firms will be screened. Reduce applications by around 4%.</li> </ul>   |
|                               | New Zealand residents must be ordinarily resident in New Zealand to be exempt from screening.                         | New Zealand residents exempted from requirement to be ordinarily resident.  | <ul style="list-style-type: none"> <li>• <b>Well targeted</b> as residents are able to reside in New Zealand indefinitely. Around 0.01% reduction in applications (2 investors affected by this since 2000).</li> </ul>                 |
|                               | Current definition is based on the degree of overseas ownership and/or control of a firm.                             | Rely only on the level of overseas <i>control</i> when assessing whether a body corporate, partnership or trust is an overseas person.  | <ul style="list-style-type: none"> <li>• <b>Well targeted</b> as concerns largely relate to how particular assets may be used, which requires control rather than ownership alone.</li> </ul>   |
| Policy change by regulation   | The factors considered when assessing an investment in sensitive land can be added to by regulation.                  | Changes to the factors considered when assessing sensitive land applications can only be made through legislation, rather than regulation. Will become redundant with proposed changes to sensitive land hurdle.                                    | <ul style="list-style-type: none"> <li>• <b>More predictability</b> and certainty for investors, less flexibility for Ministers.</li> </ul>   |
| Business assets: scope        | Business investments of more than \$100 million are subject to screening.   | Increase the threshold to \$200 million. Retain screening for greenfields investment.   | <ul style="list-style-type: none"> <li>• <b>Well targeted</b> – only screen the most significant transactions. Reduce business applications by around 43%.</li> </ul>   |
| Business assets: hurdle       | Investors must show they are of good character, have business acumen and have financial commitment to the investment. | No changes. The current criteria for assessing business applications are well targeted and adequate.  | No change.  |
| Sensitive land: scope         | Non urban land greater than 5ha (includes both farm land and other non urban land such as forestry).                  | Farmland (rather than all non urban land) is screened<br>The area threshold is increased to 10ha.   | <ul style="list-style-type: none"> <li>• <b>Well targeted</b> – small land holdings are exempted, as are commercial/industrial businesses located on non-urban land.<br/>Roughly 8% reduction in land applications.</li> </ul>          |

|   |  |  |  |
|---|--|--|--|
|   | Land adjoining local, regional and National parks and reserves is screened.  | No longer screen land adjoining local and regional parks, retain protection for National Parks.  | <ul style="list-style-type: none"> <li>• <b>Simpler and well targeted</b> – less land is subject to screening while land of particular importance is still screened.</li> <li>• <b>More predictable</b> – remove uncertainty over whether land that adjoins some parks and reserves is sensitive. Around 6% fewer land applications</li> </ul>         |
|   | Land that adjoins land subject to heritage orders or a historic place is screened.   | Remove screening for land that <i>adjoins</i> land with heritage sites/heritage orders.  | <ul style="list-style-type: none"> <li>• <b>Simpler and well targeted</b> as above. Around 4% fewer land applications</li> </ul>   |
| Sensitive land: hurdle                                | Investor must show that the investment will benefit New Zealand, and that the benefits are substantial and identifiable in the case of non-urban land. This includes whether the investment provides for adequate walking access, protection of historic places. | An objective-based test where the investor must show compliance with the Resource Management, Walking Access, Historic Places, Conservation and Foreshore and Seabed Acts (where relevant). (This recommendation in particular requires further testing to assess its practicality.) | <ul style="list-style-type: none"> <li>• <b>Simplified</b> assessment process for investor and regulator.</li> <li>• <b>Well targeted</b> as Act directly addresses common concerns but relies largely on domestic legislation to provide sufficient protection.</li> <li>• <b>Predictable</b> for investors as the test is more objective.</li> </ul> |
| Offer back of special land to the Crown               | Land that includes foreshore, seabed, lakebed or riverbed must be offered to the Crown.  | Remove requirement to offer land to the Crown. Rely on other legislation to provide for access to and use of these types of land.  | <ul style="list-style-type: none"> <li>• <b>Simplify/remove</b> the complexity associated with the offer back process.</li> <li>• <b>Well targeted</b> –address the underlying concerns which relate <i>usage/access</i> rather than <i>ownership</i>. Around 12 days saved on special land applications.</li> </ul>                                   |
| Increases in ownership/control once approved          | Investors must seek further approval if they wish to increase their level of ownership or control of an asset by more than 5%.   | Exempt such transactions from the requirement to seek consent.   | <ul style="list-style-type: none"> <li>• <b>Well targeted and simpler</b>– once an investor is approved, there is little reason to require them to seek new consent.</li> </ul>  |
| Foreigner to foreigner transactions (business assets) | Currently screened with the same criteria as used to assess all investments significant business assets.   | No changes. Concerns about good character and business experience are still relevant in foreigner to foreigner transactions.   | No change.   |
| Strategic Assets                                      | Ministers may consider whether sensitive land investments will assist New Zealand to maintain control of strategically important infrastructure.   | Remove the regulation relating to strategic assets on sensitive land. No further protections should be provided for strategic assets as the existing restrictions are sufficient.  | <ul style="list-style-type: none"> <li>• <b>Simpler</b> – no additional sub-class of screening.</li> <li>• <b>More predictability</b> for investors, since no ambiguity over whether an asset is strategic.</li> </ul>   |
| Sovereign Wealth Funds                                | No additional screening for SWFs.  | No additional screening for SWFs.  | No change.   |

## Most contentious issues

8. The most contentious recommendations from the review are outlined in the table below. The table sets out the issue, the likely arguments or concerns that will be raised by some stakeholders, and a possible response to those concerns.

| Issue  | Concern   | Counter-argument  |
|--|---|---|
| Changes to the hurdle for investments in sensitive land. | That a high test should be met before land becomes overseas owned.<br>That Ministers should have discretion via the net benefit test. | The recommended hurdle still addresses key community concerns about access and usage. The flipside to less Ministerial discretion is improved predictability and certainty for investors.     |
| Removing the offer back procedure for special land.      | That particularly sensitive land should be in Crown ownership.  | The underlying concerns relate to access to, and usage of, special land – Crown ownership is not required to achieve this, nor is the offer back mechanism the best way of gaining ownership. |
| Raising the business screening threshold.                | That the threshold should be lower to screen a wider range of business assets.  | A threshold of \$200 million will still screen the most significant businesses.   |
| No additional screening for 'strategic assets'.          | That there is not enough protection in place to prevent certain assets from becoming foreign controlled.                              | The screening regime picks up large businesses. There are specific protections in place for some assets (Telecom, AirNZ, SoEs).   |

9. Trade-offs can be made between the proposed changes (e.g. if they encounter strong opposition through the legislative process). For example:
- Land. The screening test for land and the offer back procedure for special land both relate to protections for sensitive land. In our view, the more important change is to move away from a net benefit test for sensitive land, so alternatives to removing the offer back could be considered, such as retaining the offer back, or retaining it for everything except riverbeds (which are most problematic).
  - Business. Businesses considered 'strategic assets' are often likely to be businesses captured by the business screening regime and associated threshold. In our view, the more important change is to remove additional screening for 'strategic assets' rather than raising the screening threshold, so alternatives to raising the threshold could be considered, such as a smaller increase (e.g. \$150 million) or no increase.

## Links with Free Trade Agreements

10. Changes to the business asset screening threshold have implications for New Zealand's existing Free Trade Agreements (FTAs), and the negotiation of new agreements.
11. *[withheld - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements]*

12. In existing FTAs that have been concluded so far, New Zealand has agreed that the any future increases in the business threshold will be 'locked-in'. This means that any increases in the business threshold cannot be reversed in the case of New Zealand's FTA partners. For example if the current threshold were increased to \$200 million, it could not be lowered back to \$100 million for investments from FTA partner countries (or even selectively lowered, e.g. for Sovereign Wealth Funds).
13. *[withheld - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements]*

### Issues not considered in the review

14. The review covers all the issues identified in the terms of reference, which were considered to be those issues causing the greatest problems to the operation of the regime. The following issues have not been considered in this review, but some could be if you wished and were happy with a slightly longer timeframe:
  - Organisational and implementation issues. Issues that could be considered include the functions, role, and location of the OIO, and the provisions for monitoring and enforcement of the legislation. An example of a potentially significant change in this area would be the role of Ministers in deciding applications: a regime with more independence for the OIO to make decisions on applications would provide more predictability for investors and would remove Ministers from political pressure on individual applications, at the cost of less flexibility for Ministers.
  - Fishing quota screening. Purchase of fishing quota is also subject to screening under the overseas investment regime, though only one application has been received since 2001. The screening test for quota is a net benefit test. If the review makes changes to the net benefit test for sensitive land applications, changes to the test for fishing quota could be considered.
  - Some categories of sensitive land. The review has focused only on the categories of sensitive land where most applications are received (namely non urban land, and regional and local parks and reserves). Other categories of sensitive land could be considered and potentially changes made to reduce the scope of what is screened.
  - Exemptions. The Act already provides the ability to provide specific exemptions from the Act, but these have not been extensively used to date. Consideration could be given to if and when certain overseas owned/controlled firms who undertake significant activity in New Zealand could be exempt. This issue is not dependent on legislation and could be considered after the legislative review.

### Next steps

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15. Subject to any comments you have on the recommendations, we will consult with government agencies and the Technical Reference Group (TRG) on the full policy document. We will also prepare and consult on a Cabinet paper that seeks agreement to the policy changes for consideration by Cabinet Economic Growth and Infrastructure



committee (EGI) by the end of July. The paper will seek approval to include any changes in the 2009 legislative programme.

16. The current weekly timetable we are working to is as follows:

| <b>Week of</b> | <b>Actions</b>   |
|----------------|--|
| 29 June        | Consultation with departments and TRG on full policy document and Cabinet paper.   |
| 6 July         | Consideration by Officials EGI. Continued consultation with departments/TRG.   |
| 13 July        | Revised draft policy document and Cabinet paper sent to you for Ministerial consultation and submission to Cabinet office. |
| 20 July        | Submission to Cabinet office.  |
| 27 July        | Consideration by EGI.  |