

Treasury Report: Overseas Investment Act Review - Exemptions

Date:	16 October 2009	Report No:	T2009/2335
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Action Sought

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Minister of Finance (Hon Bill English)	Agree to include proposals for two new exemptions as part of the review: (i) for New Zealand-linked repeat investors, and (ii) for trustee company and investment fund investments.	20 October 2009 (note you have a meeting with Treasury on 20 October)

Contact for Telephone Discussion (if required)

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Minister of Finance's Office Actions (if required)

None.

Enclosure: No

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Executive Summary

The Overseas Investment Act ("the Act") currently allows exemptions from consent processes for three purposes – for a number of technical transactions, for portfolio investors, and for New Zealand controlled persons. As part of the review of the Act, you asked us to consider extending the use of exemptions. We have identified two possible proposals for inclusion in the review:

- a new class of exemptions for New Zealand linked repeat investors; and
- new exemptions for trustee companies and investment funds.

New Zealand linked repeat investors

We propose that a new class of exemption be introduced targeting repeat investors with strong New Zealand links ("New Zealand linked repeat investors"). This is based on the principle that companies that have already proven benefit and can show strong links to New Zealand are unlikely to act outside of New Zealand's interests. Exemptions for this particular group of investors would be useful as the focus is on a small group of investors with high compliance costs as a result of the Act.

To qualify for an exemption, we recommend that prior successful approvals under the Act be a compulsory criterion as this means an investor has shown benefit in the past. An investor would also need to show strong links with New Zealand by meeting at least three of seven other criteria including: local incorporation, shareholding/shareholding dispersion, control of the Board, length of operations in New Zealand, locally headquartered, NZX Listed, and product is wholly produced and consumed in New Zealand (e.g. electricity).

To ensure maximum certainty and transparency for applicants, the criteria should be set out in regulations. To maximise the reduction in compliance costs for investors, the exemption should be implemented as an ongoing exemption for an investor. The exempted investor would then no longer need to apply under the Act unless there were significant changes to the company. An alternative is to only apply the exemption on an investment-by-investment basis.

The main trade-off against the reduction in compliance costs for investors is the reduction in scrutiny of these investments. A number of safeguards are proposed to prevent evasion and reduce the need for high levels of scrutiny:

- case-by-case decision making for each company's application by the OIO;
- recommendations made to the Minister by the OIO on each company application and final decision making power resting with the Minister;
- three yearly review of a company's status; and
- use of existing revocation mechanism, where necessary.

Exempted transactions for trustee companies and investment funds

We propose two new exempted categories of transactions under the current investment exemption – for trustee companies and investment funds (e.g. P.I.Es). Exempting these types of investment reflects the principle that technical transactions of little policy interest should not be screened under the Act. Both of these exemptions will require further consultation to ensure they are practicable.

Recommended Action

We recommend that you:

- a **agree** to include a proposal for a new exemption for New Zealand linked repeat investors as part of the overseas investment review, where to qualify investors would need to show strong links with New Zealand under a number of criteria and have had prior successful approvals under the Act;

Agree/disagree.

- b **agree** that the New Zealand linked repeat investor exemption be implemented as either an ongoing investor exemption (where the investor is considered for exemption once and then subsequent investments are not screened – Treasury recommended), or an investment exemption (where each investment is considered for an exemption on a case-by-case basis);

ongoing investor exemption / *investment exemption*

- c **agree** to include a proposal for trustee company and investment fund investments to be exempted transactions as part of the review, subject to further consultation of their practicality.

Agree/disagree.

Nic Blakeley
**Acting Manager, International
for Secretary to the Treasury**

Hon Bill English
Minister of Finance

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Purpose of Report

1. You asked Treasury to consider possibilities for expanding the use of exemptions in the Overseas Investment Act. This report outlines two possible proposals for inclusion in the review:

- a new class of exemptions for New Zealand linked repeat investors; and
- new exemptions for trustee companies and investment funds.

Background and general approach

Current exemptions

2. The Overseas Investment Act contains quite wide powers to make regulations to exempt “any transaction, person, interest, right, or assets, or class of transactions, persons, interests, rights, or assets, from the requirement for consent or from the definition of overseas person or associate or associated land”.
3. The purpose of an exemption is effectively to target a relatively small group of investments/investors who are facing high compliance costs as a result of the Act but who do not appear to pose a significant threat to New Zealand’s domestic interests if their transactions were exempted from screening.
4. Current exemptions are in place for:
 - specific types of investment (ie. acquiring securities etc from a member for the same group or from an overseas person that directly or indirectly owns at least 95% of the overseas person or an acquisition which does not alter the proportions of shares held by shareholders/relative voting rights; or an overseas person acquiring securities etc as a result of division of relationship property under the Property (Relationships) Act 1976);
 - 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, focussing solely on ownership and control (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).

General principles

5. We see three principles that could be used to guide when exemptions may be warranted:
 - i. **Technical changes of little policy interest** – some transactions are captured through technicalities which mean that they are required to apply for consent. However, many of these transactions do not pose a policy threat to New Zealand. Exempting these transaction reduces the level of scrutiny that Ministers/the OIO have but this does not have significant effects on the operation of the regime overall. The current exemption for specific types of investment is built on this principle.

- ii. **The investor is technically “in New Zealand hands”** – On closer examination of the ownership and control of some investors currently defined as overseas persons, it can be clearly 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 thus the reduced scrutiny for Ministers/the OIO is seen as appropriate. The current exemptions for portfolio investors and New Zealand controlled persons are based on this principle.
- iii. **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. Reduced scrutiny for Ministers/the OIO may be justified for companies who can prove these strong links and should not have a significant effect on the operation of the regime overall.

Identified gaps

6. We have identified two areas that are not currently covered by existing exemptions but that we think are consistent with the principles above:
 - companies that have strong links to New Zealand but are not captured by the existing New Zealand controlled person exemption (principle 3); and
 - transactions that are made through overseas-owned trustee companies and investment funds, but where the underlying ownership is New Zealand (principle 1).
7. The remainder of this report considers these two cases in more detail.

New Zealand linked repeat investor

8. There is a small group of repeat investors in New Zealand who also face high compliance costs as a result of the Act. These include the cost of delay to business activity, the cost of preparing and submitting an application and the cost of complying with any conditions of consent. Eight companies have made five or more applications over the last five years. The greatest number of applications over the period by a single company was 12.
9. Many of these investors have strong links to New Zealand *[Withheld - maintain the effective conduct of public affairs through the free and frank expression of opinions]*. This exemption is designed to target these types of investors.

Compulsory Prior Applications Criterion

10. As this exemption is targeted at repeat investors in New Zealand, including successful prior applications as a compulsory criterion ensures that only repeat investors are exempted. In order to qualify as a repeat investor, a threshold could be set at a company which has made at least one successful application per year over the last three years.
11. Making this criterion compulsory also ensures that companies who are exempted have a strong history of being able to prove that they benefit the New Zealand economy, as this is the major judgement that is made in screening applications under the Act. With this history, it is thus unlikely that their future applications will have negative impacts on New Zealand. It also demonstrates a level of commitment to New Zealand.

Criteria for Exemption

12. The New Zealand linked repeat investors exemption is based on the principle that investors with strong links to New Zealand are unlikely to act contrary to New Zealand's interests. Companies who have had strong links to New Zealand for an extended period of time are likely to have a high level of commitment to New Zealand, be familiar and compliant with domestic laws and legislation, and be aware of social norms and New Zealanders expectations.
13. We recommend including the following criteria for judging strong links to New Zealand:

Local incorporation	Control of the Board	Locally headquartered	NZSX Listed
Shareholding/ shareholding dispersion	Length of operations in New Zealand	Product is wholly produced and consumed in New Zealand (eg. electricity)	

Hurdle for applicants

14. Establishing a minimum level of compliance will be beneficial in assisting the OIO and Ministers to make decisions on applications, as well as providing transparency to applicants about how they are being judged. Along with meeting the prior investments criteria discussed above, an investor should have to meet any three out of the other seven proposed criteria.
15. Having a relatively high hurdle ensures that the exemption remains for usage in a small number of cases. However it could potentially reduce the flexibility for Ministers in considering applications.

Transparency

16. Providing certainty for investors is one of the major goals of the current review. The best way to improve certainty is to include criteria in the regulations. This will lead to better quality applications through greater certainty for investors and still leaves Ministers and the OIO with space to interpret the criteria as they apply to particular cases. This would, however reduce the flexibility for Ministers to use their discretion in applying the criteria and could lead to ongoing debates with companies as to why they have not been exempted.

Implementation

17. There are two options for implementation. One option is to introduce an ongoing investor exemption. This would mean that once an investor is exempted, this particular company would not need to make applications under the Act in the future. This type of exemption maximises the reduction in compliance costs for the investor. However, Ministers and the OIO also lose the ability to keep track of the investments this company is making in New Zealand.
18. Another option would be for companies to apply for an exemption each time they wish to make an investment in New Zealand. This may provide small reductions in compliance costs but this would not be as great as an ongoing investor exemption. This type of exemption provides much the same level of scrutiny over investors as the Act currently provides for Ministers and the OIO.
19. Based on the principle that Ministers and the OIO need not be concerned about these investors since they are unlikely to act contrary to New Zealand interests and have proved benefit in the past, the reduced scrutiny under the first option does not seem to be a significant trade-off compared to the compliance cost reductions that could be

achieved. Additionally, the next section discusses further safeguards for worst-case scenarios.

Safeguards

20. To deal with changes to the investor which may mean it no longer qualifies for exemption, it would seem prudent to include a review mechanism as part of the New Zealand linked repeat investors exemption. We recommend review on a three yearly cycle from the date of exemption to ensure that major changes are picked up. If it was considered necessary, an extra provision could be included for “emergency” review situations where an immediate review was seen as necessary.
21. The result of a review would be either that the company remains exempt or Ministers revoke the exemption, where a company has made significant changes in its ownership or governance structure, or where there have been significant concerns with the recent activities of the company. This power already exists within the scope of the current Act (section 61(1)(j)) and would simply apply to the New Zealand linked repeat investors class, once introduced.

Decision Making

22. We recommend that Ministers receive advice from the OIO on applications for exemption and make decisions on the basis of this advice. This reduces the certainty for investors but allows Ministers the ability to exercise a greater level of scrutiny. It could also create a greater workload for Ministers than is desirable, however. Exempted investors could then be either added to a schedule list of exemptions, or gazetted as being exempt.

Current Exemptions

23. Although it could be argued that there is no need for the current investor exemptions, we think they are of some ongoing use as they pick up companies who are actually New Zealand controlled rather than straying into the more grey area of New Zealand-linked investors. We recommend retaining the current exemptions.

Benefits and Risks

24. Implementation of the New Zealand linked repeat investor exemption would significantly reduce compliance costs for a small number of companies. This would also mean a reduction in application numbers for the OIO, however this is likely to be fairly minimal as the exemptions only intend to capture a few companies. At the most, this would result in a 9.5% reduction in applications per year, if all the repeat investors qualified for exemption.
25. There are some drawbacks to using exemptions. These include the risk of evasion through investors structuring themselves so that they meet the criteria, and the reduced level of scrutiny for Ministers, the OIO and the public. However, these risks can be mitigated through well specified criteria, case-by-case consideration and review and revocation mechanisms.

Investments by trustee companies and investment funds

26. We consider that investments made by trustee companies (as listed under the Trustee Companies Act) and investment funds such as PIEs should qualify for exemption. Trustee company transactions are often captured as they often hold the portfolio of loans/debts on behalf of banks who are involved in securitization of loans transactions. Investment funds are often investing for the benefit of policy holders who are New Zealanders, even if the trustee is an overseas person. These types of transactions would not seem to raise major policy concerns.

27. There may be some practical difficulties in exempting these types of transactions, however, as identifying the beneficiaries of both types of transactions may prove difficult. We propose to consult further on this with those involved in these types of transactions as the proposals are finalised.