

Treasury Report: Overseas Investment Act - options to take to Cabinet

Date:	27 August 2010	Report No:	T2010/1614
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Indicate which options you want Treasury to develop into a Cabinet paper	3 September 2010

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
[withheld – privacy]	Analyst - International	[withheld privacy]	– [withheld privacy]	✓
Siân Roguski	Acting Manager - International	[withheld privacy]	– [withheld privacy]	

Minister of Finance's Office Actions (if required)

None.

Enclosure: Yes [\(Australia's Foreign Investment Policy Statement:1888880\)](#)

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Executive Summary

In response to your request this paper outlines two new factors that could be added to the benefit test used to assess investments in sensitive land. It also outlines the possible content of a government statement on foreign investment. We seek your preferences on which proposals you would like us to develop into a Cabinet paper.

New factors for the benefit test

We have redesigned the former substantial harm test into an 'economic benefits' factor to be introduced by regulation into the benefit test that assesses investments in sensitive land. We understand the policy objective of this factor is to create additional flexibility for Ministers to consider a wider range of issues when assessing an investment. *[withheld - maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

We have also developed the idea of introducing 'mitigating factors' into the benefit test that would allow Ministers consider whether the investment will allow for New Zealand oversight or control in the investment. These factors aim to address concerns about a lack of transparency and are outlined in the recommendations section. They would appear as separate factors in the benefit test in their own right. A key risk with these factors is the potential for avoidance and we will further assess this risk if you wish to include them in the Cabinet paper.

There are two important constraints that apply to the use of all of these factors:

- **The factors will only apply to foreign investments in sensitive land.** The criteria for assessing business investments cannot be changed without amending the Act.
- **The factors are not pass/fail tests.** They must be balanced alongside how the investment contributes to the 25 other factors in the benefit test and it would be highly risky to decline an investment on the basis of it not meeting only one factor, particularly if other benefits are created.

[Withheld maintain professional legal privilege]

Government policy statement

We also seek your advice on the issues that should be included in a government statement on foreign investment (outlined in the recommendations section). We recommend that this statement be issued in the form of a new directive letter to the Overseas Investment Office, as this is the only way to direct, or guide, the office about the Government's policy objectives and the relative importance of different factors in the benefit test. An important constraint on the statement is that it must be consistent with the purpose of the Overseas Investment Act, i.e. *that it is a privilege to for foreigners to own or control sensitive New Zealand assets.*

Timing and consultation

We will develop a draft paper and Regulatory Impact Statement to allow you to seek Cabinet agreement on policy decisions by the end of September. Changes to the regulations will come into effect by the end of the year to allow time for drafting, approval by Executive Council and the 28 day rule.

We recommend consulting with the Technical Reference Group in the development of the Cabinet paper to seek their views on how the changes will be perceived by investors. *[Withheld - maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials].*

Recommended Action

We recommend that you:

Policy proposals for inclusion in the Cabinet paper

a **indicate** which of the following proposals you wish to include in the Cabinet paper:

Proposals	
That a new 'economic benefit' factor to be added to the sensitive land benefit test with a policy aim of: a. enabling a wider range of economic issues to be considered in the assessment of a particular investment, in particular whether New Zealand's economic interests are adequately safeguarded; and b. providing Ministers with flexibility to respond to both current concerns about foreign investment and concerns that may arise in future.	Yes/No
That the current strategic assets factor be revoked on the grounds that it is made redundant by the 'economic benefit' factor.	Yes/No
That specific 'mitigating factors' be added to the benefit test that would allow for New Zealand interests or oversight to be maintained: <i>[withheld - maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]</i>	Yes/No
That an amended directive letter to the Overseas Investment Office set out: • <i>the Government's general attitude towards foreign investment in sensitive assets;</i> • <i>any specific areas or types of investment that the Government wishes to encourage;</i> • <i>any specific areas or types of investment where the Government is likely to apply greater scrutiny to foreign investment;</i> • <i>ways in which investors could structure their investments to mitigate any relevant concerns; and</i> • <i>advice to the regulator about which factors in the benefit test are likely to be more or less important for particular types of investments.</i>	Yes/No

Timing and consultation

- b **agree** that Cabinet agreement on policy issues should be sought by the end of September 2010 to allow you to announce the changes at the same time;

Agree/disagree.

- c **agree** that Treasury should consult with the Technical Reference Group as the Cabinet paper is developed;

Agree/disagree.

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

Agree/disagree.

- e **refer** a copy of this report to the Ministers of Trade and Agriculture.

Agree/disagree.

Siân Roguski
**Acting Manager - International
for Secretary to the Treasury**

Hon Bill English
Minister of Finance

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Purpose of Report

1. You have asked us to develop the details of a substantial harm test (or similar) and government policy statement on foreign investment, following our advice in T2010/1413. This report responds to your request by:
 - a. outlining how a redesigned substantial harm test could be used to strengthen the benefit test that assesses investments in sensitive land and be introduced by regulation;
 - b. outlining the possible content of a government statement on foreign investment; and
 - c. seeking decisions on which options should be developed into a Cabinet paper.

Purpose and objectives

2. We understand you are trying to address two issues:
 - a. **Maintaining public confidence and ministerial flexibility:** addressing concerns that foreign investment in some cases or sectors may be detrimental to New Zealand's interests, that the current screening regime does not allow for the consideration of all relevant issues or concerns, and that it is difficult to specify in advance what all the relevant issues might be.
 - b. **Providing certainty for investors:** addressing the current uncertainty investors have over government policy on foreign investment, particularly as to whether there may be 'sensitive' sectors that are 'off-limits' or subject to special conditions.
3. In addressing these issues the following constraints are relevant:
 - a. You have asked that any new factor be able to be introduced through regulation.
 - b. Any new measures should be an appropriate use of regulation-making powers, be consistent with the principles of good regulation and should minimise any grounds for review by the Regulations Review Committee.
 - c. Any new measures should be consistent with international obligations that allow New Zealand to alter the factors used to assess investments in sensitive assets, but not to add new classes or categories of screening.
 - d. Factors in the benefit test are worded in the positive in that if they are met they *create or add* benefit. Hence a new factor needs to be worded in a similar way and cannot directly consider detriments.
 - e. Any changes need to be consistent with the purpose of the Act (i.e. that it is a privilege for overseas persons to own or control sensitive New Zealand assets).

Widening the benefit test for investments in sensitive land

4. This section outlines two possible new factors that could be introduced to the benefit test that is used to assess investments in sensitive land.

A wider 'economic benefit' factor

5. We have previously reported to you about a substantial harm test that could be introduced by amending the Act as a criterion that must be met before consent is given to invest in sensitive land and significant business assets.
6. An adapted version of the substantial harm test could be introduced to the benefit test as a new factor that is considered when assessing investments in sensitive land. The aim of this factor is to:
 - a. allow Ministers to consider a wider range of economic issues in their assessment of a particular investment, in particular whether New Zealand's economic interests are adequately safeguarded; and
 - b. provide flexibility to respond to both current concerns about foreign investment and concerns that may arise in future.
7. In addition we propose that this factor replace the current strategic assets factor on the grounds that it becomes redundant. *[withheld - maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

New 'mitigating factors'

8. In addition to creating an economic harm factor, we have also considered whether 'mitigating factors' should be added into the benefit test. These are factors which would allow for New Zealand oversight or involvement in the investment in order to offset concerns about the foreign investment. Such a factor might address concerns that some investors may operate in jurisdictions where reporting standards are less transparent or robust than in New Zealand, and that there may be some cases where New Zealand is not prepared to relinquish complete control of an asset.
9. *[withheld - maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

10. While these factors would have to be considered with each investment in sensitive land, they would not be relevant for every investment. For example they are unlikely to

be useful in the case of an overseas investor purchasing a holiday home with a few hectares of land. Ministers could issue guidance to the OIO about the types of investments where these factors are likely to be important.

11. The table below summarises the key advantages and disadvantages of introducing these factors that we have identified to date.

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

12. A key constraint that we have identified is that many of these factors may be able to be avoided by the use of proxies who simply act for the foreign investor. We are further assessing the extent of this risk. One option for managing it may be to require the investor to demonstrate to the satisfaction of Ministers that there is real New Zealand influence/control before consent is given to invest. Ongoing monitoring is also likely to be necessary.
13. Another generic disadvantage is the potential for these factors to be seen as new barriers to foreign investment in New Zealand which add costs and deter investors from considering New Zealand as an investment destination. On the other hand, many investors already undertake joint investments with New Zealanders and are likely to already meet one or more of these factors.

Do the factors create flexibility for Ministers?

14. We consider that the 'economic benefit' factor gives Ministers the ability to consider a wide range of issues. As noted above, the term 'economic interests' could cover many things. The 'mitigating factors' also create additional flexibility by allowing Ministers to consider whether concerns about the investment can be offset. More specific discussion about the kinds of concerns both factor could address is outlined in the 'overall impact' discussion below. However there are a number of important constraints relating to the use of these factors:

- **The factor will apply only to investments in sensitive land** and cannot be applied to investments in significant business assets. The regulation-making power allows only for changes to the factors used to assess investments in

sensitive land. The criteria for assessing business investments cannot be changed without amending the Act.

- **The factor will be weighed up against the other factors in the benefit test.** The substantial harm test was a pass/fail test that could be used to decline an investment in its own right. However, as part of the benefit test, any new factor must be weighed up against the 25 other factors in the test. Hence an investment that brings benefits such as new jobs, exports and heritage protection could not be automatically declined if it did not meet this new factor. While Ministers can issue directions about the relative importance of the various factors, declining an investment based only on one factor would create a judicial review risk.
- **The factor is drafted to consider positive effects, rather than directly considering detriments.** The substantial harm test considered whether the investment would 'harm' New Zealand. However to 'fit' with the benefit test, the factor considers how the investment will benefit New Zealand. The substantial harm test placed the burden of proof to show harm on Ministers. The economic benefit factor places the burden on the investor, which will mean more work on their part.
- **The factor no longer refers to threats to essential security interests, threats to public health and public order.** Serious threats such as terrorism and proliferation of nuclear weapons should be pass/fail issues in their own right rather than being traded-off against other benefits the investment may bring. As such it is not appropriate to include them in the benefit test.

Do the factors provide certainty for investors?

15. We think introducing these factors in isolation is likely to reduce certainty for investors, at least in the short term. We expect the first question investors will ask about the 'economic benefits' factor is what New Zealand's economic interests are, given that these are undefined. In part this is because it is very hard to define with any precision and also because the factor is deliberately wide ranging to provide Ministers with future flexibility. The wording is probably no more certain than the current strategic assets factor in terms of what it could be applied to. Likewise, it will be unclear to investors when the Government might consider the 'mitigating factors' to be relevant. However both of these concerns can be mitigated to some extent by providing more detailed guidance in a government policy statement (discussed in the next section).

Overall impact

16. It is difficult to judge the effect these factors would have on a particular investment. A lot will depend on whether the investment creates other benefits and how these are weighed against how investment contributes (or not) to the new factor. Such benefits are weighed up on a case by case basis and depend on the specific investment.
17. The table below outlines the number of concerns about foreign investment which are currently being publicly debated and assesses how the possible changes could address them. These concerns largely focus on the current debate around farmland. We have previously reported to you about whether we think these concerns are valid.

Concern	How addressed
Farmland aggregation by individual foreign investors	<ul style="list-style-type: none"> • Could be considered as part of the assessment of whether economic interests will be safeguarded.
Foreigners as a group owning a large portion of New Zealand's farmland	<ul style="list-style-type: none"> • Partially addressed by introducing 'mitigating factors' – <i>[withheld - maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]</i>
Lack of transparency of how some investors operate	<ul style="list-style-type: none"> • Partially addressed by introducing 'mitigating factors' – <i>[withheld - maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]</i>
Foreign ownership of 'strategic assets'	<ul style="list-style-type: none"> • Could be considered as part of the assessment of whether economic interests and infrastructure will be safeguarded or promoted.
Foreign government investors with non-commercial motivations	<ul style="list-style-type: none"> • Could be considered as part of the assessment of whether economic interests will be safeguarded. • Also addressed if 'mitigating factors' allow for a degree of New Zealand control and oversight.
Vertically integrated foreign-owned firms	<ul style="list-style-type: none"> • Could be considered as part of the assessment of whether economic interests and infrastructure will be safeguarded or promoted • Also addressed if 'mitigating factors' allow for a degree of New Zealand control and oversight.

Options to improve investor confidence

18. To avoid deterring investment it is important that investors have a degree of certainty about government policy towards foreign investment, regardless of whether these policies are open or restrictive.

Issuing a statement on foreign investment

Statement content

19. To provide greater clarity, the government could set out its position on foreign investment in a public statement. This approach would be similar to what occurs in Australia (discussed further in Annex 1). The statement could cover issues such as:
 - a. The Government's general attitude towards foreign investment in sensitive assets.
 - b. Any specific areas or types of investment that the Government wishes to encourage.
 - c. Any specific areas or types of investment where the Government is likely to apply greater scrutiny to foreign investment.
 - d. Ways in which investors could structure their investments to mitigate any relevant concerns.
 - e. Advice to the Overseas Investment Office (OIO) about which factors in the benefit test are likely to be more or less important for particular types of investments.
20. Subject to your views we will develop the statement further for consideration by Cabinet.

Issuance mechanism

21. The statement could be made through the existing directive letter that Ministers may issue from time to time to the OIO. Alternatively the Government could issue a separate stand-alone policy statement. We recommend using the directive letter because is the only way in which the OIO can be directed about the relative importance of factors in relation to particular assets or investments.

Other considerations

Use of the regulation-making power

22. Amending the benefit test by regulation poses a number of risks. The first risk is how the change will be perceived by investors. The last time a new factor was added to the benefit test there was significant concern amongst investors about changes to the regime affecting an application that was already being assessed. The situation is somewhat different this time as the factor does not target a specific investment. However, we still expect that the changes will be perceived as a tightening of our screening regime.
23. A further risk is how any new regulation will be viewed by the Regulations Review Committee. The Committee has previously recommended that this regulation-making power be removed or significantly curtailed and it had a number of concerns about its use in relation to strategic assets.
24. *[withheld - maintain professional legal privilege]*
25. *[withheld - maintain professional legal privilege]*
26. *[withheld - maintain professional legal privilege]*

Impact on the Overseas Investment Office

27. Introducing new factors to the benefit test will add to the workload for the OIO and will increase the time required to assess an application. The actual impact will depend on the final design of any new factors and how well the Government can specify which investments they are relevant to. We recommend that that OIO assess the impact on application times six months after any changes to the benefit test are implemented, and consider whether more resources are required (which would need to be supported by a fee increase).
28. If some of the new factors create avoidance risks, further consideration will also need to be given to the amount of monitoring and enforcement resources available to the OIO.

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

Timing and publicity

30. We understand you wish to seek Cabinet agreement to the policy decisions by the end of September. The table below outlines a summary timeline that meets this objective. While you will be able to make announcements at the end of September, any changes will not come into force until later in the year to allow time for drafting and the application of the 28 day rule.

Week beginning	Key tasks
30 August	Treasury drafting RIS and Cabinet paper drafting and send for consultation
6 September	Consultation with government agencies and the Technical Reference Group
13 September	Papers submitted to the Minister of Finance Ministerial consultation Submission to Cabinet Office
20 September	Seek Power to Act for EGI at Cabinet Seek policy agreement at EGI on 22 September <i>[Withheld - maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]</i> Public announcement
27 September	PCO drafting
4 October	PCO drafting
11 October	PCO drafting
18 October	PCO drafting
25 October	LEG
1 November	Cabinet and Executive Council. Regulation comes into force 28 days later.

31. There is likely to be a high level of public and investor interest in these changes to the screening regime. It will be important that the changes are well explained so that their intent is understood.

Consultation

32. We have started to consult with key departments (MFAT, MAF, MED and the OIO) on these policy proposals and will consult with a wider range of agencies as we develop the Cabinet paper and Regulatory Impact Statement.
33. We also seek your agreement to consult with the Technical Reference Group on the proposals. The Group has provided useful input in earlier stages of the review and we think it is important to seek their views about how the proposals will work in practice and impact on investors. An alternative would be to just inform the Group of the changes.

Annex 1: Australia's approach to foreign investment screening

Australia's approach to foreign investment screening differs from New Zealand's in that it has a general national interest test, but does not list specific criteria and factors that are used to assess investments. Instead Australia has released a policy statement that outlines a non-exhaustive list of issues considered when assessing an investment.

The table below briefly outlines the Australian considerations and the full policy statement is attached to this report, with the most relevant information on pages 1 and 6-7.

Australian considerations	Comment
Ability to protect strategic and security interests	Not assessed in the New Zealand screening regime, but general anti-terrorism laws etc likely to apply. Likely to require legislation to implement in New Zealand.
Extent to which an investor will control the global supply of a product or service	Likely to reflect the importance of mining in the Australian economy and a desire to avoid concentration of market power. Not considered in New Zealand but may be possible to introduce in the benefit test with regulation.
Impact on tax revenues and the environment	New Zealand considers environmental concerns in the benefit test. Tax revenue impacts are not explicitly considered.
Level of Australian participation in the investment	Not currently considered under the screening regime, but the 'mitigating factors' could assess this in New Zealand.
Ensuring Australia remains a reliable supplier to all customers in the future	Likely to reflect the importance of mining and a desire to avoid a certain supplier being favoured over others. Not considered in New Zealand but may be possible to introduce in the benefit test with regulation.
Nature of the investor: <ul style="list-style-type: none"> • extent to which investor operates on a transparent commercial basis; • how the investor plans to exercise their voting power; • whether the investor is pursuing political objectives. 	Not directly assessed in the New Zealand regime, character test may indirectly consider some of these issues. The 'mitigating factors' could partially assess these issues in New Zealand.
For investments by governments, Australia lists a number of mitigating factors that may assist in overcoming national interest concerns: <ul style="list-style-type: none"> • existence of external partners or shareholders and their size and nature; • level of non-associated ownership interests; • governance arrangements; • arrangements to protect Australia from non-commercial dealings; and • whether the target will be listed on the Australian Securities Exchange or another recognised exchange. 	The New Zealand screening regime does not differentiate between investments from foreign governments and private investors. To do so would require legislation.