

Treasury Report: Response to Questions on Overseas Investment Review Options

Date:	3 March 2010	Report No:	T2010/318
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Action Sought

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Minister of Finance (Hon Bill English)	Indicate whether you want to include changes to the definition of an overseas person and strategic assets in the OIA review proposals	9 March 2010

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
[withheld – privacy]	Analyst, International	[withheld – privacy]	[withheld – privacy]	✓
Colin Hall	Manager, International	[withheld – privacy]	[withheld – privacy]	

Minister of Finance's Office Actions (if required)

Relate this report to T2010/295. The Minister should consider both at the same time.

Enclosure: No

Treasury Report: Response to Questions on Overseas Investment Review Options

Purpose of Report

1. This report responds to questions you have asked in response to our report outlining a revised package of options for the overseas investment review (T2010/295 refers).

Analysis

Would the proposed exemption for portfolio investors cover investors who have previously passed the good character test?

2. No. The portfolio investor exemption would be targeted at investments from portfolio investment entities (PIEs) with New Zealand beneficiaries. The aim of this exemption is to avoid screening investments from PIEs that have overseas controlled managers or trustees, but where at least 75% of the beneficiaries are New Zealanders. Given that the investment is being made for the benefit of New Zealanders, we do not see a strong case for screening.

Could exemptions be granted for investors who are entitled to reside in New Zealand but live outside of New Zealand for more than 6 months?

3. Legislation would be required to create such a change. Investors in this situation are screened because they do not meet the 'ordinarily resident' requirement in the Act. That is, although they hold a residence permit or visa, they do not reside in New Zealand for at least 6 months of the year. A change to this 'ordinarily resident' definition in the Act would be required to exempt such investors. The OIO has advised that there is likely to be only one to two investors in this situation.
4. The first Cabinet paper on the review proposed such a change to the Act but it was rejected by the Economic Growth and Infrastructure Committee. *[Withheld - maintain the current constitutional conventions protecting collective and individual ministerial responsibility]*.

Does Treasury have any ideas to solve the strategic assets problem?

5. We consider it would be desirable to remove the potential for uncertainty over how the strategic asset test will be applied in future. However, any change to the status quo would require the repeal of the current regulation and potentially significant legislative change if it is to be replaced. The main trade-off in designing a replacement is between regulatory certainty for investors and policy flexibility for Ministers in future. Broadly we think your options are:
 - **Repeal the current strategic assets regulation without replacing it.** We have previously suggested that specific restrictions on strategic assets are not required (T2008/1382 refers). The reasons are that there are already restrictions in place in a number of areas (Telecom, Air NZ, SOEs, banks), the difficulty of defining what strategic assets are, and that the existing screening regime already provides protection. *[Withheld - maintain the current constitutional conventions protecting collective and individual ministerial responsibility]*.

- **Repeal the current regulation and replace it with a substantial harm test.**
We consider a viable replacement would be the 'substantial harm test' developed earlier in the review process (T2008/2323 refers). The test would be in line with national security measures used by other countries such as the United States and is based on OECD guidance on such measures. The test would add the following new factor to the business and sensitive land tests: *"In the Minister's view, the investment will not, or is not likely to, result in substantial harm to New Zealand by threatening public order, public health and safety, or essential security interests"*. The terms in the test would be defined in legislation. Essential security interests would include *actions that would threaten economic capacity that is critical for New Zealand's economic well-being*.
 - **Define strategic assets.** A further option would be to create more certainty for investors by providing some sort of definition of strategic assets. This could take the form of either a narrow list of particular assets or a broad list of criteria that are likely to make a particular asset 'strategic'. T2009/1382 contains more detail on this option. We recommend against this option because broad criteria are unlikely to provide much additional certainty for investors and a specific list could have a significant impact on the valuation of any firms/assets included on the list.
6. In short we think the substantial harm test is the best alternative if some form of strategic asset or reserve power is desired. Its high hurdle for use provides greater certainty for investors, it is based on international practice and it does not have to be considered in each land investment application like the current regulation.

Recommended Action

We recommend that you:

- a **indicate** if you want to include a change to the definition of an overseas person with the review proposals being developed for Cabinet; and
- Yes/No
- b **indicate** if you want to include a substantial harm test as a replacement for the current strategic assets test with the review proposals being developed for Cabinet.
- Yes/No

Colin Hall
Manager - International
for Secretary to the Treasury

Hon Bill English
Minister of Finance