

The Treasury

Venture Capital Fund Bill: Policy Approval and Approval for Introduction Information Release

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Office of the Minister of Finance

Office of the Minister for Economic Development

Chair, Cabinet Economic Development Committee

VENTURE CAPITAL FUND BILL

Proposal

1. This paper seeks the Cabinet Economic Development Committee's agreement to the detailed policy decisions behind the Venture Capital Fund Bill and agreement to introduce this Bill. This Bill establishes a Venture Capital Fund and provides for the Guardians of New Zealand Superannuation (the Guardians) to manage and administer the Fund.
2. This Bill proposes amendments to the New Zealand Superannuation and Retirement Income Act 2001 (NZSRI Act) and the creation of a new Venture Capital Fund Act.

Executive Summary

3. There is currently a venture capital gap experienced by New Zealand firms and this is leading to firms either being constrained in their growth or having to seek foreign investment.
4. The purpose of the Bill is to establish a Venture Capital Fund to fill this venture capital gap in New Zealand.
5. The Bill amends the NZSRI Act to enable the Guardians to take on the new role of managing and administering the Venture Capital Fund, in addition to their role in managing and administering the New Zealand Superannuation Fund (NZ Super Fund). The Bill makes no changes to the functioning of New Zealand Superannuation or the Guardian's role in managing the NZ Super Fund.
6. The Bill will bring into force a new Venture Capital Fund Act. This Act will require the Guardians to invest the Venture Capital Fund in accordance with best practice investment management that is appropriate for institutional investment in those markets, subject to the requirement to comply with any directions in a policy statement issued by Ministers.
7. The policy statement allows the Minister of Finance to establish certain policy settings, and define key terms, where it is not appropriate for these to be fixed in legislation (such as the amount of private capital that has to be invested alongside the Crown's investment).

8. The best outcome will be achieved by having the Guardians initially draw on the existing capability and experience of New Zealand Venture Investment Finance Limited (NZVIF). NZVIF will be the delivery agency, investing the Venture Capital Fund via a “fund of funds” model, while the Guardians will provide oversight, monitoring, and ultimately be accountable for the Venture Capital Fund. To ensure this, the Bill requires that the Guardians and NZVIF make reasonable efforts to reach an agreement for investing the Venture Capital Fund. If no agreement can be reached, the Minister of Finance may specify a contract or other arrangement that will be binding on the Guardians and NZVIF.
9. The Minister of Finance can direct the Guardians to wind up the Venture Capital Fund if the Minister is satisfied that adequate venture capital is available to New Zealand entities to enable them to grow into successful and sustainable businesses.

Background

10. Well-functioning early stage capital markets are required to support investment in new internationally competitive firms and capabilities. This will support New Zealand to shift to a more productive, sustainable and inclusive economy.
11. Prior government interventions have had limited success to date in developing a well-functioning early stage domestic venture capital industry, particularly in the Series A and B funding stages.
12. Many early stage high-growth companies continue to struggle to access the capital they need to develop to their potential. This leads them to being either constrained in their growth or having to seek foreign investment to overcome this funding gap, and may require start-ups to sell down prematurely or move abroad. This may also result in the shareholder value of any success accruing to offshore investors, rather than being recycled back to domestic investors and the domestic venture capital ecosystem. This limits the economic benefits to New Zealand from its Research & Development and science investments.

Policy

13. Cabinet Economic Development Committee (DEV) on 3 April 2019 [DEV-19-MIN-0063 refers]:

*“agreed to use \$240 million (being 3 percent) of the \$7.7 billion earmarked for the New Zealand Superannuation Fund between 2018 and 2022 (with the \$240 million being 0.6 percent of the total \$40 billion funds under management), together with \$60 million from New Zealand Venture Investment Fund Limited’s available assets, to make \$300 million available for new government investment into venture capital funds (the preferred option)”;*and

“agreed to amend the New Zealand Superannuation and Retirement Act 2001 to enable a ‘New Fund’ (separate to the New Zealand Superannuation Fund) to be set

up and allow the Guardians of New Zealand Superannuation to administer this new fund”; and

“agreed that \$240 million be transferred to the ‘New Fund’ to be administered by the Guardians, and that it invests in venture capital via New Zealand Venture Investment Fund Limited’s fund of Funds”; and

“noted that ongoing funding of the Seed Co-investment Fund (currently at \$8 million per annum less any returns) is also required”;

14. This decision was in response to DEV agreeing on 12 December 2018 that the government needs to deepen early stage capital markets and address the venture capital gap experienced by New Zealand firms [DEV-18-MIN-0316 refers].
15. A Bill is required, as under the NZSRI Act the Guardians have no authority to administer and manage a Venture Capital Fund.
16. The Bill will be divided into the following two separate Bills at the committee of the whole House stage:
 - a New Zealand Superannuation and Retirement Income Amendment Bill.
 - a Venture Capital Fund Bill.

Amendments to the New Zealand Superannuation and Retirement Income Act 2001

17. The NZSRI Act needs to be amended to enable the Guardians to take on the new role of managing and administering the Venture Capital Fund, in addition to their role in managing and administering the NZ Super Fund.
18. Making amendments to the NZSRI Act can be contentious. However, this is reduced in this case as the amendments make no changes to:
 - the functioning of New Zealand Superannuation
 - the NZ Super Fund, or
 - the Guardians’ role and responsibilities in managing and administering the NZ Super Fund.

Venture Capital Fund Bill

19. Rather than simply amending the NZSRI Act to include clauses to establish the Venture Capital Fund, we decided it was more appropriate to bring into force a new Act for this specific purpose. The NZ Super Fund and the Venture Capital Fund are separate funds and this ensures the purpose of the NZSRI Act remains focused on New Zealand Superannuation and changes to the NZSRI Act are minimised.
20. However, we decided, where appropriate, to base the new Bill on those parts of the NZSRI Act used to establish the NZ Super Fund. Namely, the Bill establishes the

Venture Capital Fund as a Crown-owned fund that is managed and administered by the Guardians, for a clear purpose, within a particular investment mandate. There are however, differences between the Venture Capital Fund and NZ Super Fund legislation. This reflects the different policy objectives to develop a venture capital market which is relatively immature, without significant opportunity to diversify investments and with significant uncertainty as to returns.

21. The Bill establishes that the purpose of the Venture Capital Fund is to:

- increase the venture capital available to New Zealand entities; and
- develop New Zealand's venture capital markets to function more effectively so that over time:
 - more venture capital is available to New Zealand entities from sources other than the Venture Capital Fund, and
 - New Zealand entities that receive venture capital are more likely to grow into successful and sustainable businesses.

22. The Bill contemplates that there will be a policy statement issued by the Minister of Finance to the Guardians in respect of the Venture Capital Fund, and that (at least initially) there will be a contract between the Guardians and NZVIF for the management of the Venture Capital Fund. In brief, the way these work together is set out below:

- The Bill enables and defines the boundaries of the policy goal, sets out the governance structure and institutional arrangements, and fixes terms that are not expected to change. For example, the Bill establishes that the Guardians are generally required to invest the Venture Capital Fund in accordance with best practice investment management that is appropriate for institutional investment in those markets. This is subject to the requirement to comply with any directions given in the policy statement.
- The policy statement allows the Minister of Finance to establish certain policy settings, and define key terms where it is not appropriate for these to be fixed in legislation. The policy statement is intended to be generally enduring but can also provide flexibility where required (for example, where amendments are required to achieve desired market outcomes based on lessons learned in early investments).
- The contract/arrangement with NZVIF is the mechanism under which the Venture Capital Fund is expected to be managed day-to-day. The Guardians are expected to execute any necessary due diligence, and monitor NZVIF's (or any equivalent counterparty's) performance, in accordance with their best practice obligations. The contract will also need to be consistent with the Bill generally and any directions in the policy statement.

23. More detail on the policy statement and the contract with NZVIF is set out below.

Policy Statement

24. One of the key features of the Venture Capital Fund Bill is the ability for Ministers to issue (and, if necessary, amend) a policy statement. As noted above, the policy statement will establish certain key policy settings and define key terms where it is not appropriate to do this in legislation.
25. The Bill provides that:
 - the policy statement **must** include certain terms which the Guardians must **give effect to** (such as what must be considered to be venture capital);
 - the policy statement **may** include certain terms which the Guardians must **have regard to** (such as the Government's expectations as to the time period within which capital must be made available); and
 - the policy statement can include other terms (such as directions on an overarching model for investing the Venture Capital Fund), but only if the Guardians agree (such as directions on an overarching model for investing the Venture Capital Fund). This provides flexibility, while providing certainty to the Guardians and the market that the commercial arrangements of the contract will remain in line with best practice investment management.
26. In addition, the Guardians must be consulted on the policy statement before it is issued. The effect of the above is that the Guardians will have a reasonable degree of certainty as to what the policy statement will contain, and will also have an opportunity to comment on how the proposed directions will affect them and the wider market.
27. The NZSRI Act deliberately gives the Minister of Finance limited powers to influence how the NZ Super Fund is invested. However, in the case of the Venture Capital Fund it is desirable to retain a greater ability to react to the policy environment in the future. Being too prescriptive in legislation would make implementation difficult, limit flexibility and impact outcomes, given the immature state of the venture capital market and the unknowns associated with the market development purpose of the Venture Capital Fund.
28. Any changes to the policy statement will only be able to be applied to future commitments of the Venture Capital Fund. It is therefore important that a well-developed policy statement be put in place shortly after the Bill passes. We expect that the initial policy statement will be enduring, but if we find the policy objectives are not being achieved we do have some flexibility to make changes.
29. Officials have started work on the initial policy statement, and will be guided by feedback from the Guardians, NZVIF, and other stakeholders.

Requirement for the Guardians to use NZVIF

30. We believe the best outcome will be achieved by having the Guardians initially draw on the existing capability and experience of NZVIF. NZVIF will be the delivery agency while the Guardians will provide oversight, monitoring, and ultimately be accountable for the Venture Capital Fund.
31. To ensure this, the Bill requires that within two months of the policy statement being issued, the Guardians and NZVIF make reasonable efforts to reach an agreement for investing the Venture Capital Fund. The Minister of Finance will also have an option to extend the deadline for up to two months. In reality, the due diligence processes that support the agreement are running concurrently to the legislative process, to ensure timely progress.
32. If no agreement can be reached, the Minister of Finance may specify a contract or other arrangement that will be binding on the Guardians and NZVIF. The parties will still have the right to cancel or amend the agreement in accordance with the terms of the agreement (which we expect to reflect normal commercial practice).
33. The bringing together of parties into an agreement in this way is unusual. However, the Guardians and NZVIF are both Crown entities and the intention is to harness the Crown's best investment managers and the Crown's best expertise in venture capital markets.

Amendments to other Acts

34. The Venture Capital Fund Act also amends:
 - the Income Tax Act 2007 so that the Venture Capital Fund will have the same tax treatment as the NZ Super Fund (The Venture Capital Fund will be taxable, but taxed as if it was a Portfolio Investment Entity (PIE)); and
 - the Crown Entities Act 2004, to remove the exemption that NZVIF currently has from section 165 of the Crown Entities Act 2004 "Net surplus payable by certain statutory entities and Crown entity companies". Removing this exemption will enable Ministers to require NZVIF to return \$60 million of NZVIF funds that Cabinet agreed would be available for venture capital funds if Ministers agree these funds are required to be paid into the Venture Capital Fund. Officials will provide advice on the split of capital to best support both the Seed Co-investment Fund and the new Venture Fund as part of an eco-system of early stage investments.

Authorise Ministers to make any minor or technical changes

35. We are requesting Cabinet authorise us to make decisions on any minor or technical changes required to the submitted Bill prior to its introduction. In particular, officials are looking at the potential to tighten the drafting contained in schedule one of the Bill

so that there is absolutely no ambiguity around the obligations the Guardians have even though they are being required to use NZVIF and a funds of fund model.

Impact analysis

- 36.** A formal Regulatory Impact Assessment was not carried out at the time that Cabinet agreed to this policy, but Ministers considered both written advice and oral advice (including discussions with key industry stakeholders) on the advantages and disadvantages of the different options to deepen our early stage capital markets.

Regulatory Quality Team's Comment

- 37.** Cabinet's regulatory impact analysis requirements apply. Normally the regulatory impact assessment carried out for the original decision would have been updated to inform the more detailed decisions taken in this paper.
- 38.** However, a regulatory impact assessment was not completed for the original paper, and so has not been updated. The lack of a regulatory impact assessment triggers Cabinet requirements for supplementary analysis. Following advice from officials, Ministers have agreed that, in addition to the post-implementation review already planned, the supplementary analysis take the form of proactive release of the Cabinet papers and proactive release of analysis currently held by agencies. The release of this material will help inform Parliamentary and public consideration of the Bill. The material will be released on the Ministry of Business, Innovation and Employment's website.

Compliance

- 39.** The Venture Capital Fund Bill complies with:

- the principles of the Treaty of Waitangi;
- the disclosure statement requirements (a disclosure statement has been prepared for the Bill and is attached to this paper);
- the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;
- the principles and guidelines set out in the Privacy Act 1993;
- relevant international standards and obligations; and
- the LDAC Guidelines on the Process and Content of Legislation.

Consultation

- 40.** The Ministry of Business, Innovation and Employment and the Treasury were involved in preparing this paper. The Inland Revenue Department was consulted.

41. The Office of the Auditor General, the Office of the Ombudsmen, the Inland Revenue Department and the Ministry of Foreign Affairs and Trade were consulted on specific aspects of the draft Bill.
42. The Guardians and NZVIF were consulted on the development of the draft Bill.

Binding on the Crown

43. The Bill establishes a Venture Capital Fund that will be the property of the Crown. The Bill requires that the Guardians invest the Venture Capital Fund in compliance with best practice management and policy directions from the Minister. On commencement of the Bill the Guardians and NZVIF (a Crown-owned company) will be required to make reasonable efforts to enter into an arrangement for NZVIF to invest the whole of the Venture Capital Fund using a “fund of funds” model. These arrangements and obligations are binding on the Crown, although the Bill does not expressly say so.

Allocation of decision making powers

44. The Bill does not affect the allocation of decision making powers between the executive, the courts, and tribunals.

Associated regulations

45. Regulations will not be required to give effect to the provision of the Bill. However, Ministers are required to issue a policy statement within one month of the Bill coming into force. The policy statement will be consulted on before it is issued.

Other instruments

46. The Bill does not include any provision empowering the making of other instruments that are deemed to be legislative instruments or disallowable instruments.

Definition of Minister/department

47. The Bill contains a definition of Minister (being the Minister of Finance). The Cabinet Office is comfortable that it can work out the administrative details well before the Bill is passed.

Commencement of legislation

48. The Bill will come into force on the day after the date of Royal Assent.

Parliamentary stages

49. We note that this Bill has arisen during the course of the year and so has not yet been formally included on the 2019 Legislative Programme. It is important that the Bill be passed as soon as is practicable, because until that happens, the Venture Capital Fund cannot be deployed to close the “venture capital gap” in New Zealand’s markets.

On this basis we propose that this Bill be included in the 2019 Legislative Programme with a priority 3 (to be passed by the end of 2019 if possible). The Bill should be introduced in September 2019, and enacted, if possible, by December 2019.

50. We propose that the Bill be referred to the Finance and Expenditure Committee.

Proactive Release

51. We are planning to proactively release the two background policy Cabinet papers, this paper, and a range of advice that officials presented to me in the preparation of these papers.

Recommendations

52. The Minister of Finance and the Minister of Economic Development recommends that the Committee:

1. **approve** the inclusion of the Venture Capital Fund Bill in the 2019 Legislation Programme with a priority of 3 (to be passed within 2019 if possible);
2. **agree** that the Bill will establish a Crown owned Venture Capital Fund managed and administered by the Guardians;
3. **note** that the Venture Capital Fund will be established by bringing into force a Venture Capital Fund Act and by amending a range of other relevant legislation;
4. **agree** that the purpose of the Venture Capital Fund is to increase the venture capital available to New Zealand entities and develop New Zealand's venture capital markets to function more effectively so that over time:
 - more venture capital is available to New Zealand entities from sources other than the Venture Capital Fund, and
 - New Zealand entities that receive venture capital are more likely to grow into successful and sustainable businesses.
5. **agree** that the Minister of Finance can issue a policy statement (following consultation with the Guardians) that establishes certain key policy settings and definitions of key terms;
6. **agree** that the Guardians will have an obligation to invest the Venture Capital Fund in accordance with best practice investment management that is appropriate for institutional investment in New Zealand's venture capital markets, but this obligation is subject to the directions that the Guardians must give effect to in the policy statement;
7. **agree** that the Guardians and NZVIF will be required to make reasonable efforts to enter into an initial arrangement for the management of the Venture Capital

Fund, and that if they are unable to reach agreement, the Minister of Finance can specify a contract or other arrangement that will be binding on both of them;

8. **note** that any contract above must be consistent with the obligations of the Guardians, including in respect of the policy statement;
9. **note** that the Bill does not prevent the parties from terminating the contract even if the Minister of Finance imposes it on them;
10. **agree** that the Minister of Finance can direct the Guardians to wind up the Venture Capital Fund if the Minister is satisfied that adequate venture capital is available to New Zealand entities to enable them to grow into successful and sustainable businesses;
11. **agree** that the Venture Capital Fund will have the same tax treatment as the New Zealand Superannuation Fund;
12. **agree** to remove the exemption that the New Zealand Venture Investment Fund currently has from section 165 of the Crown Entities Act 2004;
13. **approve** the Venture Capital Fund Bill for introduction, subject to the final approval of the Government caucus and sufficient support in the House of Representatives;
14. **authorise** the Minister of Finance and the Minister for Economic Development to make decisions on any minor or technical changes required to the submitted Bill prior to its introduction;
15. **agree** that the Bill be introduced on 9 September 2019;
16. **agree** that the Government propose that the Bill be:
 - 16.1. **referred** to the Finance and Expenditure Committee for consideration; and

[33]

Authorised for lodgement

Hon Grant Robertson
Minister of Finance

Hon Phil Twyford
Minister for Economic Development