

The Treasury

Reform of the Overseas Investment Act Information Release

July 2020

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Key to sections of the Act under which information has been withheld:

- [1] 6(a) - to avoid prejudice to the security or defence of New Zealand or the international relations of the government
- [2] 6(b)(i) - to avoid prejudice the entrusting of information to the Government of New Zealand on a basis of confidence by the Government of any other country or any agency of such a Government
- [4] 6(c) - to avoid prejudice to the maintenance of the law, including the prevention, investigation, and detection of offences, and the right to a fair trial
- [23] 9(2)(a) - to protect the privacy of natural persons, including deceased people
- [29] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand
- [31] 9(2)(f)(ii) - to maintain the current constitutional conventions protecting collective and individual ministerial responsibility
- [33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials
- [34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions
- [36] 9(2)(h) - to maintain legal professional privilege
- [37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice
- [39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

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Treasury Report: Overseas Investment Act Reform Phase Two - draft Cabinet Paper

Date:	23 September 2019	Report No:	T2019/2834
		File Number:	IM-5-3-8 (Overseas Investment Act Phase Two)

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson)	Note the contents of this report	N/A
Associate Minister of Finance (Hon David Parker)	<p>Read and provide feedback on the attached Cabinet paper</p> <p>Note a revised Cabinet paper will be provided to you ahead of ministerial consultation</p> <p>Agree to the recommendations in this report</p> <p>Discuss the process for seeking Crown funding with the Minister of Finance</p>	25 September 2019

Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Jessica Burns	Senior Analyst, International	[39]	N/A (mob)
Megan Noyce	Principal Advisor, International	[39]	N/A (mob) ✓

Minister's Office actions (if required)

Return the signed report to Treasury.

Refer the Associate Minister of Finance (Hon. David Clark), the Minister for Land Information, and the Minister of Fisheries.

Note any feedback on the quality of the report

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Enclosure: Yes (attached)

Treasury Report: Overseas Investment Act Reform Phase Two - draft Cabinet Paper

Executive Summary

This report attaches a draft Cabinet paper, for your feedback, seeking approval for the second phase of reform to the Overseas Investment Act 2005 (the Act). The package of reform presented in the Cabinet paper aims to improve the Government's ability to manage investment in our most sensitive and high risk assets, and cut unnecessary red tape (particularly simplifying the decision-making process and removing transactions from the regime where screening does not substantially improve the Government's ability to manage risk).

We will provide a revised Cabinet paper to you ahead of ministerial consultation, following your feedback on the paper and decisions on the financial implications of the package.

[1]

Outstanding policy issues

The Cabinet paper reflects the policy decisions you have made to date. This report also seeks your decisions on outstanding policy issues. The draft Cabinet paper reflects our recommended approach. Should you disagree with our recommendations on these issues we will update the revised Cabinet paper accordingly.

The outstanding policy issues relate to:

- a A proposed class exemption for Residential Mortgage Obligation (RMO) trades (a new type of residential mortgage backed security developed by the Reserve Bank New Zealand);
- b Detailed policy design relating to enforcement, the investor test, farm land and rural land;
- c Additional advice on decisions you have made, including clarifications of the scope of the call-in power, technical changes to the definition of overseas person, further information on national interest test and investments in significant business assets, and further information relating to judicial review; and
- d Consequential amendments to other legislation (the Anti-Money Laundering and Countering of Financing Terrorism Act 2009, and the Fisheries Act 1996).

Financial implications of Phase Two

This report also provides an overview of the financial implications of the Phase Two package. The primary agency impacted by the reform is the Overseas Investment Office unit within Land Information New Zealand. There will also be costs for security [33]

The estimates will need further refinement following Cabinet decisions. This is due to the short amount of time available to undertake the costings work, the uncertainty around assumptions (particularly for the call in power and national interest test), and uncertainty regarding calibration of statutory timeframes.

The overall cost to the Crown will depend on whether costs are recovered, fully or partially, through fees charged to applicants. These costs will be assessed as part of a fees review to be undertaken by Land Information New Zealand in early 2020. We recommend that the Cabinet paper seeks agreement to delegate a group of joint Ministers to take future decisions on fees, and financial matters associated with the reform. We recommend that this group include yourself, the Minister of Finance, Minister of Land Information, and the Minister responsible for the Government Communications and Security Bureau and New Zealand Security Intelligence Services.

We recommend that you discuss the process for seeking funding with the Minister of Finance before finalising the Cabinet paper. The Treasury's preferred option is to seek an out-of-cycle funding request either through drawing down on the between-Budget contingency and/or a pre-commitment against Budget 2020. The process to seek funding may impact on the timing or nature of policy announcements on the reforms, following Cabinet decisions.

We have copied this advice to the Minister of Finance for his information and future discussion, as proposals are finalised for Cabinet consideration.

Recommended Action

We recommend that you:

- a **read and provide feedback** on the attached draft Cabinet paper;
- b **note** the draft Cabinet paper reflects our recommended approach to outstanding policy matters (detailed below);
- c **note** we will provide you with a revised paper, ahead of ministerial consultation, reflecting your feedback;

[1]

Class exemption for Residential Mortgage Obligation (RMO) trades

- e **note** that the Reserve Bank of New Zealand has developed a new type of residential mortgage backed security, a Residential Mortgage Obligation (RMO), which is designed to improve banks' and non-bank deposit takers' (NBDTs) liquidity – both in ordinary times and during periods of market turbulence;
- f **note** that the Overseas Investment Act 2005 (the Act) may serve as a barrier to the adoption of RMOs because the transfer of loans between the originator (a bank or NBDT) and a trustee will often be worth more than \$100 million and therefore a 'significant business asset' under the Act that overseas persons must obtain consent to purchase;
- g **agree** to include a recommendation in the Cabinet paper to amend the Act to ensure that transactions involving the purchase of permitted security arrangements can be exempted from the Act's consent requirements where:
 - a. the transaction is necessary to support the issuance or management of RMOs that meet RBNZ standard terms and conditions in place at the time for RMOs;
 - b. the transaction is between:
 - i. the loan originator, either

1. a registered bank under the Reserve Bank of New Zealand Act 1989; or
 2. a licensed NBDT under the Non-bank Deposit Takers Act 2013; and
- ii. a person licensed as a supervisor in respect of debt securities under the Financial Markets Supervisors Act 2011 (the trustee); and
- c. the transaction is entered into in good faith and in the ordinary course of business with no intention of using one or more of the permitted security arrangements to make an overseas investment in sensitive land or an overseas investment in fishing quota without consent.

Agree/disagree.

Enforcement: design of the new power to accept undertakings

- h **note** in T2019/2405 you agreed that the Overseas Investment Office should be empowered to accept undertakings;
- i **agree** that the a broad range of undertakings may be accepted, undertakings may include an admission of guilt, and that the OIO be required to publish decisions to accept undertakings;

Agree/disagree.

- j **agree** the penalties and remedies available for a breach of an undertaking should:
 - a. include a pecuniary penalty of \$50,000 against an individual, or of \$300,000 against a corporate or any other party;
 - b. enable the regulator to apply to the Court for a variety of orders including seeking compliance with the terms of the undertaking, discharge of the undertaking, recovery of costs associated with the proceedings to enforce the undertaking and/or costs associated with future monitoring of compliance with the undertaking;

Agree/disagree.

Investor test: determining the threshold for offences and contraventions of the law

- k **note** in T2019/1649 you agreed to a new, narrowed and simplified investor test which is more appropriately calibrated to the low level or risk posed by the majority of overseas investors. However, you sought further advice on the thresholds to be used when considering an investor's offences and contraventions of the law;
- l **agree** that, for offences and contraventions of the law, decision-makers consider whether the investor:
 - a. has been convicted of an offence for which they have been sentenced to imprisonment for a term of five years or more; or, any time in the preceding ten years, has been convicted of an offence for which they have been sentenced to imprisonment for a term of twelve months or more; and
 - b. has had any civil contraventions punishable by pecuniary penalties or enforceable undertakings within the last ten years;

Enshrining the rural land directive

- m **note** that you asked whether the Act should apply a narrower benefits test to the types of sensitive land in Schedule 1 of the Act that are not farm land;
- n **agree** that the simplified version of the existing benefits test (as agreed in TR2019/2426) should apply to the types of land described in recommendation (l) above, as a narrowed test would risk making it more difficult for high-quality investments to satisfy the test;

Agree/disagree.

- o **note** the elevated investment threshold for farm land would not apply to farm land being converted to forestry if the application has been made under the special forestry test. This would continue the existing approach to forestry conversions, and there will be an opportunity to review the outcomes of this approach through the upcoming review of the Act's forestry provisions;
- p **agree** that in light of your decisions to enshrine the rural land directive, not to progress reforms regarding exemptions for farm land advertising;

Agree/disagree.

Call in power

- q **note** that in T2019/1394 officials omitted some text from the proposed definition of critical direct suppliers to defence and security services, included in the report's body, which was intended to better tailor the definition at the risks the power seeks to manage and provide additional certainty to entities likely to be covered by the power.
- r **agree** to define critical suppliers to defence and security services as suppliers where the Minister is satisfied that:
- i. the supplier directly provides critical goods or services to the New Zealand Defence Force, the New Zealand Security Intelligence Service or the Government Communications Security Bureau; and
 - ii. no alternative suppliers can be put in place quickly for reasons of the suppliers capability or capacity, or for security reasons.

Agree/disagree.

- s **note** that in T2019/2356 officials were not clear that a decision to exclude certain transactions involving listed equity securities from the call in power should not amend the threshold for potentially reviewing transactions in media entities. You had previously agreed that this would be 25 per cent.
- t **agree** that the threshold for investment in a media entity being in scope of the call in power is the acquisition of a 25 per cent or greater ownership interest or 25 per cent or greater control of the entity's governing body or voting power.

Agree/disagree.

National interest

- u **note** that legislative change is not required to enable the government to gather information necessary to assess the prospective benefits of any transaction potentially subject to the national interest test, even where the 'benefit to New Zealand' test does not ordinarily apply (for example, transactions only involving significant business assets). The regulator can achieve this operationally.

Definition of overseas person

- v **note** that in TR2019/1649, you agreed to a numerical control threshold of more than 25% for the definition of listed bodies corporates and the exemption for non-listed bodies corporate.
- w **agree** to increase the control and ownership threshold in the definition of overseas person for all non-listed entities, partnerships, unincorporated joint ventures and trust **from 25% or more** (which is the current position in the Act) **to more than 25%**.
- Agree/disagree.*

Protection of national security information in court proceedings

[36]

Amendments to other legislation

- z **note** that Land Information New Zealand's (LINZ) and the Overseas Investment Office's (OIO) inability to share or review information related to potential money laundering or terrorist financing represents a gap in New Zealand's AML/CFT enforcement regime;
- aa **agree** that the Cabinet paper seek approval to add the Overseas Investment Act 2005 to section 140 of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML/CFT Act), which has the effect of allowing LINZ and the OIO to exchange information with other regulators to ensure compliance with the AML/CFT Act;
- Agree/disagree.*
- bb **note** that the Overseas Investment Act incorporates the provisions of the Fisheries Act 1996 regarding the screening of overseas investments in fishing quota;
- cc **agree** to align provisions of the Fisheries Act with the revised investor test to be included in the Overseas Investment Act, and to make clear that the proposed 'back stop' national interest test can be applied to investments in fishing quota;
- Agree/disagree.*
- dd **agree** to rename the 'national interest test' in the Fisheries Act 1996 the 'benefit to New Zealand' test and harmonise its factors with the revised 'benefit to New Zealand' test to be included in the Overseas Investment Act;
- Agree/disagree.*
- ee **agree** to amend the Fisheries Act 1996 to make clear that the proposed 'back stop' national interest test to be included in the Overseas Investment Act can be applied to investments in fishing quota;
- Agree/disagree.*

ff **refer** a copy of this report to the Minister of Fisheries;

Agree/disagree.

Financial implications of Phase Two package

[33]

hh **note** further work is needed to determine which of these costs will be recovered by fees and which will be Crown funded;

ii **agree** to seek authority from Cabinet for a group of Ministers to make further decisions fees, and financial matters associated with the reform;

Agree/disagree.

jj **agree** to discuss the process for seeking Crown funding with the Minister of Finance, including the Treasury's preferred option of an out-of-cycle funding request;

Agree/disagree.

kk **note** that the timing of policy announcements following Cabinet decisions will be impacted by decisions on the funding process. If funding is sought through Budget 2020 the ability to announce may be constrained;

Call in power and national financial implications

ll **note** that the main agencies impacted by the call-in power and national interest are Land Information New Zealand, the Government Communications and Security Bureau, and the New Zealand Security Intelligence Service;

mm **note** that other agencies may be required to provide advice on specific transactions depending on the nature of the transaction;

nn **agree** that other agencies referred to in recommendation (mm) will absorb the cost of providing advice within baselines;

Agree/disagree.

oo **agree** that, due to the uncertainty of the volume of transactions subject to the call-in power and national interest test, a review of the funding approach will be undertaken in two years;

Agree/disagree.

pp **note** the attached draft Cabinet paper does not include financial implications and that this section will be updated in the revised version.

Megan Noyce
Principal Advisor

Hon. Grant Robertson
Minister of Finance

Hon. David Parker
Associate Minister of Finance

Treasury Report: Treasury Report: Overseas Investment Act Reform Phase Two - draft Cabinet Paper

Purpose of Report

1. The purpose of this report is to:
 - a provide the draft Cabinet paper, *Overseas Investment Act phase two reform: Package of reform*, for your feedback;
 - b update you on the next steps for considering the Treaty of Waitangi implications of special land;
 - c seek decisions on outstanding policy matters (the draft Cabinet paper reflects our recommended approach but can be revised following your decisions); and
 - d provide advice on the financial implications of the Phase Two reform.
2. We have consulted the following agencies on aspects of this advice: Land Information New Zealand, Ministry of Justice, Government Communications and Security Bureau, New Zealand Security Intelligence Services, and the Ministry of Primary Industries.

Section One: draft Cabinet paper

Overview of paper

3. A draft Cabinet paper for your consideration is attached to this report. The package of reform aims to improve the Government's ability to manage investment in our most sensitive and high risk assets, and cut unnecessary red tape. The package has three main parts:
 - a Managing risks of overseas investment: key proposals include the new national interest back stop, call-in power, treatment of farm land and enhanced enforcement powers.
 - b Cutting unnecessary red tape: key proposals include narrowing and simplifying the investor test and simplifying the benefits test, and introducing statutory timeframes.
 - c Removing requirements for less sensitive transactions: key proposals include removing short to medium term leases from the regime, removing low-risk sensitive adjoining land from the regime, and changing the entities captured by the definition of overseas person.
4. The paper reflects your policy decisions, and incorporates our recommended approach to the outstanding policy issues discussed in Section Three. We will provide you with a revised Cabinet paper should you prefer a different approach to these outstanding issues.
5. The Cabinet paper notes that the proposals aim to strike the right balance in terms of New Zealand's openness to foreign investment, but that the agri-business community may view them as a tightening of the regime. However, proposals to reduce red tape and complexity will encourage other types of foreign investment.

6. We note decisions on whether the screening regime should consider tax practices are still to be made – we will provide further advice on this in mid-October. There is a risk that, should ministers decide to screen overseas investors' tax practices, the reform package may be perceived as an overall tightening of the screening regime. We are working with Inland Revenue to provide you with additional options for considering tax practices as part of the screening process. The Cabinet paper seeks authorisation to delegate decision making on this matter to yourself, the Minister of Revenue, Minister of Finance, Associate Minister of Finance (Hon Shane Jones), Associate Minister of Finance (Hon David Clark), and the Minister of Land Information.
7. Further advice will be provided as to whether riverbed, lakebed and adjoining strips should be transferred to the Crown either as Crown land administered under the Land Act 1948 or conservation land under the Conservation Act 1987. The paper seeks a delegation for this decision to yourself, the Minister of Land Information, and the Minister of Conservation.
8. The Cabinet paper also seeks a general authorisation for you to make any additional policy decisions that may arise during drafting. This may include minor or technical changes relating to the implementation of Phase One, consistent with the Terms of Reference for these reforms. We will provide advice on these matters in October.
9. The Cabinet paper proposes that the Treasury will conduct a review of the Phase Two reforms five years after their implementation. This timeframe will allow the new regime to bed in, suitable data to be collected and monitoring and evaluation conducted. It will also give certainty to the regulated community that significant changes will not be made in the early days of the new regime's operation.
10. We are continuing to work with our legal team on refining the recommendations in the Cabinet paper and will provide updated recommendations in the revised version for ministerial consultation.

Next steps

11. Key milestones are set out below, to keep the reforms on track for 2020 enactment. We will provide you with a revised Cabinet paper late this week, reflecting your feedback, for ministerial consultation. We will provide you with an A3 summarising the reform package to support your conversation with Ministers.

Cabinet paper required to be submitted to Cabinet Office	17 October
Cabinet paper at DEV	23 October
Cabinet	29 October

12. Your office has indicated that, subject to agreement from the Prime Minister's Office, decisions will be announced immediately after Cabinet. The timing of announcements, and proactive release of the Cabinet paper, may also depend on decisions about the process to seek funding for the package of reform.

[1]

13. [1]

14. [1]

Section Three: outstanding policy issues

15. The draft Cabinet paper incorporates a number of outstanding policy issues. Advice on these issues is provided below. Should you prefer an alternative approach to these issues we will update the revised Cabinet paper accordingly. The outstanding matters relate to:
- a a proposed class exemption for Residential Mortgage Obligation (RMO) trades (a new type of residential mortgage backed security developed by the Reserve Bank New Zealand;
 - b detailed policy design relating to enforcement, the investor test, farm land and rural land;
 - c additional advice on decisions you have made, including clarifications of the scope of the call-in power, technical changes to the definition of overseas person, further information on national interest test and investments in significant business assets, and further information relating to judicial review; and
 - d consequential amendments to other pieces of legislation (the Anti-Money Laundering and Countering of Financing Terrorism Act 2009, and the Fisheries Act 1996).

New issue: class exemption for Residential Mortgage Obligation (RMO) trades

16. In early-2020, trade is expected to commence in a new residential mortgage backed security (RMBS) developed and certified by the Reserve Bank of New Zealand (RBNZ) – a Residential Mortgage Obligation (RMO). RMO's introduction has been publicly announced by the RBNZ and banks are preparing for their launch in January 2020.
17. In March 2019, the RBNZ approached Treasury to discuss the introduction of RMOs given that some transactions necessary to issue RMOs would likely require consent under the Overseas Investment Act.
18. RMOs are intended to be simple and transparent, and therefore easier for private banks, non-bank deposit takers (NBDTs), trustees and the RBNZ to price and trade than other types of RMBS.
19. Compliant RMOs will:
- a count towards the loan's originator (that is, the bank or NBDT) meeting liquidity requirements under its prudential regulation by the RBNZ;¹ and
 - b count as collateral in market operations with the RBNZ (which means the originator can quickly borrow from the RBNZ, using the RMOs as collateral, in a 'lender of last resort' situation).

[36]

20. Due to their standardisation, RMOs will overcome a significant problem experienced during the Global Financial Crisis – the time it took the RBNZ to assess the risk profile of various RMBS' that banks were hoping to use as collateral against RBNZ loans. While this was necessary to ensure that the RBNZ was not carrying excessive risk, it slowed the flow of liquidity into New Zealand's financial markets when they needed it.
21. There are strong policy grounds to support RMOs introduction. However, without amendment, the Act may serve as a barrier to their adoption by industry and undermine the RBNZ's objectives.
22. RMOs, a form of debt security like a bond, are not an asset screened under the Act. However, in order for RMOs to be issued, a trustee must acquire a parcel of loans (residential mortgages) from an originating bank. In some circumstances, the originating bank may also have to purchase these back from the trustee. These loan transfers will often require consent under the Act given that:
 - a most New Zealand banks, and trustees operating on behalf of New Zealand banks, are overseas persons for the purposes of the Overseas Investment Act; and
 - b the value of the loan parcels will generally exceed \$100 million (that is, they will be a 'significant business asset').
23. Reflecting their low risk and importance to financial markets, the Overseas Investment Regulations 2005 already include a class exemption for these types of loan transfers to the extent that the security includes an interest in sensitive land or fishing quota. This exemption does not extend to significant business assets.
24. [36]

25. We are continuing to explore whether individual consents or exemptions could be made to relevant entities (that is, the relevant bank, NBDT or trustee). This would be a stop-gap measure at best due to the considerable costs that it would still impose on applicants and the government. The RBNZ anticipates that up to 20 banks/NBDTs will be issuing RMOs (if the product is successful) within two years, which would require consents or exemptions to be issued to up to 40 different entities.³
26. To overcome this problem, we recommend amending the Act to ensure that loan transfers necessary to support the issuance or management of RMOs can be exempted from the Act's consent requirements. To ensure that the exemption is no wider than necessary to facilitate the use of RMOs for prudential and other financial

² [36]

³ Depending on how transactions were structured, the OIO have advised that it may be possible to issue consents to fewer entities to achieve this outcome.

stability purposes, we recommend that any exemption for banks and NBDTs be subject to the following conditions:

- a the transaction is between:
 - i the loan originator, either
 - a registered bank under the Reserve Bank of New Zealand Act 1989; or
 - a licensed NBDT under the Non-bank Deposit Takers Act 2013; and
 - ii a person licensed as a supervisor in respect of debt securities under the Financial Markets Supervisors Act 2011 (the trustee);
- b the transaction is necessary or desirable to support the issuance or management of RMOs that meet RBNZ standard terms and conditions in place at the time for RMOs; and
- c the transaction is entered into in good faith and in the ordinary course of business with no intention of using one or more of the permitted security arrangements to make an overseas investment in sensitive land or an overseas investment in fishing quota without consent.

27. These requirements are consistent with existing requirements to obtain exemptions in respect of the transfer of loan parcels where they grant an interest in sensitive land or fishing quota.

Detailed design aspects of decisions you have made already

Enforcement: design of the new power to accept undertakings

28. In T2019/2406 you agreed to introduce a new power for the OIO to accept undertakings for mid-level breaches. An enforceable undertaking grants the regulator a broad discretion to accept an undertaking from an investor to take specific actions, in exchange for the regulator agreeing not to bring proceedings in respect of an alleged breach of the Act. We undertook to provide further advice on design of this power, drawing from recent examples in the Commerce Act 1986, Financial Markets Authority Act 2011, and the Health and Safety at Work Act 2015. We recommend the following design features:
- (i) Broad scope of undertakings that may be accepted
29. There is a need, in the context of the variety of investments and enforcement situations that may arise, to enable bespoke solutions which address breaches in a proportionate manner. We recommend providing a broad scope in terms of the range of undertakings in which the OIO may accept. This is a similar approach to the Health and Safety at Work Act 2015.
30. The design should preclude the OIO from accepting a payment in lieu of a penalty. We consider there should be judicial oversight of the imposition of financial penalties on an investor, and public scrutiny of the quantum of penalties being imposed.
- (ii) Undertakings may include an admission of guilt
31. The Act should allow but not require undertakings to include admissions of guilt. Admissions should be left to the OIO and investor to address as part of the negotiation process. We would also expect an investor to negotiate conditions relating to immunity from further proceedings in relation to the conduct which forms the basis of the undertaking.

32. We do not recommend mandating such an admission, as this may unduly protract the length and cost of negotiations. However, we do not consider that the Act should prohibit such undertakings from including an admission of breach, as this may limit the ability of the OIO to hold the defendant to account for the wrongdoing.
- (iii) Undertakings should be published
33. The Act should require the OIO to publish online:
- a the decisions it makes to accept an undertaking;
 - b the reasons for the decision (this is consistent with the obligation on WorkSafe under the Health and Safety at Work Act 2015); and
 - c the details of that undertaking where it involves the payment of the OIO's costs, (this is consistent with the obligations on the Commerce Commission under the Commerce Act 1986 and on the Financial Markets Authority under the Financial Markets Authority Act 2011).
34. This provides an important check on the exercise of this power by the OIO, improves public accountability and supports more predictable and transparent outcomes for investors.
- (iv) Breach of an undertaking
35. In T2019/2406 you also agreed that the undertakings power should be accompanied by pecuniary penalties⁴ for breach of the undertaking (set at a lower level than civil penalties that exist for breach of the Act). Consistent with other penalty regimes, any penalties imposed would be paid to the Crown, rather than the regulator. We recommend that the civil penalty level for a breach of an undertaking is set at \$300,000 for corporations, and \$50,000 for individuals. This is based on:
- a Alignment with the proposed changes to the general civil penalties in the Act: in T2019/2406 you agreed to increase this to \$10 million for corporates and \$500,000 for individuals (the current maximum penalty is at \$300,000 for both corporations and individuals);
 - b Deterrent value: the proposed penalties should be sufficient to deter parties from breaching a term of the undertaking, but not so high as to discourage the uptake of undertakings and incentivise parties to bear the risk that the regulator will instigate proceedings. The proposed penalty aligns with the enforceable undertaking regime in the Telecommunications Act 2001 which also has a general upper limit for civil penalties of \$10 million.
36. We recommend enabling the OIO to apply to the Court for a variety of orders where an investor breaches a term of the undertaking. These orders should enable the OIO to seek the party's compliance with the terms of the undertaking, to seek a discharge of the undertaking, to recoup costs associated with the proceedings to enforce the undertaking and to recoup the costs it anticipates it will incur in future monitoring of compliance with the undertaking. This is consistent with other regimes discussed above.

Investor test: determining the threshold for offences and contraventions of the law

37. In T2019/1649 you agreed to a new, narrowed and simplified investor test which is more appropriately calibrated to the low level or risk posed by the majority of overseas investors.

⁴ Pecuniary penalties are non-criminal monetary penalties imposed by a court in civil proceedings.
T2019/2834 : Treasury Report: Overseas Investment Act Reform Phase Two - draft Cabinet Paper

38. In order to assess the risks an investor may pose to New Zealand, decision-makers currently consider whether the investor has committed any offences or contraventions of the law. We recommended narrowing this part of the investor test by setting a threshold for the offences and contraventions considered. This will ensure the focus is on those matters that are likely to pose a risk to New Zealand, rather than low-level issues.
39. You agreed with our proposal, but sought further advice on what the threshold would be.
40. We recommend that decision-makers consider whether the investor:
 - a Has been convicted of an offence for which they have been sentenced to imprisonment for a term of five years or more, or, any time in the preceding ten years, has been convicted of an offence for which they have been sentenced to imprisonment for a term of twelve months or more. This is consistent with the Immigration Act, and is intended to balance the seriousness of offending (for which time of imprisonment is a proxy) with relevance (for which time passed since offending is a proxy).
 - b Has had any civil contraventions punishable by pecuniary penalties or enforceable undertakings within the last ten years: this is intended to capture serious regulatory misconduct.
41. We also note that, following discussion with officials, you agreed that our previous recommendations on two other criteria in the investor test (business experience and acumen and financial commitment) would sufficiently address the risks posed by investors in rural land. The Cabinet paper reflects your decisions to:
 - a Replace the current business experience and acumen criterion with an objective assessment of factors such as undischarged bankruptcies and disqualifications.
 - b Remove the financial commitment criterion.

Farm land and rural land

- (i) Enshrining the rural land directive – treatment of other categories of sensitive land
42. When you agreed options to enshrine the rural land directive, you asked whether the Act should apply a narrower benefits test, or entirely remove the test, for the remaining types of sensitive land in Schedule 1 of the Act as these are less sensitive than rural land.
43. We recommend these remaining types of land should continue to be subject to the simplified benefits test agreed in TR2019/2426. A narrowed benefits test would make it more difficult – rather than easier – for high-quality investments to demonstrate sufficient benefit to satisfy the test, as there would be fewer types of benefit that could satisfy the test. We consider the simplified benefits test and proposed changes to the counterfactual achieve the right balance.
44. An alternative option would be to introduce a more risk-based, checklist-style test for the remaining types of land. However, as the remaining land includes sensitive types such as islands, foreshore and seabed, and land held for conservation purposes,⁵ it is

⁵ The remaining types of land are:

- non-urban land over 5 ha that is not farm land
- land over 0.4 ha on specified islands
- land of any size on other islands (excluding the North and South Islands)
- foreshore or seabed of any size
- beds of lakes over 0.4 ha

likely this land is sufficiently sensitive to require a benefits test. A risk-based approach could also duplicate the negatively-framed national interest test.

45. We note that enshrining the rural land directive would not change the current approach to forestry conversions. As with the status quo under the Act and rural land directive, applications involving conversions of farmland to forestry could be screened under the special forestry test (if they can satisfy that test), rather than the elevated farmland threshold. Previous advice (B19-0322) has noted some concern about the relative ease of forestry conversions of farmland, but that the full effect of the forestry changes was not yet clear. Enshrining the rural land directive may further embed an incentive to convert farmland to forestry, as it is expected to introduce a slightly more restrictive investment threshold than currently exists under the directive. [33]
- (ii) Farm land advertising – clarification of guidance on exemptions
46. In T2019/1649, as part of decisions on farm land advertising requirements, you agreed that the Act should provide guidance clarifying when discretionary exemptions from the farm land advertising requirements should be granted by specifying the intent of the farm land advertising requirement, and including some criteria for exemptions.
47. You have since decided to enshrine the rural land directive, which will lock in a significantly higher threshold for farm land sales. We will also provide further advice on options for clarifying the definition of farm land, which has been a source of ambiguity in applying the current exemption provision. We consider these decisions will alleviate the need to amend the exemption provisions, and seek your agreement not to progress these changes.

Clarifications of previous decisions

Call in power

- (i) Technical clarification: treatment of investments in media entities
48. In T2019/2356, you agreed to exclude transactions from the call in power that resulted in the acquirer holding less than 10 per cent of an entity's publicly-listed equity securities, unless the investment granted disproportionate access or control rights that could give rise to risks to national security and/or public order.
49. We were not sufficiently clear that agreeing to this recommendation should not alter the threshold for transactions in media entities being in scope of the call in power – which you had agreed would be obtaining a 25 per cent or greater interest. As such, under the policy decisions as they stand, it could be harder to acquire listed equity interests in a media entity than other types of interests despite these transactions posing no risk. To resolve this, we recommend that the Cabinet paper make clear that the threshold

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- land over 0.4 ha held for conservation purposes
 - land over 0.4 ha that a district plan or proposed district plan under the Resource Management Act 1991 provides is to be used as a reserve, as a public park, for recreation purposes, or as open space
 - land over 0.4 ha subject to a heritage order, or a requirement for a heritage order, under the Resource Management Act 1991 or by Heritage New Zealand Pouhere Taonga under the Heritage New Zealand Pouhere Taonga Act 2014
 - a historic place, historic area, wahi tapu, or wahi tapu area over 0.4 ha that is entered on the New Zealand Heritage List/Rārangī Kōrero or for which there is an application that is notified under the Heritage New Zealand Pouhere Taonga Act 2014
 - land that is set apart as Māori reservation and that is wahi tapu under section 338 of Te Ture Whenua Māori Act 1993
 - sensitive adjoining land.

for investments in media entities becoming subject to the call in power is 25 per cent or greater, irrespective of whether or not it is publicly listed.

- (ii) Technical clarification: definition of critical direct supplier to the NZDF and security agencies
50. In T2019/1394, we sought indicative decisions on the definition of “critical suppliers to defence and security services” for the purposes of the proposed call in power. You agreed that critical suppliers to defence and security services are suppliers where the Minister is satisfied that:
- a the supplier directly provides critical goods or services to the New Zealand Defence Force, the New Zealand Security Intelligence Service or the Government Communications Security Bureau; and
 - b no alternative suppliers can be put in place quickly.
51. In this recommendation, we omitted some additional clarifying text, included in the report’s body, relating to why an alternative supplier cannot be put in place quickly. That is, that no alternative suppliers can be put in place quickly for reasons of the supplier’s capability or capacity, or for security reasons.
52. This clarification better tailors the definition to the risks the call in is trying to manage, while providing additional certainty to entities likely to be covered by the power. We recommend that this additional language be reflected in the definition presented to Cabinet for its approval.

Considering benefits under the proposed national interest test (and call in power)

53. In T2019/1649, we recommended that the national interest test empower the government to decline investments deemed contrary to New Zealand’s national interest, with broad reference to prospective benefits, risks to national interests, the extent to which risks can be mitigated by conditions, and any other relevant matters.
[37]
54. When discussed with officials you noted that in practice, even without a requirement to consider an investment’s prospective benefits this information will still need to be presented to decision makers in order for them to make an informed decision on whether an application should be denied.
55. For investments in sensitive land and fishing quota, the OIO will already collect this information as part of the ‘benefit to New Zealand’ test. For investments in significant business assets, however, this will not be the case (investments in significant business assets only have to satisfy the investor test to receive consent). You have asked for clarification on how this assessment will work for significant business assets.
56. The OIO has extensive information gathering powers, including in respect of investors applying for consent. Further, it is in investors’ interests to comply with requests for information to support the national interest assessment (particularly when information on a proposal’s benefits will, in many cases, be critical to determining whether an investment can proceed). We consider that the approach to assessing benefit is an operational matter for the OIO.
57. The above will also be true in respect of gathering information on prospective benefits of an investment subject to the call in power (where you have indicated that you would like the legislation to indicate that benefits can be formally considered before an application is declined, T2019/1394 refers).

Technical clarification: increase the threshold for the definition of overseas person from 25% or more to more than 25%.

58. Currently, a body corporate (A) is an overseas person if overseas persons own or control **25% or more** of A. In TR2019/1649 you agreed to increase the control limb to an interest of **more than 25%** for New Zealand **incorporated and listed bodies corporate**, and an applied for exemption for **non-listed bodies corporate**. This change reflects that an interest of more than 25% (rather than 25%) is required to assert 'negative control'⁶ over a body corporate. A 25% holding does not grant an overseas person any more control rights than a smaller holding.
59. We recommend marginally increasing the ownership and control limb for **non-listed bodies corporate** to **more than 25%**. This would ensure that:
- a the control limb for non-listed, the exemption for non-listed bodies corporate, and listed bodies corporate, are consistent;
 - b overseas persons must be able to cumulatively assert negative control over an entity (or trust or unincorporated joint venture) before consent is required. This is in line with our general view that screening should only be required when overseas persons potentially have the capacity to exercise control (or greater control) over sensitive New Zealand assets.

Protection of national security information in court proceedings: additional context

60. In T2019/2405, you agreed to include provisions in the Act for the protection of national security information (NSI) which would be broadly aligned with the Telecommunications (Interception Capability and Security) Act 2013. [33]

61. [36]

62. [33]

Amendments to other legislation

Enabling overseas investment information to be shared for AML/CFT purposes

63. New Zealand's Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (the AML/CFT Act) creates a framework for information sharing and cooperation amongst various government agencies and reporting entities (such as banks) to allow the government to detect and deter money laundering and the financing of terrorism.

⁶ Negative control gives a person the power to block special resolutions, which are required to, among other things, approve major transactions of a company

64. The New Zealand Police Force's Financial Intelligence Unit (FIU) is responsible for collecting, analysing and sharing intelligence relating to suspicious transactions. They have advised that two significant ways that money is laundered internationally is through:
- a the sale and purchase of land; and
 - b the sale and purchase of, and trading activity involving, 'significant business assets.'
65. Despite this, LINZ and the OIO cannot systematically share information with other agencies involved in detecting and preventing money laundering and terrorism financing. They also cannot obtain information from those agencies when considering whether the source funds for an investment are legitimate or ascertaining whether investors have a history of involvement with money laundering. This presents a significant gap in New Zealand's anti-money laundering regime – a gap that will become more pronounced once the OIO is responsible for administering the proposed national interest test and call in power.
66. To resolve this issue, we recommend that regulators be able to use and disclose information supplied or obtained under the Overseas Investment Act 2005 for AML/CFT purposes. This recommendation is supported by LINZ, the OIO, the Department of Internal Affairs (which administers the AML/CTF regime), the Ministry of Justice (which administers the AML/CTF legislation), and the FIU.

Aligning the Fisheries Act with changes to the Overseas Investment Act

67. In T2019/1649, we indicated that completing the Phase Two reform would require amendments to the Fisheries Act 1996 (Fisheries Act), to ensure that the consent requirements for overseas investments in fishing quota continue to align with the requirements to purchase sensitive land.
68. To achieve this alignment, the Cabinet paper seeks agreement that:
- a any changes to the investor test in the Act be reflected in equivalent provisions of the Fisheries Act;
 - b the factors in the Fisheries Act's 'national interest test' (which mirrors the economic factors in the Act's 'benefit to New Zealand test') be aligned with the broad economic factor proposed to be included in the Act's 'simplified benefit test';
 - c the Fisheries Act's 'national interest test' be renamed the 'benefit to New Zealand test' to
 - i reflecting its harmonisation with that test in the Act; and
 - ii to avoid confusion with the proposed new backstop 'national interest test'; and
 - d the Fisheries Act making clear that, if adopted, the proposed 'back stop' national interest test can be applied to prospective investments in fishing quota.
69. We have consulted with the Ministry of Primary Industries, which supports these proposals.

Section Four: Financial implications

70. The attached Cabinet paper does not currently include information on the financial implications of the reform. Following decisions on the advice outlined below, this section of the Cabinet paper will be revised and an updated copy provided to you ahead of Ministerial consultation.
71. The financial implications of managing special land, when in Crown ownership, have not yet been estimated.

Phase Two reform will have financial implications

72. We have worked with affected agencies to identify the financial implications associated with policy changes across the reform package (T2019/2665 refers). Affected agencies include:
 - a the OIO, within Land Information New Zealand (LINZ);
 - b the security agencies (New Zealand Security Information Services and Government Communications and Security Bureau), who will be required to input security/intelligence assessments as part of the national interest test and call in power;
 - c 'specialist agencies' that may need to provide advice on specific transactions under the national interest test or call in power (such as the Ministry of Business, Innovation and Employment, Ministry of Defence, or Ministry of Culture and Heritage).
73. In addition to these agencies, others may also be impacted depending on decisions regarding tax (Inland Revenue will be affected if a new tax component is introduced into the screening process) and special land (there may be an impact on the Department of Conservation).
74. The OIO also consults other agencies, where appropriate, on specific applications (such as the Walking Access Commission). However, given that input from other agencies is currently a small proportion of time spent on applications generally, we have not costed these impacts. Implications for these types of agencies may be considered as part of further work to set statutory timeframes.
75. To estimate the financial implications we have split the policy changes into:
 - a core Phase Two package: the costs for the OIO to implement proposed changes to the existing regime which largely involve streamlining and speeding up current processes and removing low risk transactions from the regime; and
 - b proposed national interest test and new call in power: these proposals would create additional powers to the regime with the costs largely falling on the OIO and the security agencies.
76. The estimated financial implications for each of the above components is set out below. The extent to which the costs are borne by the Crown will depend on whether a partial or full cost recovery framework is implemented.
77. These estimates will need further refinement following Cabinet decisions. This is due to the short amount of time available to undertake the costings work, the uncertainty around assumptions (particularly for the call in power and national interest test), and uncertainty regarding statutory timeframes. The financial impact of introducing statutory timeframes will be worked through following Cabinet's decisions on the overall reform package.

Estimate of costs: the core Phase Two package ^[33]

[33]

⁷ Reduced transaction volumes are expected due to reducing the categories of sensitive adjoining land, limit screening of leases to those under 10 years, and changes to the definition of an overseas person

⁸ Includes enforcement related to new call in power and national interest.

⁹ This includes licences and databases which will support call in power and national interest.

Estimate of costs: the proposed national interest test and call in power functions [33]

[33]

The Crown's costs depend on the split between Crown funding and fee recovery

91. The overall cost of the reform for the Crown will depend on whether costs are recovered, fully or partially, through fees charged to applicants.
92. Currently the OIO largely operates on a cost recovery basis and we expect that this will continue for existing application pathways (e.g. sensitive land and significant business assets).¹¹ The OIO is undertaking a fees review in early 2020 and this review will also consider the impact of these reforms. It is anticipated that the simplification of the consent framework and removal of lower risk transactions could increase fees for applicants (as the fixed costs for OIO to consider transactions are spread across fewer applicants).
93. For the call in power and national interest test, we will provide you with advice on whether we recommend fees be charged for both functions (and hence the costs in Table 2 recovered) in the week beginning 23 September 2019. This advice can support your ministerial consultation on the draft Cabinet paper.
94. Due to the timing between OIO's fee review, and our advice on fees for the call in power and national interest test, we recommend that the financial recommendations in the revised Cabinet paper note that:

¹¹ Time-limited funding to partially recover the costs of enforcement and litigation was provided as part of Phase One on the basis that some of this activity was a public good.

95. We recommend that the Cabinet paper seeks agreement to delegate a group of joint Ministers to take future decisions on fees, and financial matters associated with the reform. We recommend that this group include yourself, the Minister of Finance, Minister of Land Information, and the Minister responsible for the Government Communications and Security Bureau and New Zealand Security Intelligence Services.

The process used to seek funding affects when you can announce decisions on the reform, we recommend you discuss an approach with the Minister of Finance

96. We have previously (T2019/2665 refers) recommended that you discuss with the Minister of Finance his appetite to seek an out-of-cycle funding request either through drawing down on the between-Budget contingency and/or a pre-commitment against Budget 2020.
97. An out-of-cycle funding request is Treasury's preferred option to seek funding for the reform, compared to seeking funding through Budget 2020, as:
- a an out-of-cycle funding request would allow you to progress the reform in accordance with your desire to introduce legislation in April 2020, and would provide agencies with certainty of funding when policy decisions are taken. However, this would not provide an opportunity for the Minister of Finance to weigh the relative priority of this reform package against other Government priorities as part of Budget 2020.
 - b seeking Cabinet agreement to in-principle policy decisions, subject to Budget 2020 funding, may constrain the Government's ability to make public announcements about the reform after Cabinet decisions are made in October. In-principle policy decisions may also compromise your ability to enact this parliamentary term because introducing legislation in April will publicly commit the Government to the proposed reform before funding is confirmed.
98. Regardless of which option is chosen, the final expected costs for the Phase Two package can be confirmed ahead of, or during, the Budget 2020 process. Policy changes that occur during the legislative process may also impact on costs.

Appendix 1: options for statutory timeframes – for costings

Application pathway	Option 1 (short)	Option 2 (longer)
Significant business assets	30	50
Sensitive land and fishing quota	45	75
Residential property (other than commitment to reside)	30	60
Commitment to reside	10	15
Forestry	30	60
Standing consent (residential)	45	75
Standing consent (forestry)	45	75
Residential land	30	60
Call-in	30	60
National Interest	20	40

DRAFT

Initial review period, to be completed in line with specified statutory timeframes

Point at which transaction 'called in', new timeframe to permit required analysis to be undertaken

