

# The Treasury

## Overseas Investment Act Reform Information Release

October 2020

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**Treasury Report:** Economic Response: Reform of the Overseas Investment Act 2005: draft Cabinet paper and proposed clarification to treatment of loans

<b>Date:</b>	14 May 2020	<b>Report No:</b>	T2020/1399
		<b>File Number:</b>	IM-5-3-8-9 (COVID Response Reforms)

**Action sought**

	<b>Action sought</b>	<b>Deadline</b>
Minister of Finance (Hon Grant Robertson)	<b>Note</b> the contents of this report.	N/A
Associate Minister of Finance (Hon David Parker)	<b>Provide feedback</b> on the draft paper seeking approval from the Cabinet Legislation Committee to the Overseas Investment Regulations.  <b>Agree</b> to clarify that loans do not require consent under the Overseas Investment Act.	18 May 2020

**Contact for telephone discussion (if required)**

<b>Name</b>	<b>Position</b>	<b>Telephone</b>	<b>1st Contact</b>
[35]	Analyst, International	[39]	N/A (mob)
Thomas Parry	Manager, International	[35]	✓

**Minister's Office actions (if required)**

**Return** the signed report to Treasury.

Note any feedback on the quality of the report

**Enclosure:** Yes (annexed)

# Treasury Report: Economic Response: Reform of the Overseas Investment Act 2005: draft Cabinet paper and proposed clarification to treatment of loans

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## Purpose of Report

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1. This report provides you with the draft LEG paper “*Overseas Investment Amendment Regulations 2020*” (Annex 1), for your feedback. The paper seeks approval from the Cabinet Legislation Committee (‘LEG’) to submit the Overseas Investment Amendment Regulations 2020 to the Executive Council.
2. The report also seeks your agreement to clarify that loans do not require consent under the Overseas Investment Act 2005 (‘Act’). This would resolve concerns that have been raised during consultation with technical experts on the proposed exemption for some lending activity.

## Background

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3. On 11 May 2020, Cabinet agreed to a package of reforms to the Act, as part of the Government’s economic response to the COVID-19 pandemic and its impact on the foreign investment risk environment [CAB-20-MIN-0212 refers].
4. On 14 May 2020 (today), the two Bills which give effect to these changes will be introduced. These are the Urgent Measures Bill, and the Overseas Investment (Other Measures) Amendment Bill (‘Other Measures Bill’).
5. We understand from your office that you agreed that the regulations to support the Urgent Measures Bill would be progressed separately from the Bill itself. The extra time for drafting the regulations was necessary to allow for further consultation and to reduce the risk that they result in unintended consequences.
6. The regulations will be introduced in two tranches, with the Overseas Investment Amendment Regulations 2020 (‘Essential Regulations’) proposed to come into force on 11 June 2020 and the Overseas Investment Amendment Regulations 2020 (No 2) (‘Other Regulations’) on 7 July 2020.

## Draft Cabinet paper

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7. A draft paper seeking LEG’s approval to submit the Essential Regulations to the Executive Council is attached to this report, for your consideration. The Essential Regulations include:
  - a changes to the existing exemption for acquisitions of parcels of securitised loans so that it applies where the underlying asset is a significant business asset (only sensitive land and fishing quota are covered under the current exemption),
  - b defining the assets covered by the new emergency notification regime,
  - c defining the strategically important businesses covered by the new national interest test and call in power, and

- d specifying the reserves and land managed by governance entities for collective groups of Māori, which is included in the definition of sensitive land.
8. The LEG paper also seeks agreement to waive Standing Order 7.96, which requires that regulations must not come into force until at least 28 days after they have been notified in the New Zealand Gazette. Standing Order 7.97 permits a waiver to be sought in certain circumstances, including where regulations are made in response to an emergency. Otherwise, the LEG paper is consistent with standard practice and notes that the Essential Regulations comply with the relevant requirements and guidelines.

#### *Next steps*

9. We will reflect your feedback in an updated Cabinet paper and provide it to you on 19 May 2020, for Ministerial consultation. We recommend that you take a version of the Cabinet paper to LEG on 26 May 2020. The paper is subject to revision following agency consultation.
10. We will provide you with a draft LEG paper seeking approval to introduce the Other Regulations (the second and final tranche of regulations) in mid-June, and recommend that you take a version of that paper to LEG on 30 June 2020.

### Policy issue: proposed clarification to treatment of loans

#### *The Act's ambiguous treatment of loans is causing issues*

11. The Act's position on whether loans require consent is ambiguous. Due to this ambiguity, Cabinet agreed to exempt loans made by registered banks from screening. This required amending the purposes for which exemptions can be made in the Urgent Measures Bill to include a new purpose for "loans by financial institutions" [T2020/914 and CAB-20-MIN-0212 refer].<sup>1</sup>
12. During consultation on the Urgent Measures Bill, experts expressed concern at the proposal to introduce an exemption for this class of transactions. Several experts reiterated their view that loan obligations do not amount to "property" or "security" that would be capable of requiring consent under the Act, meaning there was no need to introduce an exemption.<sup>2</sup> We are aware that this is the shared view among a range of financial and legal professionals (though note that, on occasion, the OIO has taken the alternative view), and accordingly expect there is currently a large number of investors in the market who do not generally seek consent for transactions involving loans.

[34]

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<sup>1</sup> Clause 49, Overseas Investment (Urgent Measures) Amendment Bill.

<sup>2</sup> Section 13 of the Overseas Investment Act 2005 requires consent for overseas investment in significant business assets. Significant business assets can either be securities or property. The section 6 definition of securities excludes the right to repayment of money.

14. The experts also noted concern at the proposal that the exemption would only apply to transactions by registered banks and exclude other lenders. They considered this problematic because:
  - a the limitation may inhibit the provision of loans by non-bank lenders during the pandemic, which could negatively affect firms' economic resilience and ultimately harm economic growth, and
  - b the limitation may have unintended consequences, as it could subject lending activity by non-banks to screening once the emergency notification regime is removed. This similarly risks inhibiting firms' access to debt financing.

*Clarifying treatment of loans in the Act would address concerns*

15. To address these concerns we propose clarifying in the Act that loans do not require consent. This change would achieve the intent of the exemption by allowing all lending activity to occur without consent. We consider there is little risk associated with this approach, because:
  - a loan obligations are not a particularly sensitive class of asset, so there is a low probability that negative consequences would result from not screening them. This is because a loan does not grant control over the real asset underlying the transaction (the business) but only confers an interest in the future cash flows of the business, and
  - b in practice, consent is rarely sought for loan transactions, because many market participants do not consider that they require screening under the Act. Explicitly clarifying that screening is not required is therefore unlikely to change the status quo.
16. We consider that the Act is sufficiently ambiguous on the consent requirements for loans that it would be preferable to resolve this through a clarification in the primary legislation, rather than through regulations. This approach would avoid unintended consequences in relation to previous transactions and provide the greatest certainty for investors.

[36]

18. As noted above, officials do not consider that this would change the integrity of the Act given the likely high volume of lending transactions that proceed without visibility at present.
19. The Overseas Investment Office and the Ministry of Foreign Affairs and Trade were consulted on this proposal.

*Resolve issue through Select Committee process*

20. In CAB-20-MIN-0212, Cabinet delegated authority to you to "make decisions on any additional policy or drafting issues that arise during the implementation of the Emergency Measures Bill and Other Measures Bill, and the Regulations including minor technical changes, in consultation with relevant portfolio Ministers as necessary".

21. We consider that this policy decision falls within the bounds of your delegated power on the basis that you are achieving the same policy intent through different means. If you do not agree, an alternative option would be to table an oral item at the Cabinet meeting on Monday 18 May 2020.
22. Clarification of the treatment of loans in the Act would require an amendment to the Urgent Measures Bill, which has already been introduced to Parliament. We therefore recommend making this amendment through the Select Committee process for the Urgent Measures Bill, which is due to commence on Monday 18 May.

## **Recommended Action**

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We recommend that you:

1. **Provide feedback** on the attached Cabinet paper “*Overseas Investment Amendment Regulations 2020*”.

*Agree/disagree.*

2. **Note** you and Cabinet agreed that all loans issued by registered banks should be exempt from consent requirements under the Overseas Investment Act 2005 (‘Act’) [T2020/914 and CAB-20-MIN-0212 refer].

3. **Note** that technical consultation revealed issues with the proposed exemption for loans, including that:

- i an exemption may be unnecessary, given differences of opinion as to whether loans require consent under the Act, which could give rise to unintended consequences, and
- ii as the exemption would not be available to non-bank lenders, it could limit beneficial lending activity.

4. **Note** officials consider that loans are low risk transactions that do not warrant screening, as they do not grant control over real assets but only confer a right to the future revenue of a business.

5. **Agree** to instead clarify in the Act that loans do not require consent.

*Agree/disagree.*

6. **Agree** to recommend this clarification to the Act through the Departmental Report during the Select Committee's review of the Urgent Measures Bill.

*Agree/disagree.*

Thomas Parry  
**Manager, International**

Hon David Parker  
**Associate Minister of Finance**

**Note:**

The Overseas Investment Amendment Regulations Cabinet paper can be found at:  
<https://treasury.govt.nz/sites/default/files/2020-07/oia-leg-paper-4306704.pdf>