

The Treasury

Phase 2 Reform of Overseas Investment Act Information Release

March 2021

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- [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
- [25] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information
- [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
- [35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment
- [36] 9(2)(h) - to maintain legal professional privilege
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Treasury Report: Second 90-day statutory review of the overseas investment emergency notification regime

Date:	18 November 2020	Report No:	T2020/3248
		File Number:	IM-5-3-8-9-2 (90-day review)

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson)	Note that you are required to review at 90-day intervals whether conditions justify the emergency notification regime (ENR) remaining in force.	27 November 2020 <i>(Statutory deadline for Ministerial decision of 28 November 2020)</i>
Associate Minister of Finance (Hon David Parker)	Note that the effects of the COVID-19 pandemic continue to exacerbate risks to the national interest posed by foreign investment, which cannot be adequately managed through permanent tools in the Act.	
Minister of Foreign Affairs (Hon Nanaia Mahuta)	Agree to retain the ENR for a further 90 days.	

Contact for telephone discussion (if required)

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

Minister's Office actions (if required)

Refer this report to the Minister responsible for the GCSB and NZSIS, and the Minister for Land Information.
Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure:

Treasury Report: Second 90-day statutory review of the overseas investment emergency notification regime

Executive Summary

A temporary emergency notification regime was introduced into Overseas Investment Act

In June 2020, in response to the heightened foreign investment risks arising during the COVID-19 pandemic and the related economic downturn, Parliament introduced a temporary emergency notification regime (the 'ENR') into the Overseas Investment Act 2005 (the 'OI Act'). The ENR significantly broadened the scope of overseas investment transactions screened by the OI Act.

The OI Act requires you to review the ENR every 90 days to determine whether the effects of the pandemic in New Zealand justify continuing the ENR. [1,36]

The effects of the emergency justify continuing the ENR

We recommend you **agree to continue the ENR for a further 90 days** because:

- many New Zealand businesses will likely face their most significant financial pressures and will make key funding decisions in the first half of 2021. [1]
- in this economic environment, foreign investment poses heightened risks to the national interest, as ongoing national security and economic risks are amplified across a broader range of transactions (particularly in larger businesses), and the permanent screening tools in the OI Act are unable to adequately manage those risks;

[1,36]

The ENR created material regulatory costs (collecting information for notification, legal fees, delays) on previously unregulated foreign investment, and may be reducing capital flows.

[1]

A separate statutory review, of whether the ENR's scope could be better targeted while it remains in force, is also being progressed and will be provided to Ministers later this year.

You will be required to review the ENR again in a further 90 days

Subject to your agreement to continue the ENR, you would be required to reconsider the effects of the emergency and whether to retain the ENR within 90 days of your decision on this review. A draft press release is attached for your feedback (Annex Three) and will be published on the Treasury's website following your decision. If you disagree, and wish to repeal the ENR, we will provide you with a draft Cabinet paper reflecting this decision, and advice on the process to follow, as soon as is practicable.

Recommended Action

We recommend that you:

- a **Note** that every 90 days you are required to assess whether the effects of the COVID-19 pandemic justify retaining the emergency notification regime (the 'ENR') in the Overseas Investment Act 2005 (the 'OI Act'), with the second 90-day review due by 28 November 2020.

[1,36]

- c **Agree** that the effects of the COVID-19 pandemic justify continuing the ENR and, accordingly, that it should be retained for a further 90 days.

Agree/disagree.

Hon Grant Robertson
Minister of Finance

Agree/disagree.

Hon David Parker
**Associate Minister of
Finance**

Agree/disagree.

Hon Nanaia Mahuta
Minister of Foreign Affairs

- d **Note** that if you agree to recommendation (c), you will be required to make a further decision about whether the conditions justify the continuation of the ENR within 90-days of your decision on this review.
- e **Provide feedback** on the attached draft Treasury press release (Annex Three) to communicate your decision on the first 90-day review of the ENR.
- f **Refer** this report to the Minister responsible for the GCSB and NZSIS, and the Minister for Land Information, for their information.

Thomas Parry
Manager, International

Hon Grant Robertson
Minister of Finance

Hon David Parker
**Associate Minister of
Finance**

Hon Nanaia Mahuta
Minister of Foreign Affairs

Treasury Report: Second 90-day statutory review of the overseas investment emergency notification regime

Purpose of Report

1. The Overseas Investment Act 2005 (the 'OI Act') requires you to assess, at 90-day intervals, whether the effects of the COVID-19 pandemic justify the continuation of the emergency notification regime (the 'ENR').¹ In September 2020, the first 90-day review was completed and Ministers agreed to retain the ENR for a further 90-days.
2. This report provides you with an updated assessment of the current and forecast conditions and seeks your agreement to retain the ENR for a further 90 days. This decision must be made by 28 November to satisfy your statutory obligations.
3. Land Information New Zealand ('LINZ'), the Ministry of Foreign Affairs and Trade ('MFAT'), the New Zealand Government Communications Security Bureau ('GCSB') and the New Zealand Security Intelligence Service ('NZSIS'), the Ministry of Business, Innovation and Employment ('MBIE), and New Zealand Trade and Enterprise ('NZTE') contributed to and support this report's recommendation.

Background to the ENR and 90-day review

4. Foreign investment can provide better access to markets, technology, and capital, resulting in a more productive New Zealand economy. However, overseas ownership or control of New Zealand's sensitive assets can pose risks to our national economic and security interests.
5. The OI Act provides a framework for regulating foreign investment in New Zealand's sensitive assets, which are sensitive land, significant business assets (generally those valued at \$100 million or more),² and fishing quota. The OI Act allows the government to screen foreign investment transactions to ensure that they are not contrary New Zealand's national interest.

The ENR responds to the heightened and additional foreign investment risks caused by the COVID-19 pandemic

6. The COVID-19 global pandemic and related economic downturn created new foreign investment risks and amplified existing gaps in the foreign investment screening regime, which justified a temporary expansion in the Act's scope. In particular, Cabinet noted increases in the following risks:
 - a strategically important assets (such as key airports or other critical national infrastructure) being opportunistically acquired for the purpose of undermining our economic or national security;
 - b ordinarily productive businesses that offer significant positive externalities to New Zealanders being acquired at prices that do not reflect their value; and

¹ Clause 27, Schedule 1AA, Overseas Investment Act 2005 (the 'OI Act').

² Some of New Zealand's Free Trade Agreements provide for a higher monetary screening threshold. For example, Australian non-government investors do not ordinarily require consent for business investments of less than \$536 million.

- c significant portions of key sectors (such as tourism) being foreign owned.
7. Cabinet considered that these risks were relevant both in respect of:
- a entities that would have been subject to screening prior to the economic downturn (for example, entities worth \$150 million at the start of the year now worth less than \$100 million), given their economic significance; and
 - b entities that would not ordinarily be reviewed under the Act for a range of reasons, [1]
8. The Government reformed the OI Act to improve its ability to manage foreign investment risks in this changing environment. It brought forward measures from the already-agreed Phase Two reforms of the OI Act (for example, the national interest test), and introduced the ENR, which came into force in June 2020.

The ENR broadened the scope of overseas investment transactions screened by OI Act

9. The ENR requires overseas persons to notify the government of any new controlling investment in an existing New Zealand business or certain business assets that would not ordinarily require consent. In effect, the ENR temporarily reduced the screening threshold for controlling investments in New Zealand businesses from \$100 million to \$0.

[1,36]

ENR must be reviewed at 90-day intervals

11. Recognising that the ENR is imposing a regulatory burden, and that it has the potential to impose broader economic costs, the OI Act requires joint Ministers to review whether the effects of the emergency justify retaining the ENR, at 90-day intervals, against the three statutory criteria underpinning the ENR.
12. A first 90-day review was completed in September 2020. Ministers decided to maintain the ENR for a further 90 days. The next 90-day review must be made by 28 November 2020.
13. Once the ENR is repealed, it will be replaced by a narrower and permanent national security and public order call-in power (the call-in power), which will apply to a narrower subset of businesses defined as “strategically important businesses” and only allows intervention on national security or public order grounds (not the broader national interest grounds).

14. A separate statutory review of whether the ENR's scope could be targeted while it remains in force is also being progressed and will be provided to Ministers before the end of the year. This is a domestic legal requirement and any decision does not have bearing on whether the ENR can justifiably remain in place in its current form under our international obligations.

Assessment of the effects of the emergency and justification for the ENR

15. Your decision on whether the effects of the emergency justify retaining the ENR must have regard to:³
- a the economic, social, and other effects of the emergency in New Zealand;
 - b any risks to New Zealand's national interest posed by foreign investment; and
 - c New Zealand's international relations and obligations.
16. To support a consistent, robust and transparent approach to each 90-day review, we developed a framework for how we will assess each of the criteria above (see Annex One). Since the first 90-day review in August, we have refined the framework. In particular, we have narrowed the economic indicators to focus on the specific policy concerns underpinning the ENR (recapped in Annex Two).
17. The following analysis relies on the best data available. However, due to the short time the ENR has been in place there is a degree of uncertainty in the assessment of current and future conditions.

Economic, social and other effects of COVID-19

18. Many New Zealand businesses will face their most significant financial pressures and will need to make key funding decisions in the first half of 2021. We therefore consider that current and forecast economic conditions continue to justify the ENR remaining in place for a further 90-days, because the first half 2021 will be marked by:
- a an increase in businesses' need for foreign capital as government support measures end and cashflow challenges increase with credit and domestic capital constrained. This is likely to lead to:
 - i heightened foreign investment risks as business values potentially fall to 'fire sale' prices, and
 - ii a greater need to ensure New Zealand's regulatory system is not deterring high quality overseas investment necessary to support domestic businesses, especially smaller businesses where the proportionate costs of the ENR are higher and risks to the national interest are likely to be less common.

³ Clause 27, Schedule 1AA, the OI Act.

19. Globally, we also expect the first half of next year to be marked by continued weakness in the economic performance of some traditional partner countries, such as the United States and United Kingdom, while some other jurisdictions seem on track to continue a robust recovery (including China). This may result in a change in the composition of where foreign investment is being sourced, as investors in economies doing well look globally to maximise their returns.

National interest risks posed by foreign investment

20. We recommend the ENR remain in force for a further 90 days because there is an ongoing potential for overseas investment transactions to pose national security or economic risks that the OI Act's permanent screening tools are not able to fully manage.

COVID-19 has heightened national security and economic foreign investment risks in New Zealand

[1]

23. In addition to these national security risks, economic risks remain – that is, the risk of ordinarily productive businesses that offer significant positive externalities to New Zealanders being acquired at prices that do not reflect their value to New Zealand, and or/result in the loss of those broader societal and economic benefits.⁴

⁴ Examples of positive externalities include employment, the generation or diffusion of intellectual property, and strong international connections.

[1]

Foreign investment risks to the national interest unable to be adequately managed by the permanent call-in power

25. When the ENR is repealed, the OI Act's enduring screening framework will be in place, which is much narrower than the ENR. As such, it cannot manage as broad a range of risks. The risks identified above would not be able to be adequately managed if the ENR were repealed, because:
- a the call-in power, which will replace the ENR, is designed to manage certain national security and public order risks, so it cannot be used to manage the current broader economic risks identified; and
 - b the call-in power only applies to specific sectors, such as critical national infrastructure, sensitive data, and military and dual-use technology. [1]

New Zealand's international relations

26. As stated above, New Zealand's economy is reliant on the flow of productive foreign investment. New Zealand has agreed investment obligations with a number of international partners to support a transparent and certain environment for foreign investment. [1]

[1]

28. The ENR remains broadly aligned with the changes other jurisdictions have made to their foreign investment screening regimes to manage the economic and national security foreign investment risks posed by the COVID-19 pandemic and related economic downturn. We are not aware of any countries repealing their equivalent regimes. While such equivalent measures are also in place internationally, the ENR is unlikely to generate significant concern.

[1]

the ENR has created material regulatory costs where screening was previously not required. [1]

the ENR is not seen positively by some investors and New Zealand businesses due to the additional burden it imposes on previously unregulated foreign investment.

30. The costs of the ENR are largely fixed and include collecting information, in many cases paying legal fees, and other costs caused by delays in completing a transaction. These costs are proportionally larger for investments in small businesses and may deter investment in such firms. Other factors are also impacting investors' decision about whether to invest in New Zealand (e.g. border closures and ongoing economic uncertainty). It is not possible to isolate the effect of the ENR from these matters.

Next Steps

33. If you agree with our recommendation that the ENR should be retained for a further 90 days, the next periodic review of the conditions and the ENR must occur within 90 days of your decision on this review. If you disagree, and wish to repeal the ENR, we will provide a draft Cabinet paper reflecting this decision, and advice on the process to follow, as soon as is practicable.
34. We have prepared a draft press release communicating your decision on this second 90-day review that we intend to publish on the Treasury's website (see Annex Three). You may wish to provide feedback on this press release or publish a version of this on the Beehive website. We will update the press release accordingly if you disagree with the recommendation to continue the ENR.

Annex One: Revised assessment framework for the 90-day review

The Emergency Notification Regime (ENR) was introduced into the Overseas Investment Act (OI Act) in response to concerns that the COVID-19 pandemic and related economic downturn increased the risk of:

- falling firm values and revenues of ordinarily productive firms to a level below the OI Act's screening thresholds,
- opportunities to acquire distressed assets at fire sale prices,
- increasing numbers of firms requiring urgent access to foreign capital (debt or equity) to remain viable,
- as a result of the above, increased likelihood that foreign investment poses a risk to New Zealand's national security [1]

[1]

The OI Act requires you to make a decision, at 90-day intervals, about whether to continue or withdraw the ENR.⁵ The legislative test is: do the effects of the emergency (the COVID-19 pandemic) continue to justify the ENR remaining in place, with regard to three statutory criteria. An assessment against each of these criteria will guide this decision, with this framework supporting your overall judgment of the costs and benefits of retaining the ENR.

We have developed the framework below to ensure the assessment against the criteria is robust, consistent and transparent. This framework sets out the metrics by which we will generally assess each element of the statutory test and provides qualitative thresholds to guide judgment on whether the conditions support the ENR remaining in force, or whether it should be repealed. This assessment will focus on how the conditions relate to the specific policy concerns underpinning the ENR and not broader or unrelated features of the economic environment. Where significant new information becomes available, we may consider it for inclusion in the framework.

⁵ Clause 27, Schedule 1AA, Overseas Investment Act 2005.

In making the overall recommendation as to whether the ENR should continue or be withdrawn, our advice will weight each component equally and take into account the interrelationship between components. Ministers may elect to weigh factors differently when determining whether the ENR should be continued or withdrawn.

Elements of the emergency (statutory criteria)	Relevant metrics or indicators	Threshold at which effects support continuation/withdrawal of the ENR
<p>The economic, social, and other effects of the emergency in New Zealand.</p>	<p>The economic effects of the emergency should be assessed against, among other factors, the following metrics:</p> <p><i>Macroeconomic indicators</i></p> <ul style="list-style-type: none"> International (and state-level) and domestic economic forecasts, to the extent these indicate projected levels of economic and firm distress. New Zealand activity index (NZAC): this provides a timely and granular assessment of economic conditions, relative to prior years. As such, we assume the economic effects of the emergency will be subsiding when current activity begins to approach pre-COVID levels as measured by the NZAC. <p><i>Firm health indicators</i></p> <ul style="list-style-type: none"> Presence, absence, and expected timeframes for withdrawal of fiscal support schemes: this provides an indication of the degree of reliance of firms on external stimulus, which is relevant to their value and risk to opportunistic acquisition. Equity market valuations: these signal the value of listed firms according to the stock market, and whether those are falling below the OI Act's permanent screening thresholds. Corporate bond and equity activity: these activity levels indicate how well the market is functioning, and therefore whether firms are likely to be undervalued. 	<p>Whether the economic effects support the <i>continuation</i> or <i>withdrawal</i> of the ENR will depend on whether there is an ongoing or anticipated risk of:</p> <ul style="list-style-type: none"> firm values falling below the threshold at which screening requirements would be triggered under the OI Act's enduring screening frameworks, opportunities to acquire distressed assets at fire sale prices, and/or increasing numbers of firms requiring urgent access to foreign capital (debt or equity) to remain viable. <p>To assess this risk, the metrics cited will best reveal the state of firm health, while taking into account the broader landscape (e.g. the extent to which the presence or absence of other schemes may be deferring or masking expected changes in firm health and viability).</p> <p>No bright-line threshold can be set to show when these risks have subsided. As such, we will consider the collective weight and overall trend shown by the metrics to assess whether the market is correctly pricing firms and/or has equilibrated to a 'new post-COVID' normal. We will also consider the extent to which the costs associated with the regime are discouraging investment flows into New Zealand, and the regulatory burden on the OIO associated with the processing of notifications.</p>

	<ul style="list-style-type: none"> • Credit conditions: the supply of domestic credit is indicative of how effectively New Zealand's capital markets are functioning. To the extent that markets are performing and there are few constraints on business' access to capital, the risk that businesses are being 'undervalued' by the market is lessened. • Bank health, including profitability, non-performing loans, and loan loss provisioning: these are indicators of banks' ability to support lending, which affect businesses' access to capital. Loan loss provisioning can also be an early warning indicator of stressed assets, as banks may report non-performing loans before they reach the point of insolvency. • Household and business balance sheets, cashflow pressures, interest cover: these convey the room firms have in their balance sheets to recapitalise, and by extension the extent to which business cashflows are sustainable and resilient or at risk of credit distress. Consideration must be given to whether fiscal support schemes such as payment deferral schemes, which reflect cash flow, are contributing to the creation of 'zombie firms', which are dependent on those schemes for their viability. This can prevent the efficient reallocation of resources within the market. • Insolvency activity: a spike in business insolvencies may indicate that firms are experiencing financial distress and at risk of being undervalued or acquired at fire sale prices. Insolvency activity must be considered in the context of the government fiscal support scheme landscape, and the extent to which insolvency data does or does not account for firms that will cease to be viable once those schemes are withdrawn. Further, higher insolvency activity is not of itself a reason to retain the ENR as it supports the efficient reallocation of resources in the market. <p>The assessment may also take into account any other relevant economic indicator.</p>	
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<p>Any risks to New Zealand's national interest associated with transactions by overseas person.</p>	<p>The emergency's effects on the risks to the national interest should be assessed against, among other factors, the following metrics:</p> <ul style="list-style-type: none"> • Intelligence and Security Agency assessment of foreign investment as a risk to New Zealand's national security and public order, including intelligence on planned or anticipated transactions, • the risk profile of transactions (both those notified and those required to notify but which did not), and the extent to which they pose risks to the national interest, [1] <ul style="list-style-type: none"> • OIO advice on the nature and extent of any transactions that did not comply with notification requirements. 	<p>Whether the conditions support the <i>continuation</i> or the <i>withdrawal</i> of the ENR will depend upon:</p> <ul style="list-style-type: none"> • the nature of the present or anticipated foreign investment risks relative to the pre-COVID environment, and • the sufficiency of the call-in power or other permanent consent frameworks at managing foreign investment risks, to be determined by reference to the risk profile of transactions notified under the ENR.
<p>New Zealand's international relations</p>	<p>The emergency's effects on New Zealand's international relations should be assessed against the following metrics:</p> <ul style="list-style-type: none"> • MFAT and NZTE reporting on the reaction of foreign governments, including as informed by foreign investors, and • status of equivalent policy changes to foreign investment screening regimes in other jurisdictions. 	<p>Whether New Zealand's international relations support the continuation or withdrawal of the ENR will depend upon:</p> <ul style="list-style-type: none"> • the nature (positive or negative) and significance of reactions from foreign governments, including as informed by foreign investors, to the ENR, and • whether other jurisdictions are adopting or retaining similar foreign investment screening policy changes.
<p>[1,36]</p>		

Annex Two: Foreign investment risks posed and exacerbated by COVID-19

The COVID-19 global pandemic and related economic downturn created new foreign investment risks and amplified existing gaps in the foreign investment screening regime, which justified a temporary expansion in the Act's scope. In particular, Cabinet noted increases in the following risks:

- a Strategically important assets being opportunistically acquired for the purpose of undermining our economic or national security. [1]

- b Ordinarily productive businesses that offer significant positive externalities to New Zealanders being acquired at prices that do not reflect their value to New Zealand and/or result in the loss of those broader societal benefits (e.g. employment, the generation or diffusion of intellectual property, or strong international connections). That is, some of New Zealand's wealth would be transferred to the investor's jurisdiction.

- c Significant portions of sectors of New Zealand's economy being foreign owned [1] which in some cases could pose risks.

Cabinet considered that these risks were relevant both in respect of:

- d entities that would have been subject to screening prior to the economic downturn (for example, entities worth \$150 million at the start of the year now worth less than \$100 million), given their economic significance; and
- e entities that would not ordinarily be reviewed under the Act, given
 - i that some sectors that are not ordinarily strategically important, would be for a period of time (e.g. producers of personal protective equipment, logistics companies and providers of certain digital platforms),
 - ii the potential loss of positive externalities generated by these businesses could compound other effects of the COVID-19 pandemic (particularly in regional areas of New Zealand where fewer alternative employers, for example, may exist), and
 - iii that smaller businesses do, in some sectors of the economy, hold significant market share (for example, advanced technology). This increases risks of greater foreign control of certain sectors without action.

Temporary overseas investment screening rules retained

The Government will retain the Emergency Notification Regime in the Overseas Investment Act 2005 for another 90 days to ensure that New Zealand's national interest remains protected.

In June 2020, the Emergency Notification Regime was introduced to ensure that heightened foreign investment risks caused and exacerbated by the COVID-19 pandemic could be managed effectively. The regime allows the Government to screen transactions that do not ordinarily require consent under the Overseas Investment Act, and to impose conditions or block transactions found contrary to New Zealand's national interest.

Ministers are required to review the notification regime at intervals no more than 90 days apart, to assess whether the effects of the COVID-19 pandemic justify it remaining in force. A first review was completed on 30 August 2020, with Ministers deciding to retain the notification regime until 28 November 2020.

Finance Minister Grant Robertson, Associate Minister of Finance David Parker and Foreign Affairs Minister Nanaia Mahuta have completed the second 90-day review of the regime and concluded that the COVID-19 pandemic justifies it continuing for a further 90 days. In making this decision, Ministers were required to consider:

- the economic, social, and other effects of the emergency in New Zealand,
- any risks to New Zealand's national interest associated with transactions by overseas persons, and
- New Zealand's international relations and international obligations.

Retaining the regime for 90 days will ensure that the government can manage any foreign investment risks that may emerge as the economy recovers from the initial shock caused by COVID-19. The Ministers also noted that decisions continue to be made quickly under the regime, with most notified transactions being approved within 10 days.

Ministers' next decision on whether the emergency notification regime should be retained is due by [XX] February 2021. When Ministers are satisfied that the emergency notification regime should no longer remain in force, it will be replaced by a narrower national security and public order call in power. This will only apply to investments in strategically important businesses that do not normally require consent under the Overseas Investment Act, such as those involved in military technology or critical national infrastructure.