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Overseas Investment Act Reform
The Treasury
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CONSULTATION DOCUMENT: REFORM OF THE OVERSEAS INVESTMENT ACT 2005

Introduction

Kia ora; thank you for the opportunity to provide feedback on Treasury's consultation document (the **Consultation Document**) on reform of the Overseas Investment Act 2005 (the **Act**).

Guardians of New Zealand Superannuation (**Guardians, we, our**) is a Crown entity that manages and invests the New Zealand Superannuation Fund (the **Fund**) to help pay for the increased cost of universal superannuation entitlements in the future.

As at 31 March 2019, the Fund totalled $41.6b of which approximately $6b is invested domestically. This includes more than $1 billion in the local share market, along with large investments in Kaingaroa Timberlands, Fidelity Life, Metlifecare, Kiwibank, Hobsonville property, Datacom, NZ Gourmet, expansion capital, and rural farmland and horticultural assets. Further information with respect to our approach to investing in New Zealand is available here.

We appreciate the early engagement and broad consultation that Treasury has undertaken to develop the Consultation Document. It accurately identifies what we perceive to be the major areas where there is scope to refine New Zealand's foreign direct investment screening regime.

We have concentrated our feedback on issues of high relevance to the Fund. While we have not commented on certain more technical aspects of the Consultation Document, we endorse the underlying intent of streamlining the regime so that it applies, more efficiently, to genuinely sensitive assets and transactions.

Our experience is that the recent reforms to the Act concerning forestry investments, which adopted many of the same themes in the Consultation Document as regards simplification and streamlining, have been very well received amongst the foreign investor community.

Context

By way of context to our feedback, Guardians has an interest in the Consultation Document and Act given our need to co-invest on most transactions.

While Guardians / the Fund is not an "overseas person", we are subject to a statutory restriction in our legislation that means we cannot control (which generally means hold more than half the shares in) certain entities.[1]

As a result, we need high quality capital partners to co-invest with in New Zealand investments. In many cases, foreign investors are a natural partner for us due to their depth of capital and expertise. This is particularly the case as the Fund grows in size over time and undertakes increasingly larger transactions.

For instance, we co-invest with PSP Investments on Kaingaroa Timberlands – the Fund's single largest asset. Such co-investors contribute valuable expertise and capital.

Efficient and predictable foreign direct investment screening rules are important to attracting the overseas capital that the Consultation Document identifies we need as a country:

- The peers we seek to co-invest with in New Zealand and elsewhere are leading global investors that can invest their capital in many different jurisdictions;
- Given the complexity and resource involved in foreign direct investments, investors value efficiency and predictability of any necessary regulatory approvals;
- In assessing opportunities, investors also consider their ability to make follow-on investments and also their liquidity/exit options. Any substantial constraints on the availability and timing of liquidity can have a chilling effect on an investment opportunity;
- Note that we also take into account these very same regulatory hurdles and liquidity considerations in our investment decisions outside New Zealand where we are classified as a foreign investor under local laws.

As the consultation document highlights, aspects of the Act's approval regime are comparatively complex and, as such, result in lengthy application processes. There is a risk that this makes investment in New Zealand less appealing than in other jurisdictions.

As well as needing to invest alongside overseas parties, the Fund also needs flexibility to exit New Zealand investments from time to time, in order to optimise its portfolio. Given the size of the private market investments we hold, this can necessitate including foreign buyers within the sales process in order to maximise value.

Feedback on issues in Consultation Document

Sensitive adjoining land

We agree that land that merely adjoins other land with sensitive characteristics (but which has no such characteristics itself) should be excluded from the definition of "sensitive land". The current position, where this adjoining land triggers a consent requirement, results in unexpected outcomes for overseas investors and avoidable compliance costs. We are aware that this is an issue of concern for overseas investors.

Leases of sensitive land that require screening

We support relaxing the screening requirements for short-term leasehold land. Vetting transactions solely because they involve a short term lease of "sensitive land" does not

[1] Section 59 of the New Zealand Superannuation and Retirement Income Act 2001.

meaningfully protect New Zealand's interests, since the very nature of a lease is that the underlying land is not permanently alienated from New Zealand ownership.

If a transaction is genuinely sensitive, then it would trigger a consent requirement on another basis (e.g. due to its cheque size exceeding the approval threshold or the transaction also involving more sensitive interests in land, such as a freehold interest or a longer term lease).

Option 2 (requiring screening of leases from 10 year terms for more sensitive land and 35 year terms for other land) is the better approach, since it calibrates the term of the lease that triggers a consent requirement to the sensitivity of the underlying land.

The definition of overseas person as it relates to bodies corporate

We support concessional rules for determining whether NZX listed issuers are overseas persons.

Ownership of listed companies changes constantly. Listed issuers can become overseas persons without necessarily being aware of it and without any single foreign shareholder being in a position to influence the issuer meaningfully.

It is simply not possible for issuers to ascertain their precise overseas ownership levels at any point in time. As the Consultation Document notes, there is a timing delay in procuring shareholder analytics reports. In addition, the information in such reports on an issuer's beneficial ownership by region does not allow an issuer to assess accurately whether or not such owners are "overseas persons" for the purposes of the technical tests in the Act.

There are also other important protections that regulate governance and control of NZX listed issuers. For instance:

- the listing rules include requirements around matters such as a minimum number of independent directors;
- the Takeovers Code precludes any person (which would include any overseas person) or group of associates from acquiring a 20% or more shareholding without complying with the Takeovers Code;
- similarly, the associate rules in the Takeovers Code would regulate a group of small overseas shareholders acting together and leveraging their collective shareholding to influence an NZX listed issuer in a significant way.

As an example of the unusual results that can arise in a listed context, the Fund is the single largest shareholder in Metlifecare Limited (NZX: MET) at 19.9% and ACC also holds 5%. Metlifecare is incorporated in New Zealand; all of its directors and senior managers are, to our knowledge, "New Zealand" persons. Nonetheless, Metlifecare is deemed an "overseas person" by virtue of its deemed aggregate overseas ownership, partly on the basis of New Zealand institutional investors who have ultimate Australian-ownership lines. This results in unnecessary compliance costs and time, together with restrictions on Metlifecare's ability to be competitive in purchasing land.

We do not have a strong view on the different options outlined in the Consultation Document, but consider the solution should be:

- available to issuers 'as of right' rather than through applying for an exemption; and
- efficient for listed issuers to apply. Ideally, issuers would not be required to continually undertake granular shareholding analysis at excessive time and cost but instead be entitled to rely upon substantial product holder filings under the Financial Markets Conduct Act 2013 (**FMCA**) which require holders of substantial interests in listed issuers to notify their interests to the issuer and market from a filing threshold of 5%.

Shareholdings below that are difficult for the listed issuer to track, and carry less influence over the issuer.

Incremental investments above a 25% interest

In assessing investment opportunities, investors want confidence that they can deploy incremental capital and increase their position in an investee company within a commercially reasonable timeframe. Overall, this is a beneficial thing to permit/encourage, since investors would often want to deploy further capital to matters such as supporting growth initiatives or averting a pressing solvency requirement.

The issue with the existing settings is that:

- providing further capital can result in an overseas person increasing its ownership percentage in the investee, requiring consent under the current rules (unless the narrow exemption applies);
- the circumstances and urgency in which capital is required would often not accommodate a further approval under the Act.

This could discourage foreign investors from partnering with local asset owners who have less capital readily available to invest, because if there is a further capital requirement it will need to be funded by the overseas owner and trigger a consent requirement[2].

Option 1 appears to be a sensible solution, in that it allows overseas persons to increase their ownership percentage without the need for consent so long as they remain within relevant control 'bands'. In our view it does not make a significant difference whether the overseas person adjusts its ownership percentage, so long as it within the applicable band and does not pass a control threshold.

Screening the impact of investments

This is the most significant aspect of the consultation. As the Consultation Document notes, the benefit to New Zealand test is complex and duplicative, resulting in application processes being more protracted and expensive for applicants than in other jurisdictions.

The existing counterfactual test, where the benefits are measured against a hypothetical scenario of (normally) a competent and adequately funded New Zealand buyer, compounds the uncertainty for investors.

Our experience is that foreign investors aim to enhance their businesses so that they are run to a high standard. However, once a business is well managed, under the current regime it becomes incrementally more difficult to sell, because a foreign buyer has less scope to demonstrate that it will bring fresh benefits required to receive consent. This ultimately becomes an insurmountable hurdle for overseas investors, because there is little that subsequent acquirers can commit to do in order to add additional benefits.

Ultimately this creates a constraint on liquidity, which can deter potential investors (both domestic and overseas) from investing in assets that are either mature or where the

[2] Note that this issue does not arise where the foreign investor partners with a domestic investor that can match their equity commitment (as the funding can be provided pro rata so does not increase the overseas ownership). As such it has a greater impact where an overseas person seeks to partner with local asset owners who may be asset rich but do not have readily available capital.

investment thesis is to develop the target assets to a mature state.[3] Even long term investors need the certainty of knowing that they can exit their investment at full value.

The threshold for determining whether an investment is beneficial

We support Option 3, being:

- rationalising the benefit factors to remove duplication;
- including a 'back stop' test under which the Ministers can decline certain specified types of transactions;
- removing the requirement for the benefits attributable to investments involving certain land to be "substantial and identifiable"; and
- removing the ability to add new benefit factors by regulation and other initiatives set out in paragraphs 201 and 209 of the Consultation Document.

In our view, it is essential that the "national interests" test is framed in the same way as in the Foreign Acquisitions and Takeovers Act 1975 of Australia – i.e. that the transaction proceeds unless it is "contrary to the national interest".

As currently described in the Consultation Document, the Ministers would be required to carry out a for/against type assessment to determine whether the transaction is in the national interests. This would be overly complex and set a high bar to foreign investment that would be out of step with the national interests test in Australia.

We believe the "contrary to" formulation is preferable for the following key reasons:

- since the "national interests" test applies as a back-stop, it is only ever engaged when the transaction has already established the requisite benefit to New Zealand;
- given the investment has already shown a benefit to New Zealand, it is sufficient that the Minister can decline consent if there are others factor which means the investment is contrary to our "national interests";
- as such, requiring the investor to positively show that the investment is in the "national interest" would be repetitive and contrary to the intended outcome of the reform process of reducing unnecessary complexity;
- if the test is framed in the manner we suggest, it will be a familiar concept for foreign investors, which will mitigate the uncertainty that the Consultation Document identifies as a risk of this option.

It will be important for Ministers to develop meaningful guidance with respect to how the test will consistently be applied. With that in mind, the indicative considerations set out in the Consultation Paper would ideally either be modified by removing the "any other matters" catch-all language or alternatively removed entirely and left to guidance.

Our feedback assumes that Option 3 is implemented as an overall package, including alongside the changes to the counterfactual test (covered below). If Option 3 was implemented in part only, or our suggested clarification to the "national interests" test was not adopted, then the resulting test could ultimately be more complex and uncertain for foreign investors than the status quo.

We agree with the broad asset classes identified in the Consultation Document as being subject to the national interest test. However, these would need to be narrowed in any detailed amendment to isolate the areas of genuine national significance.

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[3] While the commentary on this issue has largely focused on "well run" / mature asset classes, it can also be an issue for greenfield investment, which the Consultation Document states is the most valuable form of foreign investment. Once a greenfield development is complete, there may be little incremental benefits for a subsequent foreign owner to implement.

Importantly, the Consultation Documents notes that all applications by "foreign governments" and their "associates" would trigger screening on a "national interests" basis. The label "foreign government" can include a wide range of different entities, and potentially include many of our peers which have a range of different ownership and governance models. Any definition would need to be carefully thought out so that it is not overly broad, and in our view also include an exemption pathway for entities which can demonstrate that they operate on an independent commercial basis from the applicable government.

It is not entirely clear how the "associate" concept is intended to work in the context of foreign government investors. It is important, however, that the associate provisions do not have unintended consequences for domestic investors such as the Fund. For instance, we would not wish to be classified as an "associate" and subject to any requirements under the Act as a result of co-investing with overseas peer funds.

The counterfactual test

Sub-option A (comparing the investment to the current state of the land/activities) is the simplest and most effective option.

We agree that it should include the "no detriment" mechanism for sales between foreign owners. As well as the reasons outlined under "Screening the impact of investments" above:

- the original divestment from New Zealand ownership has already been approved, and the requisite benefit established;
- once the land/business is held by an overseas owner, from a policy perspective it should be sufficient that any subsequent overseas owner is of good character and maintains the required benefits;
- the "no detriment" approach is beneficial to New Zealand more generally, since facilitating transfers between overseas owners provides greater certainty around liquidity/exit which can in turn make investment in New Zealand more attractive.

Sub-options B (comparing the investment to what would happen under the vendor's continued ownership) and C (a tweaked version of the existing counterfactual test) are overly complex and/or do not meaningfully improve on the status quo. For instance, it would be artificial to compare a proposed investment against what would happen if the vendor continued to own the asset given that the vendor has made the decision to sell.

Tax and the Act

We support the Corporate Taxpayers Group's feedback on tax matters.

Timeframes for decisions

We support the concept of statutory timeframes, since they can provide greater confidence in the process to foreign investors. It will be important that any legislated timeframes are consistent with other comparable jurisdictions such as Australia, are benchmarked periodically and are also realistic. If the timeframes are extended as a matter of routine then this undermines any improved certainty provided by baking timeframes into the legislation.

It seems to us that Option 2 (with a varying timeframes based on the type of approvals required) is the preferable approach. The suggested timeframes set out in the Consultation Paper seem to be a reasonable starting point, although ideally they would be reduced once any legislative and process refinements resulting from this consultation have been bedded in.

We do not have a strong view as to when the timeframes should commence, although Sub-Option B does have the benefit of incentivising front-loading any questions to foreign investors.

We would be happy to discuss any aspects of this feedback with you. Please note that we will make the letter available on our website.

Yours sincerely

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