

# The Treasury

## Phase 2 Overseas Investment Act Reform Information Release

July 2019

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Chair, Cabinet Economic Development Committee

## **REVIEW OF THE OVERSEAS INVESTMENT ACT 2005: TERMS OF REFERENCE**

### **Proposal**

1. This paper seeks agreement to the Terms of Reference (Annex One) for a review of the Overseas Investment Act 2005 (and the associated Overseas Investment Regulations 2005), as well as timeframes for the completion of the review.
2. Consistent with paragraph 2.39 of the Cabinet Manual, I submit this paper with the knowledge and approval of the Minister of Finance.

### **Executive Summary**

3. Open capital markets and foreign direct investment can offer a number of economic advantages, including enhanced productivity, greater competition, and stronger and more diverse international relationships. However, it can also present a number of risks. It may erode social capital; may, at times, be counter to New Zealand's national interest; and can conflict with the view held by some New Zealanders that New Zealand's sensitive assets should generally be owned and controlled by New Zealanders. New Zealand has a number of pieces of legislation in place to mitigate against such risks. In particular, the Overseas Investment Act 2005 (the Act) provides Ministers with a mechanism to screen investments by overseas persons in sensitive New Zealand assets. This regime will soon also include residential land, forest registration rights, and regulated profits-à-prendre due to our successful work on the Phase One review of the Act.
4. While the Act is quite effective in screening investment, there is a perception that it is overly complicated (particularly in relation to non-controversial transactions) – a perception reported by the Organisation for Economic Co-Operation and Development (OECD) and consistent with what I have heard from those using the current system, including retirement village operators. This may reduce New Zealand's attractiveness as a foreign investment destination with potential economic costs. Operational changes alone will be insufficient to remedy this.
5. At the same time as changes to reduce the regime's complexity may be warranted, the Government's ability to screen investments on 'national interest' grounds is more limited than it is in many comparable jurisdictions, including Australia and Canada. In particular, Ministers have limited discretion to directly consider dis-benefits under a specific factor if the applicant is not claiming a benefit under that factor (that is, to negatively weight a factor). However, it remains the case that if an applicant cannot demonstrate a benefit under a factor that is of high relative importance then they may not be able to demonstrate sufficient benefits overall to gain consent (that is, while not explicitly assessing a

potential 'disbenefit' of an investment as grounds to withhold consent, failure to satisfy a benefit factor can be grounds to withhold consent).

6. Consequently, I propose a review of the Act to ensure that it strikes the right balance. We do want to facilitate additional investment that supports a productive, inclusive and sustainable economy, by creating opportunities for regions and businesses to grow and connect internationally, while ensuring that investments that are not in New Zealand's national interest or are not likely to benefit New Zealand can be efficiently declined.
7. The review would also consider any technical amendments required to ensure that recent changes to the Act relating to the screening of residential land, forestry assets (including forest registration rights) and regulated profits-à-prendre operate effectively. A reassessment of the fundamental design of these changes, however, would be out of scope.
8. Further, consideration of screening additional categories of assets under the regime would also be out of scope, given any additions would be inconsistent with New Zealand's international obligations. However, consideration of the range of factors taken into account when assessing whether to provide consent to acquire an asset that is already screened under the Act, and potentially adding to them, would be within scope of this review.
9. To ensure that the right issues are identified and to build public support for any required reforms, I propose the review be held in close consultation with key users of the Act, Māori and iwi groups, as well as relevant government agencies.<sup>[4]</sup>
10. The commissioning of this review itself has no financial or legislative implications, however any recommendations emerging from the review may. If this is the case, I will seek Cabinet authority for such changes in conjunction with Cabinet's consideration of any such policy matters.
11. I anticipate that, if approved, the review team would provide Cabinet with a discussion paper for consideration in the first quarter of 2019<sup>[4]</sup>

### **Recent changes to the overseas investment regime**

12. Consistent with our election commitments, we have just completed the most significant reform of the Overseas Investment Act 2005 in more than a decade. These changes include:
  - 12.1. bringing residential land into the screening regime for sensitive land, which means that overseas persons will generally no longer be able to purchase existing homes;
  - 12.2. rationalising the regime for forestry investment by requiring acquisitions of forestry registration rights and certain other profits-à-prendre (that

were previously exempted from the definition of sensitive land) to be screened prior to purchase; and

- 12.3. streamlining the screening regime for the acquisition of forestry land (whether via a freehold or leasehold interest or a forestry registration right) to encourage and facilitate investment in this critical part of the economy.
13. The pace of this first tranche of changes was driven by the timing of Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). After CPTPP enters into force we will be constrained in our ability to screen new types of sensitive land or other assets. Therefore, to date we have concentrated on those changes that must be in place ahead of CPTPP entering into force.

### **Costs and Benefits of Overseas Investment**

14. Open capital markets facilitate the efficient movement of capital, which can support economic growth and social wellbeing. International evidence suggests that foreign direct investment can offer particular advantages, including:
  - 14.1. increased rates of innovation and technology transfers;
  - 14.2. more rapid adoption of global best practices in governance, management, financing and/or operational expertise;
  - 14.3. access to foreign markets and participation in global value chains;
  - 14.4. productivity improvements throughout the value chain;
  - 14.5. enhanced competition; and
  - 14.6. stronger and more diverse international connections that can mitigate against some risks associated with increased global protectionism and those of being a relatively small and distant market more generally.
15. Foreign direct equity investment can also offer broader benefits in terms of macroeconomic stability, with such flows likely to be less volatile and 'stickier' than market-based debt finance.
16. These benefits, however, must be balanced against:
  - 16.1. the risks that not all foreign investment is productive or offers significant spillover benefits (for example, the benefits of foreign investment for firms operating at a similar level in the value chain seem limited in New Zealand); and
  - 16.2. that high levels of foreign investment may erode social capital in some cases and can run counter to the view held by some stakeholders that New Zealanders should generally own and control New Zealand's sensitive assets.

17. Where investment is desirable the process for approval should be as efficient as possible. This is not the case currently as applications for consent to acquire significant businesses assets (for example) take an average of five months to process (still a significant improvement on prior years) and cost \$32,000 to apply for, plus substantial legal and other professional services fees to prepare an application.

## **Rationale for a review of the Act**

### *Better balancing of costs and benefits*

18. I do not believe that the Act balances the costs and benefits of overseas investment appropriately. I consider that there is more that can be done to ensure that the screening regime supports our vision for a productive, inclusive and sustainable economy and creates sufficient opportunities for regions and businesses to grow, connect internationally, and increase productivity (consistent with Government priorities for the 2019 Budget).
19. This view is informed by the fact that our screening regime is perceived to be overly restrictive by the OECD<sup>1</sup> (irrespective of the merits of that assessment). I have also received anecdotal evidence from those using our current system who have indicated that the complexity and uncertainty associated with the regime is discouraging some investment in New Zealand. Data from the Overseas Investment Office (OIO) shows that the average processing time for consent applications is over 100 working days. While this has improved over the last 18 months and additional process improvements expected to reduce this further in the future, due to the discretion available under the Act this figure is expected to remain high.
20. Given that capital is globally mobile, perceptions and actual delays may reduce New Zealand's attractiveness as a foreign investment destination and ultimately negatively impact on the productivity and resilience of our economy. These risks do not appear to have yet materialised in light of nearly \$5 billion in new foreign investment between July 2016 and June 2017<sup>2</sup> and high levels of foreign investment in a number of sectors (for example, the financial services, agribusiness, and energy and power sectors).<sup>3</sup> However, they are worth monitoring and addressing given that:
  - 20.1. New Zealand attracts proportionately lower inflows of foreign investment than many other small advanced economies<sup>4</sup> (suggesting an opportunity for increased levels of foreign investment); and

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<sup>1</sup> OECD Foreign Direct Investment Regulatory Restrictiveness Index:

<http://www.oecd.org/investment/fdiindex.htm>

<sup>2</sup> Stats NZ: Global New Zealand International trade, investment, and travel profile Year ended 30 June 2017

<sup>3</sup> KPMG Foreign Direct Investment in New Zealand: Trends and Insights (2015):

<https://assets.kpmg.com/content/dam/kpmg/pdf/2015/08/KPMG-Foreign-Direct-Investment-analysis-August-2015.pdf>

<sup>4</sup> Landfall strategy group: Foreign direct investment in small economies (August 2018)

- 20.2. the stock of foreign investment in New Zealand was \$103.9 billion as at 30 June 2017 (which includes investment in property and other real estate).

*Ensuring investment is in New Zealand's national interest*

21. I also consider that the Act could play a stronger role in ensuring that investment in sensitive assets is in New Zealand's national interest. Other jurisdictions, such as Australia and Canada, have the explicit ability to decline proposed transactions that are found to be inconsistent with their national interest. This gap in our regime is of particular concern to me and I consider it necessary to review our approach to ensure that it is in line with global best practice.

*Limited scope for operational improvements*

22. Operational changes alone will not be sufficient to address these issues. Since 2016, the OIO has reduced processing times and improved resourcing. The OIO's processes and culture have been subject to a number of reviews, with a 2018 Office of the Auditor General (OAG) review finding that the OIO consistently addressed all the required criteria and demonstrated effective judgement when providing advice on applications. Given that, the OIO have limited ability to make more than marginal improvements to the operation of the regime within the current legislative framework.
23. It is therefore essential to simplify the legislative rules and processes around overseas investment, where this can be done without undermining the regime's strength. Unnecessary red-tape can impose significant costs on applicants and the government.

**Scope of the review of the Act**

24. I do not recommend that the Government undertake a 'first principles' review of the Act. In particular the following matters will not be considered:
- 24.1. whether the Act is required;
  - 24.2. whether the sale of sensitive New Zealand assets, irrespective of their ownership, to overseas persons is covered by the Act; and
  - 24.3. substantive issues related to the Phase One review of the Act.
25. I recommend that the Phase Two review consider whether the following aspects of the Act are appropriate:
- 25.1. the definition of 'overseas persons' as it relates to body corporates;
  - 25.2. the factors underpinning the existing generic "benefits to New Zealand" test (including whether water extraction, Māori cultural values as they relate to the physical and historical characteristics of the relevant sensitive land and tax residency should be among the positive and negative factors considered when assessing applications made under that test);

- 25.3. the extent that any 'negative benefits' of a prospective investment can be considered under the "benefits to New Zealand" test and, if necessary, whether there needs to be additional legislative guidance on how 'benefits' and 'negative benefits' should be balanced;
- 25.4. the investor test, with particular regard to whether the requirements are appropriate and provide sufficient certainty to applicants;
- 25.5. existing levels of Ministerial discretion, with particular regard to whether the appropriate balance is struck between:
  - creating certainty for applicants; and
  - allowing for a more holistic and adequate consideration of the implications of foreign direct investment on New Zealand's national interest (that is, consideration of the need for a 'national interest' test similar to those in place in Australia and Canada, and under consideration in the United Kingdom, that can grant Ministers broad powers to approve or decline investments);
- 25.6. the treatment of land adjoining other types of sensitive land, as set out in Table 2 of Schedule 1 of the Act (an important issue for retirement village operators and developers); and
- 25.7. any minor technical amendments required to resolve unintended consequences associated with the implementation of the Phase One reforms.

## Review Process

- 26. The review will be led by Treasury, working closely with other agencies including the Department of Prime Minister and Cabinet (DPMC), Land Information New Zealand, the Ministry of Business, Innovation and Employment (MBIE), the Ministry of Foreign Affairs and Trade (MFAT), the Ministry for the Environment (MfE), the Ministry for Primary Industries (MPI), Te Uru Rakau, Fisheries NZ and the Office for Crown-Māori Partnership. The review would be undertaken in two broad, concurrent, workstreams covering the scope outlined above:
  - 26.1. **A stronger Overseas Investment Act:** This workstream will consider whether the Act allows sufficient consideration of whether a transaction would be in New Zealand's national interest and, if not, what remedies are available (consistent with the second sub-point to paragraph 25.5). For example, this could include the ability to examine investments in significant business assets with monopoly characteristics by overseas persons (for example, infrastructure) on competition grounds, or greater consideration of the importance of New Zealand companies with international distribution systems to New Zealand's participation in global value chains when considering granting consent. In considering possible legislative solutions (if required), I envision that comparable jurisdictions' foreign investment screening regimes would be closely analysed to ensure that our regime operates consistent with global best practice.

- 26.2. **A better and more efficient Overseas Investment Act:** this will look at all other matters in scope of the review beyond the potential introduction of mechanisms to ensure that New Zealand's national interest is adequately protected by the Act. It will focus on identifying options to reduce decision times for applicants, as well as whether key tests embedded in the Act appropriately balance the need to create certainty for investors and allow for quicker approval of productive investments, while maintaining sufficient discretion to quickly decline investments that are not beneficial to New Zealand. This will be the largest workstream, examining the Act's key components with the objective of simplifying and streamlining processes to better facilitate productive investment, while ensuring that sensitive New Zealand assets are adequately protected.

This workstream will include all issues in scope of the review beyond consideration of whether the Act adequately protects New Zealand's national interest.

27. The review would take a collaborative approach to both ensure that the right problems and potential solutions are identified, and to build support for any recommended changes. However, given that each workstream will be of divergent value to different stakeholders it would be appropriate for officials to tailor the engagement process for each workstream, to reflect the levels of collaboration and consultation necessary to deliver outcomes consistent with our objectives.
28. For example, for the "better and more effective OIA" workstream, I propose that officials would take a user driven and bottom-up approach, working closely with heavy users of the system (such as law firms, investors and the OIO) as well as other key stakeholders to identify specific inefficiencies caused by the legislation. The Government's new Advisory Group on forestry will have a role in providing advice on any technical changes that are necessary as a result of the Phase One amendments.
29. It will also be critical for the Government to engage with Māori and iwi groups to help ensure that any recommendations for reform are consistent with the Crown's Treaty of Waitangi obligations. Treasury will work with the Office for Crown-Maori partnership and TPK to develop an engagement plan for the review, which is likely to include informal engagement alongside the policy development process, to build relationships and mutual understanding of key issues ahead of the formal public consultation.
30. I anticipate bringing a discussion document informed by these initial engagements to Cabinet for consideration by March 2019, to be followed by public consultation.

### **Interaction with other Government priorities**

31. There are several other key pieces of work that this review would need to consider before making any recommendations to ensure that they are consistent with, and complement, the Government's broader agenda. This will be achieved through ongoing consultation between the Treasury and other relevant agencies. Relevant projects across government include:

[4]

31.4. consultation on the Trade for All strategy (MFAT).

32. During the proposed review, the operation of the residential and forestry changes introduced following the Phase One review of the Act will become clearer and any unintended consequences will begin to become apparent. I propose to address any minor and technical issues related to Phase One that emerge during the Phase Two review as part of the Phase Two review's legislative process.

### **Consultation**

33. The following departments and agencies were consulted in the development of this paper: MFAT, Land Information New Zealand, MBIE, NZTE, MfE, MPI, Te Uru Rakau and Fisheries NZ. DPMC was informed.

### **Financial Implications**

34. There are no direct financial implications associated with this paper's recommendations. Recommendations arising from the review may have financial implications and, if required, I will seek Cabinet authority for any additional funding required in conjunction with any policy changes when those are considered.

### **Legislative Implications**

35. There are no legislative implications arising from the recommendations in this paper. Legislative and regulatory changes will likely be required once the proposed review is complete. I will report to Cabinet on proposed options for reform as policy progresses.

### **Publicity**

36. I intend to publicly release the attached Terms of Reference following Cabinet's agreement. Continued public engagement throughout the review will also be important, hence my proposal to release a discussion document in the first quarter of next year and commitment to engage throughout the review process with our Treaty partners.
37. This review is likely to attract comment from a range of stakeholders with divergent perspectives on the role of foreign investment in New Zealand. It will therefore be important for the Government to continue to publicly articulate both the value of foreign investment as well as the need for an effective screening regime to ensure that such investments are of benefit to New Zealand to ensure that any amendments required to be made to the Act can proceed with broad public understanding and support.

## **Proactive Release**

38. I intend to proactively release this paper, subject to redactions as appropriate under the Official Information Act 1982.

## **Recommendations**

The Associate Minister of Finance recommends that the Committee:

1. **agree** to a further review of the Overseas Investment Act.
2. **agree** to the attached Terms of Reference for the Overseas Investment Act Review: Phase Two.
3. **note** that I intend to publicly release the attached Terms of Reference following confirmation by Cabinet.

Authorised for lodgement

Hon David Parker

**Associate Minister of Finance**

## **Annex One**

### **Review of the Overseas Act 2005: Terms of Reference**

The Associate Minister of Finance, the Honourable David Parker, has requested that the Treasury lead a review of the Overseas Investment Act 2005 (the Act) and the associated Overseas Investment Regulations 2005. This review is to build on the Government's recent amendments to the Act to rationalise the screening regime for forestry assets and certain other profits-à-prendre and generally require overseas persons to obtain consent to acquire residential land.

#### **Purpose**

The review's aim, having regard to the Act's purpose "that it is a privilege for overseas persons to own or control sensitive New Zealand assets", is to:

- enable the Government to effectively manage overseas investment; while
- ensuring that the Act operates efficiently and effectively; and
- supporting overseas investment in productive assets.

#### **Context and rationale**

Open capital markets and foreign direct investment can offer a number of economic advantages, including enhanced productivity, greater competition, and stronger and more diverse international relationships. However, they can also present risks and may conflict with both our cultural identity and the view held by some New Zealanders that sensitive New Zealand assets should generally be owned and controlled by New Zealanders.

New Zealand has a number of pieces of legislation in place to mitigate against such risks, including the Act. Consistent with the Act's purpose (Section 3) ("that it is a privilege for overseas persons to own or control sensitive New Zealand assets"), the Act provides Ministers with a mechanism to screen investments by overseas persons in sensitive New Zealand assets and, in respect of investments in sensitive land, to ensure that these investments are of benefit to New Zealand.

While the Act is effective in screening investments, there is a perception among some domestic and international stakeholders (particularly the Organisation for Economic Co-Operation and Development) that it is overly restrictive and operates too slowly (particularly in relation to non-controversial transactions). For example, critiques of the Act include that:

- the application process is too complex and that both the criteria for consent and the conditions imposed after receiving consent are more onerous than necessary;
- the level of discretion in the Act both creates unnecessary uncertainty for investors and for decision makers and can result in significant delays in decision making;
- the Act could do more to attract investment to productive sectors of the economy; and

- the Act is not sufficiently clear on the grounds for which a prospective investment in sensitive New Zealand assets would be declined.

Negative perceptions may reduce New Zealand’s attractiveness as a foreign investment destination, with potential costs for economic strength and resilience. Given that there was nearly \$5 billion in new foreign investment between July 2016 and June 2017 and that processing times for consent applications have considerably reduced over the last 18 months, these risks do not appear to have materialised. However, they are worth monitoring and addressing in light of both: the significant stock of foreign investment in New Zealand (\$103.9 billion as at 30 June 2017, including investment in property and other real estate)<sup>5</sup> and the fact that New Zealand receives proportionately lower levels of foreign direct investment than many other small advanced economies.<sup>6</sup>

There is also a counter view that the Act does not sufficiently protect New Zealand’s national interest. The Act is much less developed than those in many comparable jurisdictions – including Australia and Canada – in relation to screening investments on a holistic basis to ensure that they are consistent with New Zealand’s national interest. For example, under the criteria available under existing consent pathways New Zealand has limited ability:

- to screen investments in significant business assets with monopoly characteristics (for example, some types of infrastructure) on competition grounds;
- to consider the importance of New Zealand companies with international distribution systems to New Zealand’s broader participation in global value chains; or
- for Ministers to examine benefit factors identified in the Act and regulations, but deemed not relevant to the particular foreign investment by the applicant.

Reviewing the Act will aim to ensure that it strikes the appropriate balance between the need for high-quality investments to be efficiently approved, against:

- the need to restrict investments that may be unproductive, unbeneficial to New Zealand, or otherwise inconsistent with New Zealand’s national interest; and
- the view held by some stakeholders that New Zealanders should retain ownership and control of sensitive domestic assets and the Act’s purpose “that it is a privilege for overseas persons to own or control New Zealand assets”.

### **Objectives for the review**

The review will seek to ensure that New Zealand’s screening regime for overseas investment:

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<sup>5</sup> Stats NZ: Global New Zealand International trade, investment, and travel profile Year ended 30 June 2017

<sup>6</sup> Landfall strategy group: Foreign direct investment in small economies (August 2018)

- a) provides a clear pathway for consent for investment that supports a productive, inclusive and sustainable economy and creates opportunities for regions and businesses to grow and connect internationally;
- b) provides appropriate protection against risks to New Zealand associated with the overseas ownership of sensitive assets, with particular consideration of whether New Zealand's national interest is sufficiently protected; and
- c) imposes compliance and administrative costs (as distinct from fees and other direct costs of applying for consent) that are proportionate to the risks associated with overseas investments.

Further, any proposed changes to the regime should:

- improve predictability and transparency around the process and decision making (by Ministers, and where relevant, the Overseas Investment Office) wherever possible; and
- ensure that discretionary powers appropriately balance the need to both create certainty for investors while reserving the ability to decline investments that are not beneficial to New Zealand.

In working to achieve these objectives, the Act is to comply with the Crown's Treaty of Waitangi obligations as well as our international obligations, including Free Trade Agreements and commitments at the World Trade Organisation.

Finally, if national interest considerations were to be more explicitly accounted for when screening investments following the conclusion of this review, the intention is that consent would only be refused on national interest grounds rarely, with the goal of supporting confidence in New Zealand as a foreign investment destination.

## **Scope**

Consistent with the objectives listed above, the review will consider whether the following are appropriate:

1. the definition of 'overseas persons' as it relates to body corporates;
2. the factors underpinning the existing generic "benefits to New Zealand" test (including whether water extraction, Māori cultural values as they relate to the physical and historical characteristics of the relevant sensitive land and tax residency should be among the positive and negative factors considered when assessing applications made under that test);
3. the extent that any 'negative benefits' of a prospective investment can be considered under the "benefits to New Zealand" test and, if necessary, whether there needs to be additional legislative guidance on how 'benefits' and 'negative benefits' should be balanced under that test;
4. the investor test, with particular regard to whether the requirements are appropriate and provide sufficient certainty to applicants;

5. existing levels of Ministerial discretion, with particular regard to whether the appropriate balance is struck between:
  - 5.1. creating certainty for applicants; and
  - 5.2. allowing for a more holistic and adequate consideration of the implications of foreign direct investment on New Zealand's national interest (that is, consideration of the need for a 'national interest' test similar to those in place in Australia and Canada, and under consideration in the United Kingdom);
6. the treatment of land adjoining other types of sensitive land (that is, land as described in Table 2 in Schedule 1 of the Act); and
7. any minor technical amendments required to resolve unintended consequences associated with the implementation of the Phase One reforms.

### **Out of scope**

This is not a 'first principles' review of the Act – whether the Act is required is out of scope.

Further, this review will not reconsider whether the sale of sensitive New Zealand assets, irrespective of ownership, to overseas persons is covered by the Act.

The review will not revisit substantive issues associated with the recently passed Overseas Investment Amendment Act (for example, requiring purchases of residential land and forestry rights over sensitive land by overseas persons to be screened).

### **Constraints**

The review is not intended to result in the screening of investments that are not currently screened (or those that will not be screened following the commencement of the Overseas Investment Amendment Act).

The review will only develop policies consistent with New Zealand's international obligations.

### **Process**

Treasury will lead the review in two broad, concurrent, workstreams:

1. **a stronger OIA**, which will consider whether the Act adequately protects New Zealand's national interest; and
2. **a better and more efficient OIA**, under which all other issues within the scope of the review will be considered.

In conducting the review, Treasury will work collaboratively with other agencies and external stakeholders as appropriate. Key government agencies including the Overseas Investment Office, the Ministry of Foreign Affairs and Trade, the Ministry for Business, Innovation and Employment, New Zealand Trade and Enterprise, Te Puni Kōkiri, the Ministry for the Environment, the Office for Crown-Māori Partnership and the

Department of Prime Minister and Cabinet. In addition to consultation within Government, Treasury will consult with users of the regime, Māori and iwi groups, and the general public throughout the review.

It is expected that the Government will commence consultation on options to amend the Act in the first quarter of 2019, with a view to legislating reforms by the middle of 2020.