Business Council of Australia

SUBMISSION

Submission to Treasury on Major reforms to the Foreign Investment Review Framework - Tranche II

October 2020

Business Council of Australia ABN 75 008 483 216

ABOUT THIS SUBMISSION

The Business Council of Australia welcomes the opportunity to make a submission to the Treasury on the exposure drafts of the Foreign Investment Reform (Protecting Australia's National Security) Regulations 2020 (Exposure Draft Regulations) and the Foreign Acquisitions and Takeovers Fees Imposition Regulations 2020 (Exposure Draft Fees Regulations).

This submission should be read together with the Business Council's August 2020 submission on the Foreign Investment Reform (Protecting Australia's National Security) Bill. Noting the Government's limited consultation period, this submission focuses on key elements of the draft regulations in the context of the broader reforms and current temporary foreign investment screening measures.

The Business Council would welcome the opportunity to discuss the contents of this submission with government representatives.

KEY RECOMMENDATIONS

With the proposed changes to the FIRB regime the Government is removing the 'welcome' sign for foreign investors and seriously risks undermining other measures to revitalise business investment.

The Business Council recognises the intent of the regulations to give effect to a strengthened foreign investment framework accounting for national security risks. We support measures in the regulations that seek to balance the restrictive elements of the draft legislation with streamlining measures. However, the delay in lifting monetary screening thresholds, the availability of a 'last resort power' for 10-years and the effective imposition of a 'stamp duty' like tax on foreign investment will only further discourage investors from Australia's shores. In the context of a domestic recession with already weak business investment and a prolonged global downturn we urge the Government to consider ways to accelerate foreign investment.

Our key recommendations include:

- Reinstating FIRB monetary thresholds immediately;
- Vastly expanding the streamline measures for non-sensitive cases by introducing a registration process, rather than substantive approval process, for non-sensitive transactions, and removing some transactions from the regulatory net altogether;
- Limiting the time available for the Treasurer's exercise of the 'call-in power' to three years;
- Retaining the existing moneylending exemption;
- A wholesale restructure of fees so they are proportionate to the cost of administering the regulatory system.

SUBSTANTIVE COMMENT

Resumption of monetary thresholds

The Business Council welcomes the proposed reinstatement of monetary thresholds under the draft Regulations, indexed at rates the thresholds would have otherwise been had the temporary measures in response to COVID-19 not been implemented.

Increased oversight over proposed foreign investment during the initial COVID-19 outbreak was an emergencymeasure -six months on from these changes the threat of opportunistic acquisitions of distressed assets has receded, while the risk to the economy from an investment shortfall poses an even larger downside risk.

Under the proposed changes, the reinstatement of thresholds will not come into effect until 1 January 2021. This means continued delays, disruptions and potential abandonment of investment proposals, including for major job-creating projects. We note the explanatory memorandum outlines the possibility that thresholds remain at $0 beyond the 1 January date linked to COVID-19 developments, adding more uncertainty for investors.

As a result of the temporary measures, a much larger volume of transactions must be screened through FIRB. This has dramatically slowed down processing of FIRB cases.

The following examples, drawn from evidence compiled by members, illustrate these FIRB bottlenecks and the negative economic consequences (additional to those examples already set out in the Business Council’s first submission).

- An Australian fund manager's transaction was unable to proceed due to the length of time needed for the FIRB review. After three months passed with the application still under review by FIRB, the vendor decided it was unwilling to extend the deal ‘sunset date’ for the fund manager. The business to be acquired was a ‘bolt-on’ and hence very similar to those already in the fund's portfolio. Had it not been for the COVID-19 temporary measures, the transaction would not have been subject to screening.
- Numerous foreign businesses have been considering shutting down Australian operations where they account for a small component of a global business network, in order for global transactions to proceed without FIRB delay. This is occurring where there are between 5 to 25 employees in Australia, and the businesses would have otherwise fit within the 'de minimis' rules previously available under the FIRB regulations.
- The ‘streamlined’ exemption certificates on offer have not been processed in time for meaningful use by investors, despite applicants paying the fee for a full exemption certificate. For example, an applicant needing a certificate for their retail footprint (including land technically characterised as vacant due to hardstand car parking associated with those retail sites) was informed that such land could not be included in a streamlined review process after two months of engagement with FIRB.
- An investor operating in Australia for 60 years has required FIRB approval to secure a long term lease on a car park in order to simply install solar panels in the car park and lease it back.
- An investor who was otherwise exempt prior to the COVID-19 rules is required to comply with an open and transparent sales process in relation to landlocked parcels

of land. The vendor is, in practice, limited to selling to the proposed buyer but must go through the costly process of publicly advertising the land for sale.

- The executive of a major foreign investor in Australia recently commented "*When you have a board in another country looking at where to deploy capital, it is a negative having to highlight the need for FIRB, as well as including the best estimates of delays to transaction closing due to FIRB*" .

We note these examples would be (at least partly) resolved with the reinstatement of ordinary monetary thresholds. However as described in the August submission, the introduction of the draft legislation, including the broad definition of 'national security business', would likely result in a level of FIRB applications and case-loads not dissimilar from the current temporary measures.

We recommend:

- Reinstating FIRB monetary thresholds immediately.

Time limit on the Treasurer's call-in power

The Business Council welcomes the imposition of a time limit on the availability of the Treasurer's 'call-in' power. Under the Regulations the proposed call-in power is to apply for a period of 10 years and is intended to provide foreign persons with greater certainty as to the Treasurer's powers and to assist in the foreign person's decision as to whether to voluntarily notify.

The Business Council is concerned that a 10 year call-in power will not provide that certainty and may well result in the unintended consequence of strongly encouraging foreign persons to voluntarily notify FIRB in circumstances when it is not strictly required. This will increase costs and time delays for foreign investors in making foreign investments into Australia.

The existence of a 10-year call-in power, when taken together with the new proposed last resort power, creates a sovereign risk issue: the rules can be changed after material investment decisions, which may discourage foreign investment into Australia.

We recommend:

- If the call-in power is to be maintained, the appropriate period should be significantly reduced to a period of three years.

Narrowing of the moneylending exemption

Under the regulations the moneylending exemption will not apply where an interest in an asset of a national security businesses and national security land is acquired by way of a moneylending agreement.

As a country which relies heavily on foreign lenders due to the relatively small size of the domestic lending market, there are serious potential consequences flowing from this change to the financing and re-financing landscape in Australia.

It appears that under the regulations, all lenders would need to seek approval, with a zero monetary threshold, before taking security over any national security business, even if that business is 100% Australian-owned. If that is the effect of the proposed change, the necessary consideration of FIRB issues for every secured finance transaction, regardless

how small, could have serious impacts on the costs of, and access to, finance for Australian businesses.

Obtaining financing on transactions and for large infrastructure projects in Australia is already complicated, competitive and time-sensitive. Having access to overseas debt providers and debt markets is an essential part of procuring competitive debt financing arrangements for Australian businesses.

The notion that foreign lenders will need to obtain FIRB approval before taking security over any national security business creates a significant barrier to Australian businesses successfully accessing debt from foreign debt providers. This is very problematic when foreign debt providers are fundamental to facilitating an efficient and effective debt market in Australia.

We recommend:

- the current moneylending exemption should not be narrowed in any way and consideration be given to the exemption being expanded to address certain anomalies such as acquisitions of debt in distressed companies which potentially trigger a need for a FIRB filing;
- If this cannot be accommodated, it is considered more appropriate that foreign moneylenders should be exempted from needing FIRB approval subject to meeting certain pre-conditions (for example, a positive compliance record and not being owned or 'controlled' by a foreign government).

Streamlining less sensitive investments

The Business Council supports the proposed amendments to the definition of 'foreign government investor' so that some will be considered to be a private foreign investors and able to access the higher monetary thresholds available.

However, the streamlining reforms could go much further. As noted in our August submission, should the call-in and last-resort powers be introduced, the government will have new powers to review investments once established. Under the new framework there would be a strong case to ease the level of 'front door' screening of investments by simplifying and / or removing certain transactions from the system.

We recommend:

A registration only processes

The Government consider introducing a registration process, rather than substantive approval, for non-sensitive transactions. This approach would not extinguish the Treasurer's powers but would avoid the need for routine upfront screening. Data acquired through a registration process would improve visibility of actual acquisitions. Registration filings for non-sensitive transactions can be made in a simpler form than the full application prepared for notifiable actions and notifiable national security actions. Such non-sensitive transactions could include, but not limited to:

- buy-backs;
- Australian entities that have no Australian assets;
- small land acquisitions that are incidental to land already approved;

- commercial property leases;
- bolt on transactions; and
- existing shareholders making creep investments within certain parameters.

Removing routine non-sensitive transactions completely

Certain non-sensitive transactions could be removed entirely from the foreign investment system. These could include:

- internal corporate restructures of foreign persons where the ultimate beneficial ownership remains unchanged. Any tax concerns arising from internal restructures for foreign entities should be regulated through the usual tax system on a non-discriminatory basis with domestic entities, rather than through the foreign investment system;
- initial or further capitalisation of wholly-owned subsidiaries by foreign persons where there is no new acquisition or new business created and the foreign person is simply contributing further working capital to an existing business owned through a wholly-owned subsidiary.

Fees

The Business Council is concerned that the new fee structure will not only be out of proportion with the cost of delivering the investment screening regime, some fees will be so prohibitively expensive – up to $500,000 per transaction - they will deter investment in vital sectors of the economy, particularly agriculture.

The Productivity Commission already noted in its June ‘Foreign Investment in Australia’ that in 2017-18 the government collected $114 million in fee revenue while the operational costs of FIRB and its secretariats in the Treasury and the ATO totalled only $14.7 million.

While the Business Council accepts that increased resources come at a cost, the new fee structure will pale in comparison to the imbalance the Productivity Commission has already identified. The reality is that the fees will be an inefficient ‘stamp duty’ tax on foreign investment.

We note in particular:

- Despite the hike in fees proposed, statutory processing times are planned to be extended from 30 to 90 days under the new (non-temporary) rules;
- There is a high risk that changes result in entrenching an effective default fee of $13,200 for foreign investments, and increasing from there up depending on transaction;
- Effectively the same fee applies to non-national security related transactions as it does to a national security related transactions.

Fees and agriculture sector

Agriculture, and particularly the agri-food and beverage sector, is well placed to be one of the most internationally competitive and a key part of Australia’s economic recovery.

We note the flow of global investment capital into agriculture and agricultural supply chains has continued to grow strongly, particularly over the last fifteen years. Within this space, Australia has increasingly grown as a focus for this investment, owing to our low political

risk, robust institutions, reputation for safe food, efficient production and strong relationships with key markets.

While this investment focus on the sector has come from global capital providers, much of it has stemmed from institutional investors in North America and Europe, with an increasing growth from Asia and the Middle East.

New Zealand presents perhaps the most notable example where regulatory changes on agricultural investment by the Overseas Investment Office for land over five hectares will largely exclude most foreign investors.

Importantly, while Australia remains a major focus for agri-food investment outside of North America, that focus has not translated into the same level of actual investment.

It is therefore vital that we do not unintentionally apply breaks to investment in the sector.

The proposed fee schedule may have that unintended consequence: Current fees for agricultural land, already greater than $100,000 in certain transactions, will face a maximum five-fold increase to $500,000.

This means an agricultural land transaction worth $76 million attracts the same fee - $500,000 - as a commercial business transaction of $1.9 billion.

It is unlikely that agricultural land transactions would produce the kind of regulatory complexities, particularly around national security risks, that would consume government resources at a cost of $500,000.

These fee increases add to other complexities already outlined, and to existing restrictive monetary threshold arrangements for agribusinesses and agricultural land.

Fees and Exemption Certificates

The excessive fee structure may render the exemption certificates program largely unworkable. Hitherto exemption certificates have provided high volume foreign investors with peace of mind to participate in a range of competitive bid processes, knowing that not all bids may be successful, but that FIRB approval would not be a deal-breaker.

Currently the fee is a flat $36,900 which, under the changes, will increase to 75 per cent of the notional fee (based on the combined number of planned multiple high-value actions). Effectively an exemption certificate fee relating to $1 billion in value of potential transactions would increase from the current $36,900 flat fee to $188,100.

The Business Council is concerned that instead of opting for the exemption certificate process, high-volume investors will likely seek FIRB approval only once they are short-listed in a bid, adding further regulatory pressure on the screening system through the accumulation of additional approvals that would not otherwise have been notified.

Absence of fee refunds

Noting the proposed introduction of the call-in power and an enhanced penalty regime, there is a risk that more prospective purchasers will seek FIRB approval even in instances where it may not be strictly required. Yet despite this prospect, there are no provisions in the regulations for investors who were unsuccessful in bids to apply for a refund.

We recommend:

- A wholesale restructure of fees so they are proportionate to the cost of administering the regulatory system, accounting for increased resourcing of FIRB / consulted agencies;
- The fee structure should align with the need to screen for national security risks, with particular attention to setting appropriate fees for transactions in the agricultural sector;
- Greater consideration given to refunds of FIRB application fees being provided to prospective purchasers that ultimately do not enter into binding legal documentation with an Australian vendor on a transaction in relation to which a FIRB application has been submitted.

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