BCA
Business Council of Australia

Evaluation of the 2021 foreign investment reforms

Submission from the Business Council of Australia

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1. About this submission

The Business Council of Australia (BCA) welcomes the opportunity to provide the Department of Treasury with assessments on the impact Australia's foreign investment framework following the 2021 reforms. Within the short time in which submissions were open the BCA has consulted a range of business leaders in the manufacturing, infrastructure, information technology, property, retail, financial services and banking, energy and telecommunication sectors. The diversity of members coming forward reflects the growing extent to which the Foreign Investment Review Board's (FIRB) touches on everyday Australian business and economic life.

2. Key recommendations

The BCA recognises and strongly supports the intent of the recent reforms to address risks, particularly national security risks, associated with foreign investment. Aspects of the reforms bring Australia into closer alignment with mature foreign investment regimes such in the US, Canada and Europe. However much of the original baggage of a screening system, designed in the 1970s, remains. To that end we recommend four measures to enhance the reforms:

- Faster processing times and greater accountability by establishing a 21-day maximum deadline on FIRB's consult agencies;
- Improve targeting of material risks by moving non-sensitive, routine transactions to a register system;
- Relieve pressure on the volume of cases by introducing a client-focused Trusted Investor scheme; and
- Benchmark Australia's screening system to international best practice and lead reform efforts in the OECD and trade negotiating fora to enhance minimum standards on foreign investment screening.

3. Substantive comment: Investment Matters

Foreign investment has a significant role to play in our recovery from the pandemic and a return to full employment. As a country, we have long relied on foreign investment to supplement domestic savings, to boost infrastructure and productivity and create employment opportunities. The technology, skills and know-how that comes with foreign investment has transformed Australia and Australians for the better and is critical in developing the new industries Australia needs for the 21st Century.

But we can't be complacent. As a result of the pandemic recession, global capital flows have taken a major battering. According to UNCTAD, Foreign Direct Investment (FDI) flows dropped 35 per cent in 2020, to $1 trillion, which is almost 20 per cent below global financial crisis levels. For Australia, FDI inflows fell by around half, worse than both Japan (one third) and the US (one quarter).[1] It would be wrong to assume that maintaining business as usual policy settings will see foreign investment return to pre-pandemic levels.

We need to send clear signals to foreign investors that Australia is open for business. That involves tackling some of the bigger structural problems that hold us back. A heavy regulatory burden is one of those barriers. Poorly designed foreign investment screening can dampen investment, impacting on job creation and wages growth. The pervasive nature of Australia's foreign investment regime is increasingly putting sand in the wheels of Australian firms making domestic investments, just because they have interactions with a foreign owned business. We need to ensure we do not allow growing barriers to turn away a global economy that offers the opportunities we depend upon to grow future prosperity.

3.1 FIRB reforms in perspective

The 1 January 2021 national security reforms to the Foreign Acquisitions and Takeovers Act 1975 (FATA) are some of the most significant changes in recent decades. They have been underpinned by a reasonable assessment that evolving technological and international security risks mean policy adjustments were been necessary. However, the design of the reforms implicitly assumes a business-as-usual scenario for foreign investment flows into Australia.

Economic analysis and an understanding of commercial decision making has been lacking. Indeed, as was noted in the Office of Best Practice Regulation's assessment of Treasury's Regulatory Impact Statement (RIS) "...given the importance of foreign investment in Australia, the RIS Impact Statement could have provided a more fulsome picture of the total costs and benefits ...".[2]

An evaluation of the reforms must take a whole-of-system approach. Changes to FATA have accumulated over the years since establishment in the 1970s. Incremental changes to FATA have sought to account for new risks, loaded on to the original legislative design. That makes it difficult to unpick measures and consider them in isolation.

Under the recent reforms FIRB's gatekeeper model has been reinvented. The Treasurer has acquired new call-in and last resort powers. Prior to the reforms, the Treasurer had broad powers in respect of a broad range of investments. Once an application was approved, the Treasurer's FATA powers were extinguished, and foreign investors were subject to the same laws and regulations as other investors.

The reforms have put a much greater emphasis on conditions, the potential for comebacks and forced divestments, compliance monitoring and significant penalties for breaches. Once through the front gate, investors are not home free. FIRB now has an enhanced role policing risks, including future risks, behind the

[1] UNCTAD World Investment Report 2021 p5.
[2] Regulation Impact Statement – Second-Pass Final Assessment – Foreign Investment Reform Package 2020, Office of Best Practice Regulation

border. The various conditions applied over time form a patchwork of ad hoc and often commercially unworkable rules that foreign investors, and the Australian companies connected to them, are forced to comply with. Yet the original gatekeeper operating model – assessing transactions at the border – remains largely unchanged. That means more and more transactions are getting caught up in FIRB's net.

3.2 Accumulating pressures on FIRB

BCA members report mixed assessments of the effectiveness of the FIRB system. A minority are relatively satisfied with the reforms and how FIRB is functioning. Many agreed that senior and experienced staff in the Foreign Investment Division of Treasury acted with professionalism, commercial understanding, and were responsive to stakeholders.

However unfortunately the majority of BCA members consulted were not satisfied with the operation of the regime. Negative perceptions relate to issues surrounding the enduring reputational costs to businesses from perceived politicisation of certain decisions on major deals. Almost all businesses report more and more sand is getting thrown in the wheels of the system.

Added together, a prevailing sentiment exists that foreign investment attraction has not been helped by the FIRB reforms, with the importance of attracting foreign investment is being subjugated to other policy priorities like national security. One Asian-based investor described investing in Australia as simply too hard "because of FIRB", while a US investor described the FIRB rules as "a joke". An Australian CEO noted that "for a global private equity firm that operates in dozens of countries, Australia is amongst the most difficult from a foreign ownership perspective".

Below we outline in more detail the key symptoms and underlying causes creating increasing costs and uncertainty.

3.2.1 Application delays

FIRB's most recent annual report estimates the average application processing time at approximately 48 days.[3] As an average, it is regrettably higher than the 30-day statutory target. In addition, this estimate accounts for all foreign investment reviews, including residential real estate involving fewer complex transactions and ownership structures. Anecdotal evidence suggests larger business transactions continue to be unduly delayed, with reports of 6 to 12 months far from uncommon.

The reforms amended FATA so that the Treasurer may extend the statutory 30-day decision period by up to 90 days by providing written notice to the applicant, and another 90 days by publishing an interim order. Under the rules, investors can further 'voluntarily' extend the period by providing written consent. In practice it is the rule rather than the exception for FIRB case officers to request extensions with the bar being set low and including reasons such as accommodating FIRB staff leave. The relationship asymmetry between the regulator and applicant means that such a request is difficult to refuse even when there appears to be poor justification for the extension.

Such delays can have a material impact because major investments typically involve M&A project teams and large project implementation teams. These are established and funded in advance of application and continue to operate during the decision period to ensure implementation can occur upon approval. The cost of delays can often be in the millions.

3.2.2 Consult agencies

One of the most common reasons provided by FIRB for delays is that advice is pending communication from a consult agency. These agencies include the ACCC, the ATO, the Department of Defence, the Critical

[3] Foreign Investment Review Board, *Annual Report 2019-2020*, p. xii

Infrastructure Centre, ASIO and several others depending on the nature of the application. While FIRB is accountable for the timeliness, professionalism and commercial acumen of its own staff (and feedback suggests this is largely positive), the consulted agencies are one step removed from the process and, as a result, only indirectly accountable to the client's needs.

FIRB clients report opaque decision making and irrelevant enquiries from consulted agencies. Often questions are asked that have little to do with the type of business or transaction being undertaken. At times questions relating to matters like competition and taxation can appear to be opportunistic regulatory fishing expeditions. For example, the post-merger market share threshold for the ACCC to be notified is greater than 20 per cent, but in a FIRB approval process, which has lower review thresholds, the ACCC can assert itself into transactions where it would not otherwise get a look in.

Above all, the elevation of national security interests has led to greater emphasis and more widespread and complex consultations with national security agencies. Staff in consulted agencies are not necessarily experienced in managing time-sensitive commercial transactions, with duties, functions and training oriented to address threats emanating from hostile governments and other actors. Unsurprisingly, the significance of a deadline for a major M&A transaction can be poorly understood, or worse, considered irrelevant in the scope of an agency's priorities.

While Treasury has been increasing capabilities in terms of resources and commercial stakeholder training for FIRB staff, judging by the way commercial deadlines are treated and the types of conditions that are being applied, the commercial and regulatory capabilities in consulted agencies has considerable room for improvement. Addressing the accountability, stakeholder responsiveness and commercial exposure of consulted agencies should be a top priority for the investment screening system as a whole.

3.2.3 A case-based approach that puts the client last

Feedback strongly suggests that the case-based, transaction-oriented model is contributing to inefficiencies in the FIRB screening system. Some foreign owned businesses have been present in Australia for over 100 years and engaging with FIRB in some form or another since the 1970s. However, each time they begin a transaction of interest to FIRB, they are all too often treated as if it were the first contact, requiring a range of ownership checks and verifications. This approach also results in FIRB requiring approval for corporate re-organisations in which there is no change in ultimate beneficial ownership. The system effectively resets each time.

High staff turn-over means clients face a carousel of different case-officers, with new officers often requiring information about an entity or transaction which has already been communicated in prior exchanges. In one example, when asked by a client why a FIRB case officer did not review relevant information contained in a prior transaction, the response came back that access to the information was 'not allowed'. This response indicates some inefficiencies inherent in the systems FIRB uses to manage its cases. Substantial additional funding has been provided to FIRB to improve its systems, funded by large hikes in the fees paid by investors, some of which can amount to $500,000 and which appear hard to justify based on the service delivery offered by FIRB.

Although the exemption certificate system has been promoted as a streamlining mechanism that allows a client to undertake a series of investments, they have not performed this role in practice. Several users of the system report that the process of obtaining exemption certificates can be extremely prolonged – up to 12 months in some cases. In such cases the value of certificates to execute time sensitive transactions is completely lost. Reporting requirements under exemption certificates have gone from being annual to monthly, creating an additional heavy regulatory burden.

A passport to FIRB

Imagine every time you travelled overseas you had to apply for a new passport. And every time you applied you faced a different case officer who requested the same identity information you provided on your last overseas trip. And on each occasion the processing time varied, often with unexpected delays, causing you to delay your trip. Not only would this be a burden on the traveller, but it would also place an unnecessary and costly burden on the resources of the Australian Passport Office. Fortunately, passports are issued once every 10 years and facilitate hassle-free exit from and entry to Australia. This simple client-centred approach, if applied to FIRB, would speed up investment and allow FIRB to focus on the genuine risks.

3.2.4 Ministerial decision making

FIRB clients report that the approval process has led to the growth of bottle necks at the ministerial decision point. It is not uncommon for formal FIRB advice on an application to remain with the Treasurer's office for extended periods of time. Advice from FIRB case officers indicate that such delays are often caused by a simple lack of available time for the Treasurer to review among other priorities, rather than any sensitivity about an application. This outcome is an inevitable consequence of a system designed for ministerial decision making that does not account for the growing regulatory case load combined with the range of activities and portfolio responsibilities of the Treasurer. Greater use of delegated decision-making could be applied where non-sensitive transactions are involved.

3.2.5 Conditions

The ability to implement conditions on FIRB approvals issued by the Treasurer is a mechanism used to protect the national interest and allow investment rather than prohibit it. Under the FIRB rules, the Treasurer can impose any condition on an investment that the Treasurer considers is necessary to protect Australia's national interest (or national security, as the case requires). In 2019–20, the number of approvals made subject to conditions reached 3,713 proposals.

The increasing reliance on conditions for FIRB approvals has resulted in a variety of impractical conditions being imposed, which send mixed, and at times conflicting, signals to investors. Evidence suggests that the conditions attached to approvals are drafted by officials with little regard for commercial realities, compliance, enforceability, and consistency with Commonwealth and State and Territory laws. In some cases use of conditions by FIRB effectively overwrites competition, privacy and corporations law and establishes inconsistent and conflicting obligations.

Examples of impractical conditions reported by businesses include a requirement that an external auditor certify logs of every person who had been in and out of a particular building. Not only is the condition unreasonable level of reporting, it conflicted with basic tenancy laws prohibiting landlords unfettered access to a tenant's building.

Another business cited an example of FIRB imposed conditions on control and operation of an energy asset. This undermined competitive neutrality and certainty by establishing inconsistent sets of compliance rules for a critical infrastructure asset (i.e. one by FIRB and one by the energy regulators).

The lead time for identifying required conditions and obtaining clearance can be a significant impediment to foreign participation in transactions. Foreign investors can be put in an awkward position of negotiating with FIRB's legal unit while a deadline for a major deal is passing, causing uncertainty, delays and threatening successful participation in competitive processes.

3.2.6 Data centres

Related to the broader issue of conditionality for approvals, a range of businesses have encountered blockages and impractical imposition of conditions associated with data centres. The focus on data centres has been elevated in foreign investment screening, underpinned by concerns that sensitive data and personal information is a target for espionage, sabotage and foreign interference activity.

Opaque decision-making and impractical conditions attached for acquisitions and leases involving data centres appear out of proportion and a potentially ineffective way to manage security risks. One respondent explained that the prospect of having to go through FIRB approval could be enough to rule-out space for data centres in the design of a development project.

The focus on ownership of a physical asset as a risk vector for data overlooks the myriad of other ways data could be compromised. Further clarity on the scope of measures for data centres is needed. Given that sensitivities around data are not exclusive to risks arising from foreign investment, an optimal approach would involve a single authority within the Commonwealth to drive the effective use of data governance, including the rules applying to data centres.

3.2.7 National Security rules

The concepts around national security remain unclear. Guidance notes have provided some assistance, but the complexity, conflicting interpretations, and still developing definitions siloed in other reforms on critical infrastructure add to uncertainty. Fundamental rules can change simply by editing and releasing a guidance note.

Uncertainty from FIRB on what constitutes national security assets can lead to minor transactions getting caught up. For example, one FIRB client operating an existing lease for a business at an airport was required to submit a FIRB application when moving the lease to a new building two kilometres away in the same airport. The parties to the original transaction had not changed.

Stakeholders trying to understand FATA rules and the meaning of 'national security business or land' need to consult critical infrastructure definitions under the Security of Critical Infrastructure Act 2018. The precise regulations and guidance on what is and is not a critical infrastructure asset is still evolving but the consultations, being undertaken through a separate process, are not intended to address foreign investment policy implications. An automatic and arbitrary tying of these two definitions falls short of proper regulatory practice.

For example, in draft exposure legislation explanatory material Home Affairs held out the prospect that supermarkets could fall within the ambit of new rules if they "subcontract out the trucking of groceries from a warehouse to a supermarket". The potential consequence of this could see a ballooning in the number of entities requiring FIRB approval, with the attendant regulatory costs and consequences. Although this statement has not appeared in further drafts, it highlights the flaws in linking the definitions of the SOCI Act and FIRB regimes.

A failure to integrate national security considerations in a systemic way results in confused policymaking and uncertainty for foreign investors. At worst it can give the impression of protectionism and send a signal that Australia is closed to investments in a range of sectors. Including a prescribed list under FATA which clearly identifies investments falling within the ambit of 'national security' would help clarify where investment is welcome and where it is not.

3.2.8 Fees

The new fee structure introduced is materially impacting on the viability of proposals. The fees are overwhelmingly out of proportion with the cost of screening. They are a form of stamp duty on foreign investment.

The fee structure has a particularly negative impact relating to competitive bidding processes involving multiple foreign-owned entities, all of which require that a fee be paid, regardless of whether the bidder is successful. This costly outcome is turning foreign entities away from participation in major deals, undermining robust competitive processes and ultimately undermining value for the Australian economy. In a competitive transaction process involving multiple bids by foreign-owned entities, only one fee should be charged, paid by the successful bidder.

The agriculture sector is particularly sensitive to the new fee structure. Investors report being deterred from agriculture given they now potentially face $500,000 fee for a transaction worth only $76 million. Given the importance of agriculture to Australia's international trade competitiveness, to regional communities and to Australia's economic recovery, it is vital that we don't unintentionally apply brakes to investment in the sector.

3.2.9 Global transactions – the weakest link

Global deal activity continues to be hampered by the need for foreign investment approval in Australia. For example one large global deal, where the entity in Australia made up as little as 1 per cent of the total transaction, was delayed due to the need to satisfy FIRB rules and elongated timelines. In one case the cost of keeping an Australian entity operating that employed up to 25 people, was called into question due to the impact FIRB screening could cause to the worldwide group. This sends all the wrong kinds of signals about Australia as an outlier in global transactions.

3.2.10 Foreign Government Investor status

The 1 January reforms seeking to streamline the treatment of investment funds with Foreign Government Investors (FGIs), while well-intentioned, falls short of practical benefit for investors using the system. The new rules continue to capture incidental and indirect FGIs, irrespective of the independence from the FGI in the management, operations, control or disposals of acquisitions of the fund manager. It means fund managers designated as FGIs continue to be subject to 10 per cent equity caps on investing in Australian entities, with anything requiring FIRB approval. The availability of exemption certificates has proved sub-optimal as a solution given both the inefficiencies in the EC application process (see above), and the highly restricted categories of investment activities permitted under exemption certificates.

Feedback from affected investors is that this red tape puts them at a competitive disadvantage, notwithstanding that investment beneficiaries are often the same as other investment managers. Consequently, Australian investment management is less appealing to global capital, including global private equity firms.

3.2.11 Out of step with global peers

When introducing the FIRB reforms Treasury highlighted similar national security reforms in the US, UK, Canada and Europe among others. This is a fair comparison given these economies have mature foreign investment screening systems and similar security policy settings. However, a closer examination of how each system operates reveals a stark difference in the number of transactions screened. Accounting for foreign direct

investment projects only, UNCTAD found that in 2018-19 Australia screened a total of 689 applications, in comparison to 231 for the US and 163 for Germany.[4] Only Canada was higher at 962.

However there are fundamental differences which sets Australia's system further apart. The requirement for 'notification' in practice translates as a requirement for regulatory 'approval'. A range of other mature jurisdictions operate a register system, with full approvals required as necessary, under a more limited set of circumstances informed by risk modelling. Hence the number of 'approved' total foreign investment applications recorded in FIRB's annual report for 2019-20 comes to 9,004.[5] Even for Canada, the total number of applications considered by Innovation, Science and Economic Development Canada in the 2019-20 period was 1,032, of which only nine went to formal approval stage.[6]

No screening regime is perfect. Indeed the criteria and processes for foreign investment screening around the world is generally opaque and poorly defined. Australia's screening system has, however, been in the slowest lane, with the OECD consistently rating Australia as one of the most restrictive foreign investment regimes in the developed world. The vast majority of Australia's poor performance in the index relates to screening and approval mechanism restrictions (accounting for around 80 per cent).[7] It is time Australia took concrete steps to turn that perception around.

[4] UNCTAD, *World Investment Report 2021,* p 115
[5] Foreign Investment Review Board, *Annual Report 2019*-2020, p 22
[6] Innovation, Science and Economic Development Canada, *Annual Report Investment Canada Act 2019-20*, p 2
[7] OECD, FDI Regulatory Restrictiveness Index, 2020. https://www.oecd.org/investment/fdiindex.htm

4. Recommendations

1) Faster processing times and accountability for FIRB's consulted agencies

To resolve the delays in application approvals related to the agency referral and consultation process, administrative time limits should be imposed on consulted agencies, drawing on the model of successful regulatory reforms in other jurisdictions (see box). This would provide that:

- Referred agencies provide advice within 21 days of the application being referred, or consent is presumed
- Where the advice of two or more agencies conflicts, resulting in processing delays, the Treasurer is empowered to step in and make a determination.

Reforms to the New South Wales Environmental Planning and Assessment Act 1979

In New South Wales around 15 per cent of all development applications need to be referred to various state government agencies because the development requires some form of approval under additional legislation.

Analysis conducted in 2008 showed that referrals to various state government approving bodies added an additional 48 days to the processing time of a development application.[1]

To resolve this New South Wales introduced a rule permitting a determination on a planning application to be made by the consenting authority without advice from the referred agency if such advice was not received within either 21 or 40 days, depending on the circumstances of the application.

To further strengthen this system, New South Wales introduced additional powers for the Planning Secretary to step in to seek to reduce delays and resolve disputes between referred agencies where inconsistencies in advice existed.

2) Improve targeting of material risks by moving non-sensitive, routine transactions to a register system

There are significant opportunities for further streamlining of FIRB's operations so that it is targeting the types of foreign investments Australia ought to be avoiding, while ensuring more appropriate investments aren't unduly delayed. Changing the notification requirements for non-sensitive, routine transactions so they do not require FIRB's consent to proceed, but only require the registration of information so FIRB has adequate knowledge of the transaction, would make a significant difference in the case load. Such transactions could apply to:

– commercial property leases

– small land acquisitions that are incidental to land already approved

– buy-backs

– Australian entities that have no Australian assets

– bolt on transactions, and

– existing shareholders making creep investments within certain parameters.

The new consolidated Register of Foreign Owned Assets, for which the Government has already committed $86.3 million over four years, should be developed as a risk triaging tool for this purpose.

3) Relieve pressure on the volume of cases by introducing a Trusted Investor scheme for regular clients

Where FIRB's regular clients can demonstrated a track record of appropriate and prudent decision making, a Trusted Investor profile could be established in which client ownership structures and equity changes are recorded and updated as required. This would allow a 'tell-us-once' regulatory approach to the specific transactions undertaken, reducing the time cost for both investors and FIRB. There are other regulatory models to draw on, such as Australian Border Force's Trusted Trader scheme.

4) Benchmark Australia's screening system to international best practice and lead reform efforts in the OECD and trade negotiating fora to enhance minimum standards on foreign investment screening

Australia is not alone, and indeed is often cited in the international community, for elevating and pioneering national security regulation in foreign investment and other economic activity. But when considering the whole-of-system transformation of FIRB, Australia is somewhat of an international outlier in terms of the level of scrutiny that foreign investment attracts. Benchmarking against peer mature systems can better ensure investment screening regulation is not putting us at a competitive disadvantage.

It is also important that investment screening policy not be subjugated and ignored or treated as off-limits in global trade and economic policy. Australia has track record successfully reconciling legitimate non-economic objectives with open borders. We can play a role rehabilitating foreign investment policy as a priority in the OECD and stimulating engagement on governance and rules in the WTO and other trade negotiating fora. The development of measures need not interfere with sovereign national security policy, but they can address issues around minimum standards on transparency, due process and procedure in investment screening. Such a commitment would send a strong signal that Australia is open for business.

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Thank you.