Australian Treasurer announces proposed major reforms to Australia’s Foreign Investment Framework

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Key Takeaways:

- New “national security test” to require foreign investors to seek approval for acquisitions of direct interests (10% or more or which provides control) in a ‘sensitive national security business’ regardless of the value of the investment
- New “call in” powers enabling the Australian Treasurer to review foreign investments that raise national security risks before, during or after the investment
- New “last resort” powers enabling the Australian Treasurer to reassess previously approved foreign investments where subsequent national security risks emerge
- Entities which are currently classified as ‘foreign government investors’ (FGIs) but in which no foreign government has influence or control (such as private equity funds and institutional investors) to be treated as privately controlled entities
- Increased compliance measures, including stronger penalties and enforcement powers

Proposed Reforms to Australia’s Foreign Investment Laws

On Friday 5 June 2020, the Australian Treasurer announced major reforms to Australia’s foreign investment rules to ensure that Australia’s foreign investment framework keeps pace with emerging national security risks and global developments, including similar changes in foreign investment screening in other countries.

The changes are expected to come into effect on 1 January 2021 and replace the temporary changes to Australia’s foreign investment regime which were implemented on 29 March 2020 in response to the COVID-19 pandemic. For further details on these temporary measures please read our previous article.

The exposure draft legislation for the new changes is expected to be released in July 2020.

Practical considerations for proposed changes

The proposed reforms are expected to provide the foundations for increased scrutiny of foreign investment into sensitive Australian business sectors and compliance by foreign investors with conditions attaching to foreign investments approved by the Treasurer from time to time.

The Treasurer has indicated that the reforms will preserve the core principle underpinning Australia’s foreign
investment system – that "Australia welcomes foreign investment for the significant economic benefits it provides."
While further details on the scope and extent of the reforms will ultimately emerge when the exposure draft legislation is released, it will be critical that the reforms strike an appropriate balance between protecting Australia’s national security concerns and providing investment certainty for foreign investors to ensure that Australia remains an attractive destination for foreign investment.

The proposed reforms to streamline the foreign investment review process for private equity funds, managed institutional investors and other similar investors with passive underlying foreign government investment in their structures will be welcomed by such investors. The foreign investment approval process to which these investors are currently subject often results in a competitive disadvantage to similar investors with no or limited underlying foreign government investment due to the administrative and timing requirements associated with the approval process. The reforms are expected to level the playing field for these investors and facilitate the increasing appetite of pension fund investment, without comprising Australia’s national interests.

**New National Security Test**

The reforms are proposed to introduce a new national security test which will:

- Enable the Treasurer to impose conditions or block any foreign investment on grounds of national security, regardless of the value of the investment;
- Require mandatory notification of any proposed direct investment (being, generally an investment of 10% or more or where it provides the investor with a position of control) by a foreign person in a ‘sensitive national security business’ or where a foreign person starts to carry on the activities of such a business;
- Allow the Treasurer to “call in” for screening on national security grounds any foreign investment which did not fall within the proposed new pre-investment notification requirements for a ‘sensitive national security business’ or the existing national interest notification process; and
- Allow the Treasurer to impose conditions, vary existing conditions, or, as a “last resort”, require the divestment of any realised foreign investment which was approved under the foreign investment rules where a national security risk emerges.

The new national security test will complement the existing national interest test which is applied to the assessment of foreign investments into Australia (and which is proposed to remain unchanged). Factors relevant to determining what may constitute a ‘national security’ concern may include protection from espionage, sabotage, politically motivated violence, attacks on Australia’s defence system, acts of foreign interference, or the protection of Australia’s territorial and border integrity from serious threats.

The mandatory notification regime for direct investments into a ‘sensitive national security business’ are proposed to apply irrespective of the value of the investment, the investor’s nationality or whether the foreign person is a private foreign investor or a foreign government investor.

**What constitutes a ‘sensitive national security business’?**

The Treasurer has not yet provided definitive detail on what will constitute a ‘sensitive national security business’ for the purposes of the new mandatory notification regime. However, the Treasurer has indicated that consultation on the definition will take place alongside the release of the exposure draft legislation and likely explore concepts such as:

- Businesses regulated under the *Telecommunications Acts 1997* (Cth) or *Security of Critical Infrastructure Act 2018* (Cth) – the latter which applies to specific assets in the electricity, gas, water and ports sectors which are characterised by a lack of diversity and disaggregation of operators and/or existing regulatory regimes designed to manage national security risks;
- Any business involved in the manufacture or supply of defence or national security-related goods, services or technologies, or any business that can create vulnerabilities in the security of defence and national security supply chain, the defence estate and or other core defence interests;
- Any business or land situated in or proximate to defence or national security installations; and
- Any business that owns, stores, collects or maintains sensitive data relating to Australia’s national security and/or defence.
The Treasurer has indicated that the ‘sensitive national security business’ definition will be narrower than the existing ‘sensitive business’ definition in Australia’s current foreign investment regime (where foreign investments by private investors are subject to a $275 million notification threshold) given such businesses will be subject to screening regardless of the value of the investment or the country of the investor.

“Call In” Powers

Any foreign investment which is not otherwise notified under the existing notification and approval regime or the new national security mandatory notification process referred to above will be able to be called in by the Treasurer for assessment before, during or after the investment, if the Treasurer considers the investment raises national security concerns.

These “call in” powers will provide the Treasurer with the ability to compel particular investors to submit an application for screening and approval where national security concerns arise. Once called in, an investment will be reviewed under the national security test consistent with the same process as those investors who notify on a mandatory basis.

To provide investment certainty, the use of the “call in” powers is proposed to be time-limited and guidance is expected to be issued on the type of investments where these powers could be used. Investors will also have the opportunity to voluntarily notify and seek approval of their investments to avoid the possibility of being called in for review on national security grounds.

“Last Resort” Powers

The last resort review powers will allow the Treasurer to reassess previously approved foreign investments where subsequent national security risks emerge.

Under the last resort powers, the Treasurer will have the ability to impose or vary conditions and, in limited circumstances, requirement divestment of a foreign investment where:

- The applicant made a material misstatement or omission to the Treasurer in their notification related to national security risks posed by the acquisition;
- The activities of the foreign investor have changed substantially, now posing a national security risk that could not have been foreseen at the time of notification;
- A material change occurs to the operating environment, which alters the nature of the national security risk; or
- National security risks have emerged in relation to the foreign investor or the Australian business, asset or land which could not have been foreseen at the time of notification.

These powers will not be retrospective and will only apply to any future foreign investment that is reviewed once the new regime comes into effect.

Treasurer has also indicated that the last resort powers will be subject to significant safeguards for investor certainty and transparency, including that the Treasurer must be satisfied that:

- Reasonable steps have been taken to negotiate in good faith with the foreign investor to achieve an outcome of eliminating or reducing the national security risk without action;
- There are no other regulatory mechanisms that can be used to adequately address the identified national security risk; and
- Action is reasonably necessary for the purposes of eliminating or reducing the identified national security risk.

Exemptions for private equity funds and institutional investors currently classified as FGIs

Currently, certain private equity funds and managed institutional investors fall within the FGI provisions of the foreign investment regime due to significant investments within their structures by foreign governments or bodies which they own or control (including investments from certain pension funds). In practice, this means that the relevant funds and investors are subject to a $0 monetary notification and screening threshold for investments into...
Australia even where the relevant FGIs do not have any influence or control over the fund’s investment decisions (which are generally undertaken by the general partners of the funds) or operational matters.

To streamline investments by these investors in non-sensitive sectors, the Treasurer is proposing to no longer treat certain entities as FGIs where no foreign government or their controlled bodies have any management rights or influence or control over the investment or operational decisions of the entity or any of its underlying assets.

These entities would still be subject to screening at the relevant monetary thresholds for private foreign investors ($275 million or $1,192 million for FTA partner countries - which will apply again once the temporary COVID-19 measures are no longer in place) and the new ‘national security test’ will also apply irrespective of the value of the investment.

**Greater enforcement and compliance measures**

Finally, the proposed reforms are aimed at improving the Treasurer’s ability to effectively monitor and/or investigate investor compliance (including with respect to any conditions imposed on investment approvals) and to prosecute breaches of Australia’s foreign investment laws. The reforms will bring the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (*FATA*) compliance regime into closer alignment with overseas counterparts and domestic market regulators, including:

- Standard monitoring and investigation powers (e.g. access to premises with consent or by warrant to gather information);
- The power to give directions to investors in order to prevent or address suspected breaches of conditions or the foreign investment laws;
- Increased civil and criminal penalties under the *FATA* to ensure these penalties act as an effective deterrent for non-compliance:
  - Criminal penalties for all types of investments: Maximum of 10 years in prison and $3.15 million fine for an individual or $31.5 million fine for a corporation;
  - Civil penalties for non-residential investments: Fines of $1.05 million to $525 million for individuals and $10.5 million to $525 million for a corporation; and
  - Civil penalties for residential investments: The greater of 25% of the consideration for the residential land acquisition or 25% of the market value of the interest in the property;
- Expanding the infringement notices regime to cover all types of foreign investments (not just residential real estate investments);
- The power to remedy situations where foreign persons are given a no objection notification or an exemption certificate based on an application that makes an incorrect statement or omits important information;
- Expanding powers with respect to an investment that was originally made in breach of the *FATA* where the interest has subsequently been transferred to another foreign person by will or devolution by operation of law;
- The power to accept enforceable undertakings from foreign persons; and
- Requiring foreign persons who have been issued a no objection notification or exemption certificate to notify the government of certain events.

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