APLMA

31 August 2020

The Manager
Policy Framework Unit
Treasury
Langton Cres
Parkes ACT 2600

By email: FIRBStakeholders@treasury.gov.au

Dear Sir or Madam

Submission on the exposure draft of the *Foreign Investment Reform (Protecting Australia's National Security) Bill 2020* (the *Bill*)

The Asia Pacific Loan Market Association (the ***APLMA***) is a body formed in 1998 to promote the use of the syndicated loan market in the Asia Pacific. The APLMA's mission is to increase liquidity, efficiency and transparency in the primary and secondary syndicated loan markets in the Asia Pacific region. The APLMA advocates best practices in the syndicated loan market, promulgates standard loan documentation and seeks to promote the syndicated loan as one of the key debt products available to borrowers across the region.

The APLMA has a flourishing Australian Branch. The organisation has over 300 members across the region, the majority of which are active in the Australian market. The Australian Branch participation includes virtually all major banks that operate in the market, and major law firms.

Introduction - typical secured financing structure

It is very common for substantial businesses (including infrastructure projects) to be developed or acquired (eg on privatisation) by private sector investors using syndicated debt finance which is secured over the business or infrastructure asset. The syndicate of financiers may range in number from just a few to up to 50 or 60 financiers, both domestic and overseas based, and increasingly often including specialist infrastructure or other debt finance funds and superannuation funds. This depends largely on the size of the financing – prudential limits preclude individual financiers from holding large exposures to a single business. These financiers would normally be participating in the ordinary course of a moneylending business under s27 of the Foreign Acquisitions and Takeovers Regulation (***FATR***).

The security over the business or infrastructure asset is usually held by a bank or bank subsidiary (or occasionally by a specialist trustee company) (a Security Trustee) on trust for the benefit of the financiers. By virtue of the security interest, absent the moneylending exemption under s27 of FATR, the Security Trustee would hold a legal or equitable interest, and each financier, as a beneficiary of the security trust, would hold an equitable interest, in the relevant business or assets.

The Security Trustee acts on the instructions of the financiers. Decisions on enforcement are normally made by a defined majority of the financiers (by share of the total secured debt), usually around two-thirds. For major businesses and infrastructure assets with a large syndicate of financiers no single financier would ordinarily be in a position to control or influence the asset, even on enforcement of the security.

The financiers usually have the right to buy and sell their participations under the syndicated loan; and in a 'work out' or enforcement situation that right is frequently exercised, and the identity of the financiers, and hence of those with

an 'interest' in the business or asset through the security trust, can change rapidly. This debt trading is often undertaken by specialist 'distressed debt' funds.

Sometimes, especially on a refinancing of an infrastructure asset once it has been developed, the syndicated bank debt is replaced in whole or in part by a debt capital markets financing, where the business or infrastructure owner issues tradable debt instruments (in the form of notes or bonds or what is sometimes called commercial paper) to a different range of investors, often insurers, pension funds and the like. These debt instruments are designed to be liquid, that is readily tradeable, so again the identity of the holders can change rapidly.

Issues with the Bill

The Bill raises a number of issues for the syndicated loan markets.

1. Proposed Register of Foreign Ownership of Australian Assets (the *Register*)

Part 7A of the Bill requires recording on the Register of interests in Australian land (among other things). The vast majority of secured syndicated loan financings would include interests in land as part of the security package. Although equitable interests are excluded the Security Trustee's interest under many common forms of security interest could be considered to be a legal interest. For example under State real property legislation and under the *Personal Property Securities Act* the security interest is considered to be a statutory charge, and hence may be regarded as a legal interest.

There is no indication in the supporting materials that such security interests should be caught, and if they were this would pose an unreasonable burden on the Security Trustees and, indeed, on the party maintaining the Register. We respectfully suggest that it should be made clear that, as with the Agricultural Land Register, interests arising under moneylending agreements are excluded from the operation of Part 7A of the Bill.

2. National Security Business

The term “national security business” is broadly and imprecisely defined in the Bill, and lacks materiality or proportionality tests. This will make it difficult for financiers to assess whether a business which they are financing is caught by FATA.
The definition includes several areas of ambiguity, including:

- the terms “critical goods", “critical technology” and “critical services” are not defined;
- the distinction between “for a military end use” (which applies to critical goods) and “for a military use” (which applies to critical technology) is unclear;
- the distinction between things that “is / are intended” (applies to *development and manufacture* of critical goods and critical technology) versus “is / are, or is / are intended for” (applies to *supply* of critical goods and critical technology) is unclear.

In addition, the definition requires financiers to make a determination as to whether a potentially minor part of a client's business is or is not a national security business in circumstances where they may not have access to the relevant information:

- critical infrastructure - the Register of Critical Infrastructure assets is not public;
- telecommunications - carriage service providers do not require a licence so it is not possible to ascertain from public searches whether a person is a carriage service provider;
- data and personal information - it is unlikely to be public knowledge that a business has access to information with a security classification.
- whether activities are “relating to Australia’s national security” or “may affect Australia’s national security” – while in some cases this will be obvious, there are presumably a number of ways that Australian national security can be implicated which will not be obvious to a person without a security clearance who does not deal with questions of Australian national security on a day to day basis (which would include most foreign financiers).

Another particular concern for financiers is that under s10A(2)(b) of FATR (under the draft amendments) the business of the holding (and buying and selling) by a bank or other financier of debt secured over critical infrastructure will itself be a 'national security business'. This is the unintended consequence of the drafting of the moneylenders exception in the *Security of Critical Infrastructure Act*, which is explained in the attached letter from the APLMA to the Minister dated 20 December 2018. We also attach the Minister's response confirming that this was not the intention. That difficulty has not yet been rectified, and it will be exacerbated considerably if, as announced, the moneylenders exception under s27 of FATR is not to apply to security over a national security business. We intend to make substantially the same submissions on this point at the appropriate time.

The above concerns are exacerbated by the fact that the definition does not include any materiality or proportionality test – a business will be a national security business even if an immaterial part of its business can be said to involve any elements in the definition (in contrast to, say, the definition of agribusiness or the definition of Australian land entity, which both have threshold tests that must be met before the business would be considered to be caught by either of those definitions).

Further, in relation to the definition of “notifiable national security action”, the financiers may be unaware of when a company starts conducting a national security business (which is notifiable to FIRB). Unlike the position in the current FATR with respect to foreign government investors starting an Australian business, there is no carve-out for undertaking an activity that is incidental to an existing business and is within the same division under the ANZSIC code.

3. Call in and last resort powers

The introduction under the Bill of the call-in and last resort powers will impact financing transactions by significantly increasing the perceived ‘FIRB risk’, costs and the compliance burden around those investments.

Specific risks identified include:

- lenders are unlikely to accept 'call-in power risk’ on a transaction and are likely to require that bidders ‘cleanse’ this risk by voluntary reporting. Transaction costs will increase and transaction timelines will be extended to take the FIRB assessment into account. The cost of capital from lenders is also likely to increase as lenders will have to carry contingent capital for a longer period;
- lenders are likely to introduce additional conditionality in financing commitments. This will impact funding certainty, which is a key sell side focus point for private capital bidders;
- lending appetite for 'at risk' transactions may also fall – the preferred equity/debt funding mix may not be achievable and may mean that investors are unable to pursue transactions they otherwise would have. This would reduce the flow of funds into Australian businesses and potentially depress asset valuations (due to decreased competition).

In relation to the last resort review power, financiers are particularly concerned about section 73A(1)(b)(iii), which provides that the Treasurer may review a previously approved (or deemed approved) action if the circumstances or market in which the action was taken have materially changed since the time of the approval or deemed approval. Further, it seems a business could become a national security business at any time. While this is a risk financiers may be willing to take where the circumstances that trigger review are in their control (eg, by ensuring information provided is accurate, and by restricting changes in business), the inability to achieve transaction certainty as a result of unforeseen potential future changes in the market or other circumstances could be a major challenge. Financiers desire clarity regarding the potential application of the last resort review power.

As noted above, we will make further submissions concerning the moneylenders exception once we have the full picture, following release of the second tranche of proposed changes. In the meantime we stress that these comments are focussed on the workability of the detail of the reforms, rather than with underlying policy issues. We would be happy to discuss any aspect of the above submission.

Submission on FATA changes

Yours faithfully

Andrew McDermott | Chair
Australian Management Committee
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Encl.

20 December 2018

The Hon. Peter Dutton, MP
Minister for Home Affairs
Australian Parliament House
Suite MG46
Canberra ACT 2600
minister@homeaffairs.gov.au

Dear Minister

Security of Critical Infrastructure Act 2018 (Cth)

We refer to the *Security of Critical Infrastructure Act 2018* (Cth) (***SICA***), which commenced on 11 July 2018.

The Asia Pacific Loan Market Association is a body formed in 1998 to promote the use of the syndicated loan market in the Asia Pacific. The APLMA's mission is to increase liquidity, efficiency and transparency in the primary and secondary syndicated loan markets in the Asia Pacific region. The APLMA advocates best practices in the syndicated loan market, promulgates standard loan documentation and seeks to promote the syndicated loan as one of the key debt products available to borrowers across the region. I

It is headquartered in Hong Kong and has a flourishing Australian Branch. The organisation has 319 members across the region, the majority of which are active in the Australian market. The Australian Branch participation includes virtually all major banks that operate in the market, and major law firms.

Introduction

This new legislation imposes on, among others, direct interest holders, an obligation to register, to provide extensive information and to become subject to reporting obligations. These obligations may deter financiers from financing critical infrastructure assets, or at least needlessly increase the cost of doing so. Secured financiers (*moneylenders*) of critical infrastructure assets would be direct interest holders under SICA but are clearly intended to be exempt under a moneylending exemption (section 8(2) of SICA). However, the drafting of the exemption does not work.

We are respectfully seeking amendment of the exemption to ensure that it achieves its aim of avoiding imposing unnecessary financial and regulatory burdens on financiers conducting their usual business of moneylending.

The source of the problem

Entities subject to registration and reporting obligations under SICA are defined as *reporting entities* and they include, relevantly, direct interest holders. An Interest is defined in SICA as a legal or equitable interest, and direct interest holder is defined in s8(1) of SICA as follows.

> An entity is a ***direct interest holder*** in relation to an asset if the entity:
>
> (a) together with any associates of the entity, holds an interest of at least 10% in the asset (including if any of the interests are held jointly with one or more other entities); or

(b) holds an interest in the asset that puts the entity in a position to directly or indirectly influence or control the asset.

Financiers of a critical infrastructure asset will commonly take security over the assets, and it is clear that security will confer an *interest* in the asset on the security holder. Where there are multiple financiers, that security will normally held by a security trustee on trust for the benefit of the financiers, but the financiers will still, under such an arrangement, ordinarily have an interest in the secured assets by being beneficiaries under the security trust. As a result each financier and the security trustee will be direct interest holders as so defined, and so reporting entities subject to SICA, unless the moneylenders exemption (s.8(2)) applies. That exemption reads as follows.

> Subsection (1) does not apply to an interest in an asset held by an entity if:
>
> (a) the entity holds the interest in the asset:
>
> (i) solely by way of security for the purposes of a moneylending agreement; or
>
> (ii) solely as a result of enforcing a security for the purposes of a moneylending agreement; and
>
> (b) the holding of the interest does not put the entity in a position to directly or indirectly influence or control the asset; and
>
> (c) if the entity is holding the interest solely by way of security—enforcing the security would not put the entity in a position to directly or indirectly influence or control the asset.

Moneylending agreement is defined in s8(3) of SICA in a helpfully broad way. But the requirements of sub-section (2), which appear to be cumulative, are impossible to satisfy. Although a typical secured financier (and its security trustee) would readily tick the box for s8(2)(a), paragraphs (b) and (c) are problematic. It is very hard to see how a secured financier or security trustee would ever satisfy paragraph (b) or (c). The reason is that any asset security taken in the ordinary course of moneylending business allows the holder of the security to take control of the asset by enforcing the security – that is why financiers take, and why on default they enforce, security: to get control over the asset and protect it pending sale or other realisation. By holding security (and by related undertakings in the facility agreement) a secured financier will necessarily be *in a position to control or influence the asset*, and by enforcing the security the secured creditor would directly or indirectly influence or control the asset.

The Explanatory Memorandum (para 186) confirms that there was no intention to catch the typical secured financier.

> The moneylending exemption applies where the security interest in the asset is held as part of a security interest for the purposes of a moneylending agreement (sub-subclause 8(2)(a)(i)) and enforcing the security would not put the moneylender, its subsidiary or holding entity, in a position to directly or indirectly influence or control the asset (sub-subclause 8(2)(c)). The moneylending exemption still applies if the security is enforced as a result of a default, and the [security] holding entity enforces the security over the critical infrastructure asset and holds an interest in the asset (sub-subclause 8(2)(ii)[sic]). However, the exemption only applies where the interests are held in the ordinary course of a moneylending business, and the entities are not in a position to directly or indirectly influence or control the asset (sub-subclause 8(2)(b)).

The Example set out in the Explanatory Memorandum immediately following that statement confirms that the grant and enforcement of the security in the ordinary course of moneylending business will be exempt. Unfortunately the Example also implies a view that a security interest is not an *interest* until it is enforced - this is not correct as a matter of law, as the grant of security will confer on the secured financier an immediate interest in the asset. But there is a clear implication from the Example that so long as enforcement is not for purposes outside the usual business of moneylending, it is exempt.

> Company A, a moneylender, holds a security interest over a critical infrastructure asset. Company B, the borrower, defaults on the loan and Company A is required to enforce the security interest. This results in Company A acquiring an interest in the critical infrastructure asset.

> Company A, after acquiring the interest [*ie after commencing enforcement of the security*], obtains control and influence over the critical infrastructure asset, and begins to control the asset for purposes outside the usual business of a moneylending agreement.
>
> The moneylending exemption would no longer apply and Company A would be considered a ***direct interest holder*** and would be required to report on interest and control information in respect of the asset.

This intention is regrettably not fully reflected in the legislative drafting.

A suggested solution

This problem requires legislative amendment, for example by revising s8(2) to read as follows, so as to be consistent with ordinary secured moneylending practice and the Explanatory Memorandum [suggested changes underlined]:

> Subsection (1) does not apply to an interest in an asset held by an entity if:
>
> (a) the entity holds the interest in the asset:
>
> (i) solely by way of security for the purposes of a moneylending agreement; or
>
> (ii) solely as a result of enforcing a security for the purposes of a moneylending agreement; and
>
> (b) the holding of the interest does not put the entity in a position to directly or indirectly influence or control the asset <u>otherwise than as a result of the moneylending agreement and the holding and if applicable enforcing of security for the purposes of a moneylending agreement, all in the ordinary course of a moneylending business</u>; and
>
> (c) if the entity is holding the interest solely by way of security—enforcing the security would not put the entity in a position to directly or indirectly influence or control the asset <u>otherwise than as a result of enforcing the security for the purposes of a moneylending agreement in the ordinary course of a moneylending business</u>.

Alternatively, there are workable moneylending exemptions in the *Corporations Act* and the *Foreign Acquisitions and Takeovers Act*, either of which could be adapted for the purpose.

We would be happy to meet to discuss the issues further.

Yours sincerely,

Judy Busljeta | Chair
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THE HON PETER DUTTON MP
MINISTER FOR HOME AFFAIRS

Ref No: MC18-067054

Ms Judy Busljeta
Asia Pacific Loan Market Association
833 Collins Street
DOCKLANDS VIC 3008

Dear Ms Busljeta

Thank you for your letter regarding the *Security of Critical Infrastructure Act 2018* (the Act). I note the Asia Pacific Loan Market Association's (APLMA) concerns regarding section 8 of the Act and its view of the impact of these provisions on current and future investment in Australia's critical infrastructure.

The Australian Government recognises the importance of balancing Australia's national security interests and fostering our economic prosperity in a global market. This is why during Parliamentary consideration of the legislation, the provisions relating to finance arrangements, as referred to in your letter, were included.

Advice from the Department of Home Affairs confirms that the intent of the moneylender exemption is as set out in the Explanatory Memorandum to the legislation, as referred to in your letter. That is, whilst secured finance may provide a financier an 'interest' in the asset, it is not an interest for the purposes of the Act until the financier takes steps to enforce the security and through that obtains influence and control over the asset. It is at this time that the financier may meet the definition of direct interest holder, depending on the percentage of interest in the asset, and have registration obligations under the Act.

The Australian Government remains committed to working with industry to meet its obligations under the Act to safeguard Australia's critical infrastructure. As such, the Department will contact you to discuss this matter further. The contact officer within my department is Mr Andrew Kiley, Assistant Secretary, Assurance, Risk and Engagement Branch at 02 6264 4096 or andrew.kiley@homeaffairs.gov.au.

Thank you for raising this matter.

Yours sincerely

Peter Dutton

PETER DUTTON 29/01/19

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