2 October 2020

Manager
Policy Framework Unit
Treasury
Langton Crescent
Parkes ACT 2600

James McLean Dreyfus
A/Senior Adviser
Foreign Investment Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: FIRBStakeholders@treasury.gov.au

Dear Mr McLean Dreyfus

Major reforms to the Foreign Investment Review Framework – September 2020

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on the proposed reforms to the Foreign Investment Review Framework.

AFMA is a member-driven and policy-focussed industry body that represents participants in Australia's financial markets and providers of wholesale financial services. AFMA's membership reflects the spectrum of industry participants including banks, corporate advisers, stockbrokers, dealers, market makers, market infrastructure providers and treasury corporations.

AFMA in this submission is addressing the practical business operation issues arising for our members as a result of the second tranche of proposed changes to the Foreign Investment Review Framework, with a particular focus on the implications of the moneylending exemption changes, which as currently drafted will have a constraining impact on economic activity. Discussions with our colleagues in other industry associations and members indicate there are a broader range of effects on funds management and other areas such as debt issuance into the US private placements market. The question of the impact of the new rules on the distribution

of debt instruments secured by national security assets is one of the areas still being examined. There is still considerable industry confusion on the legal interpretation of the new rules and exactly what the detailed requirements will entail. Given the abbreviated time for consideration, in this submission AFMA is initially focussing on the area of syndicated lending.

We note that foreign investment will be key to both Australia's recovery from the severe economic impact of the COVID-19 pandemic and international competitiveness going forward. As noted in our August submission, while supportive of the need to protect the national interest from potential security threats, it is important for the Government to ensure an appropriate balance between national security considerations and ensuring Australia remains an attractive location for foreign investment.

AFMA recognises the importance of the policy objectives behind these changes, and that national security considerations must be appropriately addressed and raises no issue with them. Our concerns lie with the impracticality of the Foreign Investment Review Board (FIRB) procedures under the revised rules and the necessity of further consultation with the industry to find a workable solution, which we believe will not be hard to achieve within the current framework and Government policy settings.

1. Loan market implications

Foreign lenders form a major part of the loan syndication market in Australia, comprising over 67 per cent of the loan markets in terms of dollar value in 2019. In the first half of 2020 alone, foreign lenders contributed over $38 billion AUD of the total $64 billion AUD of funding to syndicated loans in Australia (source: *Refinitiv*). Importantly, this reference to 'foreign lenders' in the statistics accords with the common understanding of the term, not the technical meaning it has under the *Foreign Acquisitions and Takeovers Act 1975* (FATA). Under the FATA, many lenders, including major financial institutions listed on the ASX commonly considered to be "Australian" by the person on the street, may also be foreign persons, because either a foreign person holds a substantial interest of 20 per cent or more, or there are two or more foreign persons comprising an aggregate substantial interest of more than 40 per cent appearing on the share register. Accordingly, the 67 per cent figure is an underestimate, as it appears that the application of the foreign person test under the FATA means that most of the lenders in the market are likely covered. The result of this is that changes to the moneylending exemption will directly affect a very large proportion of market participants.

The uncertainty provided by the changes to the moneylending exemption in their present form will make it more difficult for lenders to participate in syndicates due to the costs involved of preparing applications and undergoing the review process, meaning investors (Australian or otherwise) are likely to experience difficulties in financing acquisitions, as the pool of non-foreign lenders looks like it could be quite small.

Among other things, discouraging participation in syndicated lending raises competition concerns, as it could affect pricing for borrowing. This will also impede risk management of domestic lenders who will be less able to share the risks associated with financing major projects and acquisitions. The sheer size of some large transactions requiring billions of dollars in financing necessitates that default risk is shared by a number of lenders, sometimes 25 or more.

Consequently, making it more difficult for lenders to join syndicates in Australia means that lending risk diversification to be lost. There are additional implications, such as the impact on the ability of a lender to sell down their interest which could then limit the transferability of an interest and its relative attractiveness.

2. Nature of the lender's interest

As a starting point, it needs to be understood that lenders generally do not take security interests over assets to gain a proprietary interest in the asset. Lenders should not be equated with bidders for assets. The rationale on general principles as to why they should have to go through a FIRB approval process over any asset (including where those assets relate to sensitive national security business) is perplexing to many of our members. This is because it is structurally difficult for lenders to take security in order to control a relevant asset. When security is enforced by lenders and receivers are appointed, they generally hold the asset pending the sale to a third-party buyer. Furthermore, under the *Corporations Act* receivers have an obligation to act in the best interest of all creditors, not just foreign lenders, which means that it is practically and legally difficult for a lender to take a security interest with an ultimate aim of controlling the secured property. Receivers are professional service providers who are bound by a range of corporate responsibilities, and in this way they are not "captive" to the interests of foreign lenders who are instructing them. Furthermore, in a syndicate of lenders in project finance, it is difficult to envisage a situation where a single foreign lender amongst many is able to control instructions which are being given to a receiver to control the relevant asset.

3. Nature of the problem

Requiring moneylenders to seek FIRB approval *prior* to being able to hold a security over an asset will cause significant problems for industry due to the complex and time critical arrangements that lenders operating in Australia enter into with one another and with borrowers in their ordinary course of business. The broad way in which the change to the moneylending exemption is currently drafted risks significantly impacting the liquidity of loan markets, reducing the flow of capital into Australia and stifling competition, which will be detrimental to Australia's economic recovery from the COVID-19 pandemic.

For the reasons set out below, we propose that some alternative procedural mechanism needs to be devised with the moneylending exemption in the FATR so that a more workable solution to address Government concerns can be put in place while having a minimal impact on financiers.

In this context, although we believe there may be other ways to address the concern around a security trustee or lender who is a foreign person taking on a national security asset for a period of time prior to disposal, we are seeking to find a solution that only carves out s27(1)(a)(ii) of the moneylending exemption in the *Foreign Acquisitions and Takeovers Regulation* (FATR) for notifiable national security actions, with the result being that only the actual acquisition of a national security related interest by way of enforcement of a security held solely for the purposes of a moneylending agreement is subject to FIRB approval.

4. Changes to the moneylending exemption under s27 of the FATR

The proposed drafting of section 27 of the FATR requires foreign persons who are prospective lenders to seek FIRB approval prior to taking security interests for the purposes of moneylending agreements, where the interest is related to national security business assets or land (or exploration tenements over national security land). Due to the $0 threshold applied to notifiable national security actions, lenders will be required to seek approval even where the investor itself is Australian and regardless of the amount of money being borrowed.

Lenders will need approval prior to financing the acquisition by another person of a "national security business" on a secured basis, or where acquiring existing debt secured against assets of a sensitive national security business.

We note that national security assets would cover all manner of key infrastructure commonly financed through project finance on a secured basis, including, for example, gas pipelines, ports, transmission lines and telecommunication infrastructure. The proposed definition of national security business under section 10A of the *Foreign Acquisitions and Takeovers Regulation* (FATR), subject to the July consultation, is very broad and may also encompass situations where something incidental to a business necessitates that the entire business is deemed a *national security business*. We understand that guidance on this will be released in due course which may assist with clarifying industry understanding.

Further, we note the concern raised in the submission by the Asia-Pacific Loan Markets Association (APLMA) to the July consultation, that raised the issue of the current drafting of s10A(2)(b) of the FATR. That provision has the effect that a lender's business of holding security over critical infrastructure is deemed a 'national security business' itself (due to the existing drafting of 'direct interest holder definition' in the *Security of Critical Infrastructure Act* (SOCI Act). This appears to be an unintended consequence of the reforms and needs to be rectified, particularly due to the real implications of this as a result of proposed changes to the moneylending exemption in s27 of the FATR as currently drafted.

5. Foreign persons

It is already mentioned above that the bulk of lenders participating in syndicates appear to be foreign persons, including major domestic financial institutions.

At present there is also some variation in the interpretation by expert legal advisers with regard to the existing framework as to whether a lender (foreign or non-foreign) acting as security trustee for a syndicate would be deemed a foreign person under section 4 of the *Foreign Acquisitions and Takeovers Act* (FATA) where there is a member of the syndicate who is a foreign person holding a substantial interest of 20 per cent or more, or where there are two or more members who are foreign persons holding an aggregate substantial interest of more than 40 per cent.

As even expert legal advisers have differing views on whether the security trustee is the party required to make the application, it needs to be clarified whether it is just the security trustee that needs to seek approval for a security interest or whether individual syndicate members would also be required to seek approval for their respective beneficial interest. This also brings into play issues with how an exemption certificate process would operate to apply to individual lenders' arrangements, and how FIRB would track participation by lenders in a variety of syndicates.

We note that the requirement for review would also arise when a current owner/operator of a national security asset is seeking finance or refinancing existing debt arrangements (as the acquisition for the purposes of the FATA is the security interest being obtained by the lenders). As such the implications are broader than to just potential acquisitions. The proposed amendments impact the full spectrum of lending to national security assets and not just to an investor for the purposes of a proposed acquisition of such an asset. This also means that these considerations will come into play every time a member of syndicate seeks to sell down or transfer its commitment to a facility, meaning additional costs and potential difficulties finding a willing replacement.

6. Fees

The financial services industry is already operating under a heavy regulatory burden in delivering services to clients. Additional regulatory burdens which may be duplicative do not appear to be in line with the Government's current policy intention with regard to reviving the economy. Under the proposed changes, moneylenders proposing to take a security interest over national security assets or land will be taking a notifiable national security action, subject to its own review process and application fees.

Lenders deemed to be taking a notifiable national security action are expected to pay application fees *in addition to* an investor paying fees (as it would be a separate action taken by a different foreign person), even in circumstances where the investor they may be lending to is participating in a bidding process.

While it may be comprehensible for an investor participating in a bidding process to pay an application fee to seek FIRB approval, it does not make sense that their prospective lender or lenders are also required to do so (given the sunken costs if a bidder fails to get FIRB approval or win a tender). This is an additional deterrent to lenders providing funding to an investor, with the result of limiting investors' funding options available.

We also seek explanation of the basis on which fees will be calculated for lenders and would like to clarify whether the fee for taking a security interest would be based on a consideration value related to the sum of up-front initial payments, as specified in FIRB Guidance Note 33, and not the value of the entire loan balance provided. We note that (provided that a moneylending agreement specifies that the option to acquire the secured asset is subject to FIRB approval) the act of enforcing a security interest to acquire an interest in a national security related asset would be a separate action, subject to its own fees, with fees in this case based on a consideration value of an outstanding loan balance likely to be recouped by a lender and any penalties levied on the relevant borrower (as per FIRB Guidance Note 33).

7. National security exemption certificates

AFMA understands that the reforms will introduce new exemption certificates to cover both mandatory notification of notifiable national security actions and the call-in power for reviewable national security actions, allowing a foreign person to apply for an up-front approval for a program of investments.

It is presently unclear how these certificates would work, given that the existing exemption certificate process is not set up to provide a suitable streamlining mechanism for moneylenders. Lenders would have trouble providing sufficient detail usually required for the granting of exemption certificates, given that banks lend to a broad range of borrowers across industries and it is simply not possible to determine exactly what acquisitions prospective borrowers will be looking to finance.

Even where a lender may be able to seek an exemption certificate to cover involvement in a number of syndicated loans over a period of time, doing this pre-emptively without knowing whether there is a borrower creates issues, particularly as the application will require a fee, the cost of which would likely get passed on to prospective borrowers.

There are further difficulties determining how a fee would be calculated. Given that generally (and as set out in the *Exposure Draft Regulation (Fees Imposition))*, the fee will be calculated as 75 per cent of the fee if the multiple actions were replaced by a single action. Lenders may not be able to specify single actions given that their proportionate interests in a syndicate may vary. Nonetheless, under the current proposed arrangements, assuming a scenario where an investor seeks exemption from review for both the taking and subsequent enforcing of a security interest (with regard to how consideration is treated for security interests), lenders would be subject to fees of $375,000 given that lending would in most cases be over $50 million. Any amount in excess of the 'cap' provided on an initial exemption certificate would then be subject to variation fees.

8. Implications for investors

The introduction of changes to the moneylending exemption adds another layer of complexity for investors in determining how to finance acquisitions or refinance existing debt. Requiring foreign lenders to seek approval for any security interest (where it meets the criteria of a notifiable national security action), regardless of the size of the loan provided, also imposes an additional regulatory burden on FIRB having to assess more proposals and risks causing unnecessary delay to commercial arrangements.

Problems are exacerbated in instances where investors are participating in a bidding process, where for the most part, bids are required to be unconditional. For investors proposing to acquire interests requiring approval for national security actions, their FIRB approval (and their bid) would also be contingent on their proposed financing arrangements having FIRB approval. It is unclear at this stage how the connected 'actions' will be reviewed.

9. Requests

9.1. Guidance

We ask that clear guidance be introduced to ensure clarity around definitions and relevant approval processes, to assist industry to adjust to the reforms well before the planned commencement date in January 2021.

9.2. Transition period

AFMA notes that the current is that the reforms will commence from January 2021, however given the implications of the reforms as proposed, financiers will need a longer period to restructure how their financing operations work and familiarise themselves with the FIRB review processes themselves.

9.3. Need for further financial service industry consultation on a solution

AFMA understands this change has been made from a national security policy perspective, to prevent national security related assets falling into the hands of foreign persons without regulatory oversight, however we believe there are other ways in which the same concern can be addressed to avoid the business impracticality of the requirements as presently drafted. A solution is needed.

General ideas could be:

- There is a preference to not need to use an exemption certificate mechanism, and only require a FIRB approval process for foreign lenders in circumstances only where security is enforced, and a receiver takes control and where other exceptional circumstances arise. For example, if a receiver continues to hold an asset over an initial period of time (e.g. 6 months) and the syndicate is made up of more than 50% of foreign lenders;
- An approach more akin to the current condition imposed on the moneylending exemption for foreign government investors (by requiring effective disposal of interests in a set period of months), given that in normal practice, lenders do not seek to hold onto interests acquired by way of enforcing a security under a moneylending agreement; or
- Some kind of specific lender approval arrangement that would allow sufficient flexibility for lenders to engage in lending for national security assets as the business opportunities arise for a period of time, while providing sufficient information about the lender to address FIRB concerns.

Due to the abbreviated consultation process, the industry has had insufficient time to come up with fully developed solutions. As such we propose further discussion and engagement to assist with determining an outcome that is workable for industry and adequately addresses the Government's national security concerns.

Please contact Natalie Thompson on (02) 9776 7979 or nthompson@afma.com.au if you would like further clarification on the above.

Yours sincerely

David Love
General Counsel & International Adviser