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Foreign investment reforms - Submission regarding proposed changes to moneylending exemption and definition of "national security business"

1 Ventia

Ventia is one of the largest essential services providers in Australia and New Zealand with annual revenues in excess of $5 billion and over 35,000 employees and subcontractors across Australia and New Zealand. Ventia's services include operations & maintenance, facilities management, engineering & capital works and environmental services. Ventia's clients include both government (c.60% of revenue) and large public and private enterprises (c.40% of revenue).

Ventia is a key local contributor to Australian Defence capability through the management, operation and maintenance of facilities and equipment on the Defence estate. Contracted revenues for Defence work exceed $0.5 billion per annum.

As discussed further below, Ventia may be classified as a "national security business" under these reforms, although it is not possible to be definitive on that point given the uncertainties created by the definition of "national security business" as currently proposed.

2 Introduction

The current moneylending exemption allows all Australian businesses to raise debt from foreign lenders on a secured basis, without requiring the foreign lenders to obtain FIRB approval. This deepens the pool of debt capital available to fund the growth and operations of Australian businesses.

Like many Australian businesses which are likely to be "national security businesses" under the proposed legislative amendments, Ventia is a significant user of offshore debt capital markets, having raised the bulk of its debt financing in the US Term Loan B ("TLB") market since Ventia's formation in 2015. As commonly the case in the US TLB market, Ventia's syndicated debt is widely held by a group of over 40 financiers, the vast bulk of whom hold less than 5% of the debt, and none of whom holds more than 15%.

The proposed changes will adversely affect Ventia and other businesses that are, or may in future become 'national security businesses', by reducing or effectively eliminating access to the US TLB market and other significant secured debt markets. This will lead to a reduced range of debt financing options, higher financing costs and less favourable debt financing terms and conditions, resulting in a higher overall cost of capital and a reduction in financial stability and resilience, both for Ventia and for numerous other "national security businesses".

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3 Benefits of access to international syndicated secured debt markets

For Australian businesses like Ventia, access to international syndicated secured debt markets, as facilitated by the current moneylending exemption in regulation 27, brings multiple benefits including:

- access to a larger and more diverse range of financiers: including both bank and non-bank offshore financers, collectively comprising a pool of capital which an order of magnitude larger than what is available in the domestic Australian finance market. This significantly reduces concentration risk in sources of capital for Australia's business, an important consideration given the concentration of major onshore financial capital in the big four local banks;
- access to types of financing not readily available onshore: including, as utilized by Ventia since its formation, the US TLB market;
- lower cost of capital: in many asset classes, offshore cost of capital is often lower than that available onshore. Ventia experiences that directly, obtaining a lower margin on its USD denominated debt tranches than its AUD denominated tranches, despite the two being part of the same credit facility with the same ranking; and
- more flexible financing terms and conditions: the US TLB market generally offers longer dated maturity, a more flexible amortization profile and less terms and covenants than comparable onshore bank facilities.

All of the above are to the benefit of Australian issuer companies like Ventia, providing greater access to finance, a lower cost of capital and less restrictive financing terms, resulting in a significantly lower overall financial risk profile. In short, access to the US TLB market as allowed via the current moneylending exemption allows Ventia to be a stronger, more profitable and more resilient participant in the Australian infrastructure and defence services markets, to the benefit of its state and private clients including the Department of Defence and other Commonwealth agencies.

4 Relevant features of the US TLB market and impacts of this reform

The US TLB market, like other similar international syndicated secured debt markets, relies heavily on the participation of offshore financial investors, both bank and non-bank, particularly in the Asia Pacific and North America.

In addition to debt being initially syndicated to a diverse group of investors, US TLB debt positions typically trade far more frequently than traditional bank debt. As a result, participating financiers have a clear expectation of secondary market liquidity when they enter into a US TLB facility. Most participating financiers have access to a continual flow of new US TLB investment opportunities, both primary and secondary, from issuers in a range of jurisdictions around the globe, and will routinely trade in and out of certain positions in order to manage their portfolios. The vast majority of such offerings, at any given time, are available to financiers without any need to obtain foreign investment approvals from the relevant issuer's home jurisdiction.

As a result, if FIRB approval is to be required of each foreign financier which wishes either to participate in a primary issuance or to acquire a debt position in the secondary market, regardless (amongst other things) of the size of the investor's holding in the relevant debt facility, this will, in our very strong view, severely impair investor appetite to invest in debt issued by Australian "national security businesses", as very few of the financial investors who are regular participants in the US TLB market (and comparable offshore markets) are likely to be willing to incur the cost and delay of a FIRB approval for a given syndicated debt position. To the contrary, these investors will simply decline investment opportunities which would require a FIRB approval.

As a result, we believe that the true effect of the proposed changes will be to effectively lock Australian issuers who are (or may be) “national security businesses” out of the US TLB market & other comparable international debt markets.

We understand that there are numerous Australian “national security businesses” which have existing syndicated facilities which would be severely impacted by this change. Investors have entered into these facilities with an expectation of a stable Australian foreign investment regime. A radical change such as this proposal, which fundamentally changes the costs and benefits of participation in the facility, will have a significant detrimental impact on the standing of the affected borrowers in offshore debt markets, and potentially on the reputation of Australian issuers collectively. More generally, this change will negatively impact the nation’s sovereign risk profile, as perceived by international financiers.

As a consequence of these impacts, this reform will also create a significant disincentive for Australian companies – and particularly those with diversified offerings like Ventia - from working in national security. Where defence or national security related work is one of several business lines within a given company, or a company is considering entering into national security related work, the company will be less likely to pursue this option if the price of doing so is loss of access to a variety of significant international syndicated debt markets, with consequences including a higher cost of capital, more onerous debt financing terms and accordingly reduced financial stability and resilience.

This disincentive will in turn reduce the range of Australian businesses prepared to work in the sector, which will in itself be a significant adverse outcome both for Australia’s national security and its economy.

5 Policy considerations

The draft explanatory memoranda contains very little explanation of the underlying policy drivers for this particular change to the moneylending exemption. This makes it difficult for Ventia, or other affected parties, to make informed submissions as to alternative approaches which might address the Commonwealth’s legitimate national security concerns while seeking to avoid disproportionate adverse impacts for national security businesses and accordingly for Australia’s sovereign national security interests.

We respectfully request that the Commonwealth should articulate the detailed policy objectives behind this proposed reform and then allow a further period of consultation, so as to facilitate a more productive debate as to the best way to achieve these policy aims.

That said, we offer some initial observations as to the potential policy goals at stake and other considerations which should be factored into the Commonwealth’s thinking as to this proposed reform:

- Regulation of foreign debt investments: to date, Australia’s foreign investment laws have applied only to equity investments and acquisitions of business and real property assets, so as to focus – like the foreign investment regimes of most comparable countries – predominantly on the actual ownership and control of local businesses and real property. This reform would be a dramatic move away from that conventional approach, extending Australia’s foreign investment approval regime beyond investments which confer ownership and/or control (ie equity investments in general) to purely financial, non-control debt investments. If such a change is to be made, we respectfully submit that it should occur only after a full and informed debate on the detailed policy goals at play – a debate which is not possible in this consultation process given the lack of detail provided as to the policy goals at stake, and the very short time allowed for this round of submissions.

- Identifying the relevant harm: further to the above, it is not at all obvious what the harm or risk is which this reform seeks to address. We can understand that the Commonwealth is legitimately concerned with being able to control foreign investments in national security business where those investments could give a foreign person influence over decisions which might impact on the provision of goods or services to the defence and intelligence sectors, or might allow a foreign person to obtain access to sensitive information. With respect, however, the holding of debt positions in conventional syndicated secured debt products, particularly tradeable debt products like the US TLB market, simply does not provide any such opportunity to a foreign person. Ventia's reporting obligations to its TLB lenders require disclosure of aggregated financial information at a consolidated level and data on movements in work in hand; they do not extend to details of any particular contract or tender opportunity, let alone any operational information in relation to any line of business. Our TLB lenders most definitely do not obtain any access to sensitive client information held by the business. Similarly, conventional secured debt holdings simply do not confer any operational control over a borrower. The property interest which triggers the *prima facie* need for FIRB approval (absent the moneylending exemption) is purely a security interest, the purpose of which is to allow the lending syndicate to appoint a receiver in order to realise the assets of the business in the event of enforcement of the debt.
- Overall economic impact: as the Commonwealth has made clear in recent times, foreign investment is a critical component of Australia's overall economic wellbeing, and in the international competition to attract capital, it is vital to our nation's interests that Australia is "open for business". Making good on this aspiration requires that proposed restrictions on foreign investment are carefully weighed against the resulting economic impacts, and are thoughtfully designed so as to be commensurate to the risks they seek to address, while avoiding unintended adverse consequences for Australia and Australian businesses. This exact point is the subject of Commonwealth government announcements reported in an article by John Kehoe is today's *Australian Financial Review*, which states for example that "The swift accommodation of business by regulators during the COVID-19 recession … has convinced the government to establish a permanent role to ensure regulations are "fit for purpose" and "light touch". And on impacts on the credit markets, the Treasurer wrote in *The Australian* last week that "the provision of and access to credit will be critical to rebuilding every sector of our economy". In contrast to these public statements of policy intent from the Commonwealth, this proposed reform to the moneylending exemption would have very obvious and significant adverse impacts on national security businesses access to key credit markets, while it is difficult to see how it would deliver any true national security benefit.
- Need for certainty: as extensively ventilated in other parties' published submissions on the reforms to date, the above concerns in relation to the removal of the moneylending exemption are amplified by other features of this tranche of reforms, including in particular the uncertainty as to the scope of the definition of "national security business", including by reason of use of the undefined term "critical" as a qualifier in several limbs, by reason of the several references to the "intention" of goods, services or arrangements, and by the fact that the definition turns on highly sensitive internal features of the business in question, matters which investors will struggle to assess especially at early stages in transaction timetables, and in respect of which they will be entirely reliant on information provided by the target business, despite the investor, rather than the target business, bearing the primary compliance burden including the risk of substantial penalties for non-compliance. We support the various submissions requesting that the Commonwealth address these issues with a view to creating a regime which Australian national security businesses and their investors can navigate with certainty.

6 Submissions and alternate approaches

While Ventia acknowledges the Commonwealth's intention to limit the moneylending exemption, in our view it is clear that the proposed changes would cause significant and permanent detriment to Ventia and many other Australian national security businesses' which are important components on

Australia's national security infrastructure, without actually generating a commensurate national security benefit. Accordingly, Ventia respectfully submits that the Commonwealth should consider alternative approaches as follows, presented in descending order of desirability:

(a) Withdraw the proposed changes to the moneylending exemption

While the exact policy basis for the proposed changes to the moneylending exemption is not entirely clear to us (given limited explanation for the policy basis for this particular change in the draft explanatory memorandum), we expect that policy basis for this change is likely to include a desire for the Commonwealth to attain improved visibility over foreign holdings of secured debt positions in 'national security businesses'. It also seems likely to us that it is not the Commonwealth's intention to cause the level of disruption key Australian businesses' access to debt financing which these reforms, if introduced in the form of the exposure drafts, would in fact cause.

Accordingly, we respectfully request that the proposed change to the moneylending exemption should be withdrawn at this stage, and that the Commonwealth should instead explain its policy goals in relation to foreign lenders providing secured debt to "national security businesses" in more detail, and then separately consult with industry participants as to alternative means to achieve those policy goals in a manner which does not involve effectively eliminating access to these debt markets in the process.

(b) Limit the change to enforcement

As per the submission of today's date by the Asia Pacific Loan Market Association, if the Commonwealth does not accept submission (a) above, then we submit that it should consider APLMA's proposal to limit the new s27(1)(c) of the regulations to the enforcement limb of the current exemption, eg by making the opening words of the new paragraph (c) read "in the case of an acquisition of an interest following commencement of enforcement of a security as contemplated in paragraph (a)(ii) above, …". This would limit the need for secured lenders to obtain FIRB approvals to the scenario in which an interest in the assets of the relevant national security business is acquired by that lender by way of enforcement of security - a setting which might be acceptable to participants in the relevant international syndicated debt markets given that financiers almost invariably enforce by instructing the security trustee to appoint a receiver or administrator with a view to sale to a third party, and hardly ever actually acquire the mortgaged property on an enforcement.

(c) Exemption for certain prescribed types of secured debt facilities

If the Commonwealth does decide to proceed with the proposed removal of the moneylending exemption for national security businesses, we also submit that the legislation should include a power to create 'safe harbour' exemptions by regulation for given established types of syndicated secured debt facilities, and that regulations are made to cover key established and conventional debt markets, including the US TLB market. We would welcome further consultation with industry, informed by greater disclosure of the Commonwealth's policy goals in respect of the moneylending exemption, so as to draft these 'safe harbour' regulations in a manner which facilitates ongoing access to the relevant debt markets while also achieving those policy goals. The US TLB market, for example, typically generates relatively widely held syndication outcomes (it being uncommon for any given financier to hold more than 10-15% of a given debt tranche), which is a significant further mitigant against concerns that any given foreign financier could use its debt position to obtain sensitive information from the relevant national security business which is the issuer of the debt.

(d) Exemption certificate – by issuer

An 'exemption certificate' regime for financiers is not capable of mitigating the adverse impacts of the proposed changes to the moneylending exemption, particularly in relation to the US TLB market and similar markets for tradeable positions in secured debt. Liquidity in these markets is generated by the participation of a large range of foreign financiers, many of whom hold and trade significant portfolios of these debt positions, and have access in these markets to a range of investment opportunities from various jurisdictions around the world. Debt investors of this nature are simply not going to seek a FIRB approval for acquisition of a single portfolio debt position, nor seek an exemption certificate to cover a range of such positions in Australian companies which are 'national security businesses'. Instead, they will simply elect not take up Australian offerings for which such FIRB approval would be required, which will effectively lock such Australian issuers out of these markets.

Accordingly, if the Commonwealth does decide to proceed with the proposed removal of the moneylending exemption for national security businesses, and particularly if the Commonwealth does not adopt our proposal in (b) above, we most strongly urge the Commonwealth to introduce an exemption certificate obtainable by the issuer in respect of a proposed secured debt financing arrangement, on the basis that that certificate would cover the relevant debt facility for the duration of its existence (ie, would cover both primary participants and secondary acquirers of positions in the relevant debt, so as to support ongoing tradability of the relevant debt securities).

Finally, on a related matter, we note that the definition of "national security business" is very unclear as currently proposed, particularly as a result of the lack of definition of the term "critical" (despite that qualifier being used a number of times in the proposed definition and being of vital import) and the need to assess subjective matters such as the "intention" of a given good or service and/or its potential impact on national security. As a result, we are advised by our legal counsel that if the definition remains in the form proposed, they will be simply unable to provide definitive advice as to whether Ventia is or is not a "national security business".

We are aware of multiple submissions by various parties in this regard, and we strongly support the general theme in those submissions, being that this term needs to be defined in much clearer terms so as to provide clarity and certainty to foreign investors (and their Australian transaction counterparties) as to when FIRB approval is actually required.

Given these concerns, we also submit that the draft legislation should include a mechanism which allows an Australian business to obtain a definitive ruling from FIRB, eg by way of a certificate valid for a given period (upon which third party investors would be entitled to rely), as to whether it is or is not a "national security business" (subject of course to the ongoing accuracy of the information provided by the relevant business to FIRB for that purpose).

Yours sincerely

David Moffatt
Group CEO and Executive Chairman
Ventia