

(Australian Branch)

2 November 2020

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| The ManagerPolicy Framework UnitTreasuryLangton CresParkes ACT 2600 By email: FIRBStakeholders@treasury.gov.au |  |
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Dear Sir or Madam

Submission on the exposure drafts of the *Foreign Investment Reform (Protecting Australia’s National Security) Regulations 2020* **and the *Takeovers Fees Imposition Regulations* 2020 (the *Draft* *Regulations*)**

The Asia Pacific Loan Market Association (the ***APLMA***) is grateful for the opportunity to comment on the Draft Regulations. The following comments are solely focussed on the workability of the detail of the reforms; the APLMA does not take issue with the underlying policy issues which the Government seeks to address.

The APLMA is making this submission because of a very serious concern that the proposed revocation of the moneylending exemption for financings secured over, for example, energy infrastructure, could have a devastating effect on Australian loan syndication markets. Those markets generate over A$100 billion in loan financings every year, and they are heavily dependent on the involvement of literally hundreds of foreign financiers, who between them provide the overwhelming majority of that funding. Regardless of what practical measures Treasury has in mind to ease the impact of this change, the change risks driving many of those financiers away from this market, thus resulting in unwarranted restrictions on the availability of credit for key nation building projects.

**Background**

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 syndicated loan markets are the primary source of funding for privately financed infrastructure and other major projects. Foreign financiers invariably account for the majority (usually around two-thirds) of the syndicated loan market in Australia. Needless to say a deep, vibrant and competitive syndicated loan market will be vital in supporting the recovery of the Australian economy from the COVID-19 induced recession.

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.

**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. 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 in compliance with the exemption in s27 of the (existing) Foreign Acquisitions and Takeovers Regulation 2015 (***FATR***) from the operation of the Foreign Acquisitions and Takeovers Act 1975 (***FATA***)..

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 ***moneylending exemption***), 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 for the purposes of the FATA.

The Security Trustee acts on the instructions of the financiers. Decisions on consents, waivers and 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 business or asset, even on enforcement of the security. Enforcement of the security is normally effected by the Security Trustee, on instructions from the majority financiers (typically a two-thirds majority vote is needed). Enforcement of security entails the Security Trustee appointing specialist insolvency practitioners to act as receivers and managers, or sometimes as administrators, in either case with a view to selling the business or asset to a third party (with a statutory obligation to sell at the best price reasonably obtainable).

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 (sometimes as much as daily). This debt trading is often undertaken by specialist 'distressed debt' funds.

We should add that although the APLMA's focus is on syndicated loans, many of the issues canvassed below will also be relevant to capital markets refinancings (eg in the form of secured bond issues) of major projects. It is common for, eg, infrastructure development projects to be initially financed by syndicated loans on the basis that once the construction phase is completed they can be refinanced by a bond issue. Given this 'take-out' function on which syndicated lenders rely, an adverse impact on the appetite in bond markets for Australian projects would also have an adverse impact on loan markets as a result..

**Issues with the Draft Regulations**

The Draft Regulations raise one major issue for the syndicated loan markets, and if that is not resolved, a host of other issues.

**1. Proposal to revoke moneylending exemption for security over national security business**

The proposed introduction of sub-para (c) to section 27(1) of FATR would seriously disrupt Australian syndicated loan markets. Foreign lenders play a key role in financing the infrastructure comprised in national security businesses, and those financings are often secured over the assets of the business, especially construction or development financings. The removal of the moneylending exemption will deter foreign financiers from participating in such financings, and even where they are willing to go through FIRB notification or exemption processes this will generate delay, uncertainty and expense; factors which are anathema to the competitive bidding arrangements common to major new projects. Because of concentration limits and prudential risk management practices, Australian banks may also be deterred if they cannot be confident of selling down their risk to foreign financiers or, as noted earlier, being repaid out of a capital markets refinancing.

It is respectfully submitted that this change will, at best, burden the loan syndication markets with bureaucratic red tape, and there is a real risk that it will constrict the availability of credit for vital infrastructure projects and other businesses.

Removal of the exemption will also exacerbate the difficulty raised in our submission on Tranche 1 of the FIRB changes concerning the imprecision and broad reach of the definition of *national security business*, as a result of which foreign lenders will have a major concern that removal of the exemption could lead to unwitting contraventions of FATA. Further, the way security is typically granted in secured moneylending transactions is under a general security deed (which grants a security interest over all present and after-acquired property). This means that any asset which is acquired by the grantor under such general security deed will automatically become subject to the security interest. So in a secured corporate financing, after the financing has been put in place, a borrower might acquire an asset which falls within the definition of national security business without the consent, knowledge or approval of the lenders or security trustee - in those cases, a foreign lender or security trustee could be involved in a contravention of FATA without knowing.

This would affect financiers in both new secured moneylending transactions (i.e., after the Draft Regulations take effect), and also in existing secured money lending transactions entered into before the Draft Regulations take effect where, as is common, the general security deed covers all present and after acquired property of the grantor.

**A policy focused solution**

The proposal to introduce s27(1)(c) is described as an 'integrity measure' yet in our view the moneylending exemption should continue to operate as there is no conflict between the Government’s interests in protecting national security, and the routine and low risk nature of moneylending transactions. We understand that Treasury is concerned that the exemption could be abused, as a back-door method of gaining control of a national security business. However, under the terms of the definition of moneylending agreement, to be eligible for the exemption the security interest:

1. must be granted "in good faith, on ordinary commercial terms and in the ordinary course of carrying on a business (a moneylending business) of lending money";
2. must be held solely by way of security for a moneylending agreement (s27(1)(a)(i)) (leaving aside enforcement); and
3. must not deal with "any matter unrelated to the carrying on of that business".

So the exemption is tightly constrained and protected by its own anti-avoidance provisions.

It may be that Treasury's concern derives from the second limb of the moneylending exemption, s27(1)(a)(ii) of FATR, which exempts an interest "acquired by way of enforcement of a security held solely for the purposes of a moneylending agreement". In fact this limb is little if ever used because on enforcement a receiver or administrator is appointed by a security trustee on instructions from the financiers with a view to sale to a third party. The financiers almost never acquire the mortgaged property on enforcement, as that would be inconsistent with the conduct of a moneylending business and it would entail a lengthy and complex legal procedure of foreclosure, or of 'retention' under the Personal Property Securities Act. The APLMA doubts that there would be any objection to foreign financiers being obliged to seek FIRB approval before exercising foreclosure or retention rights.

It would greatly alleviate the dire consequences of revoking the moneylending exemption under the proposed s27(1)(c) if that new provision could be limited in its effect to the second (enforcement) limb of the exemption (ie s27(1)(a)(ii)). On this approach the opening words of the new paragraph (c) could read "in the case of an acquisition of an interest following commencement of enforcement of a security as contemplated in paragraph (a)(ii) above, the interest is not…'.

The Treasurer wrote in *The Australian* newspaper last week that “the provision of and access to credit will be critical to rebuilding every sector of our economy". A key such sector is and will be privately financed infrastructure and other major projects, which generally require large amounts of debt typically provided by means of secured syndicated loan facilities in which on average around two-thirds of the funding is provided by foreign financiers. In the first 6 months of 2020, foreign financiers contributed over A$38 billion of the total A$64 billion of funding in the form of syndicated loans in Australia (source: *Refinitiv*). Unless there is a clear and cogent policy concern, why deter foreign financiers from participating in Australian syndicated loan markets, or make it harder and more costly for them to participate?

There are two alternative solutions which would avoid a seriously adverse impact on the loan syndication markets while being consistent with the Government's stated policy objectives.

1. Withdraw proposed s27(1)(c) and rely on the fact that the moneylending exemption contains within its terms comprehensive anti-avoidance provisions. Or
2. If the Government remains concerned that the second limb could be open to abuse in the case of a national security business, remove that limb from the exemption. Limit the operation of sub-para (c) to the second limb by adding to the opening words of proposed s27(1)(c): "in the case of an acquisition of an interest following commencement of enforcement of a security as contemplated in paragraph (a)(ii) above, the interest is not…'.

Both these options are simple and clear. Either would suffice.

Other less satisfactory alternatives include:

1. introducing a 'safe harbour', exempt from the exclusion in sub-section (3), defining an acceptable market standard or 'plain vanilla' method of enforcement that would be satisfactory to the Government; and/or
2. confining the operation of sub-section (3) to non-mainstream financiers (eg as per the reforms of 2015/16).

These two options are imperfect and potentially messy, and could take time to formulate and implement. We would be happy to work with interested parties to develop them, but feel that either of the first two alternatives is cleaner and more effective, particularly In the limited time available.

 **2. Consequential issues if moneylending exemption not reinstated**

If despite the above concerns the Government proceeds to implement section 27(1)(c) of FATR as proposed in the Draft Regulations, then a number of consequential issues of further concern will arise (in addition to the deterrence of foreign financiers and the disruption of competitive project bid processes).

We understand it is intended that foreign financiers will be able to apply for 'loan program' exemption certificates giving advance cover for a program of secured lending to different national security business projects over a period of time. This would be vital to avoid major delays in bids and financing transactions. There would need to be a streamlined and flexible process. Is there time to set that up before commencement of the reforms on 1 January 2021? The APLMA counsels against a rushed process, and requests an extension as a large number of foreign financiers with no operations in Australia would need time to become familiar with the process. It would be difficult to engage them on this issue at all, but if there are substantial fees (eg in the order of A$375,000 as prefigured) the task will be virtually impossible.

It is unclear how application fees will be assessed, given application fees are normally based on consideration and there is no consideration for the grant of security in moneylending transactions, that grant is simply a condition of the loan. The current guidance note, GN 33, with respect, is no help. It reads:

"*Consideration for interests related to security interests (that are not otherwise exempt under the Act):*

* *For grant of a security interest, the sum of up-front initial payments (ongoing interest payments are disregarded if reflecting a market rate of interest).*"

The upfront payments are furnished by the Borrower, who also grants the security. Those up-front payments are consideration for the loan, not, of course, for the grant of security. Equally it would be wrong in principle to calculate the fee on the value of the loan. The security interests have no consideration attached to them. Accordingly the APLMA suggests that applications for exemption certificates should attract a flat, very low or nominal, fee, not a scaled fee. Given the routine nature of these transactions, the protections built into the definition of moneylending agreement and the very low possibility that a financier will ever end up actually acquiring the assets in question (as opposed to a receiver or other controller selling them to a third party), and given banks are not in the business of operating these kinds of assets, the fee should be minimal.

A substantial fee would be just another step towards making Australia unattractive for overseas financiers, it would be a major deterrent to their participation in the financing of new infrastructure projects. Further, as soon as the lenders are charged these fees, these fees will be passed on to the borrower. In effect, a foreign acquirer will be paying twice. They will have to pay the fees of the financier, and then of course the costs will be passed on to the end consumer. The impact on competitive bids would be even worse, as governments and other procurers generally require certainty, so require fully funded bids, and will not accept that the bid or its financing is subject to conditions such as the obtaining of FIRB approvals. So any fees would have to be paid without even the certainty of a transaction proceeding.

Timing is also an issue. In competitive bids and, indeed, new projects, the sponsors don't have time to allow the financiers to wait out the FIRB notice periods, or wait for exemption certificates.

If we drive those financiers away, the Australian market will necessarily be narrower and less competitive, and infrastructure borrowing costs may well increase. And at the moment with the worldwide recession some foreign financiers have started to retreat to their home markets, meaning the domestic lending market is already somewhat constrained. Adding the burden of red tape, delays, uncertainty and substantial fees risks accelerating this retreat.

There are also some unresolved technical issues if the moneylending exemption is withdrawn.

It is not clear how the new national security provisions apply to small (below 10%) participations in loan facilities secured over a national security business where the security is held by a security trustee for the benefit of a number of financiers, some foreign. Is any interest (held through a security trust) in a security interest over an interest of 10% or more in a ‘national security business’ a ‘notifiable national security action’? If so, should there not be a de minimis exclusion for small participations? If not, and the interest of the foreign person in the security interest must be at least 10% under s16(a) of FATR, how is an interest in a security interest quantified? Presumably it is the percentage the financier's loan represents of the total outstanding facilities. .Some financiers may have contingent exposures, for example they may have undrawn facilities, or may have issued performance bonds. How does that affect this? What is to be done with currency fluctuations?

Further, is the threshold under s16 of FATR 10% (under para (a)) or is the syndicated loan agreement considered a 'legal arrangement relating to the businesses of the person and the entity or business' (so reducing the percentage to 5% under s16(b))? Also, the direct interest language is only used in certain components of the notifiable national security action definition. Which raises another issue: there is no proportionality in the test, so if any land subject to the security interest is national security land, you would need FIRB approval for the security interest even if that is one very minor asset in a much larger portfolio.

In addition, if the threshold loan facility participation requiring FIRB approval is 10% (or 5%), you run the risk that a bank could have its percentage interest in the debt increase without any action on its part, for example where the borrower repays a different tranche of its debt. What would happen if that results in the threshold being crossed?

These questions assume that the security trustee itself would only be caught by FATA (leaving aside the moneylending exemption) if it is itself a foreign person. We are aware that other views are held on this issue, which if correct would lead to a further range of complications which will make it difficult to find parties willing to undertake that role.

The security trustee is unlikely to have sufficient information about each member of the syndicate to be able to make a FIRB application on behalf of the syndicate. If the security trustee has to make applications on behalf of other entities this will considerably increase the security trustee’s workload, for which they are likely to charge increased fees. It is not clear how any application required to be made by the security trustee would sit with any ‘loan program’ exemption certificates that may have been obtained by individual syndicate banks previously. Currently when presented with documents to process a transfer of a loan interest, the security trustee and facility agent only have a discretion to decline to process the transfer if they have not completed applicable ‘know your customer’ tests. This is likely to have to change to include conditions around FIRB approval. If the transfer cannot be processed until FIRB approval has been obtained, then the incoming foreign bank is not yet a beneficiary of the security trust. It would be illogical, and untenable, for the security trustee to make an application on behalf of someone for whom they are not yet appointed trustee. If this was the requirement, then we anticipate that other documents would have to be entered into between the security trustee and the prospective financier to authorise the security trustee to make the application, in which the foreign financier makes representations and warranties to the security trustee about the accuracy of information provided, agrees to indemnify the security trustee etc. For all these reasons we submit that it should not be the security trustee who is required to make FIRB applications in relation to syndicated loans

And what are the potential liabilities of the facility agent and the security trustee if they process a transfer of a loan interest from one financier to another where unbeknownst to them the new financier requires (and has not obtained) an exemption from FIRB?

We suggest these uncertainties and potential complications demonstrate that the FIRB legislation and regulations are not well suited to dealing with loan securities, another reason to retain the moneylending exemption.

**3. Transitional arrangements**

Due to the very short consultation period these comments have been prepared in haste, without the benefit of sector wide consultations, and we may not have been able to identify all of the implications of this proposed very significant change.

If the Government does proceed with the reforms as proposed, financiers will need a reasonable period to get on top of the proposed 'lending program' exemption certificates and to familiarise offshore participants in the loan syndication markets with the new regime and the FIRB review processes themselves. The APLMA anticipates that a substantial delay in the proposed commencement date would be required to avoid major disruptions. Further, given the frequency of trading of participations in loans and bonds, it would be important to grandfather existing security interests, so that interests acquired under them after commencement continue to benefit from the moneylending exemption.

**4. Security of Critical Infrastructure Act reminder**

We take this opportunity to reiterate a particular concern for financiers, that under s10A(2)(b) of FATR (under the draft amendments) the business of the holding (and buying and selling) by a 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 letter from the APLMA to the Minister for Home Affairs dated 20 December 2018. We also provided you with 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 the moneylending exemption under s27 of FATR is not to apply to security over a national security business.

We would be happy to discuss any aspect of the above submission.

Yours faithfully

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