



22 December 2008

Mr Peter Hallahan
Committee Secretary
Senate Legal and Constitutional Affairs Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

By email: legcon.sen@aph.gov.au

Dear Mr Hallahan

Personal Property Securities Bill

The Australian Financial Markets Association (AFMA) welcomes the opportunity to provide comments to the Senate Legal and Constitutional Affairs Committee Inquiry on the Personal Property Securities (PPS Bill).

AFMA represents the interests of participants in Australia's wholesale banking and financial markets. Our members include banks, stockbrokers, treasury corporations, fund managers, traders in specialised products and industry service providers. Their business places them at the centre of the equities market; brokering transactions, arranging and underwriting capital raisings, structuring products, trading and investing.

The following submission is intended to provide a succinct presentation of the major law reform significance of the PPS Bill and commercial concerns with it in its present form that should in our view be taken into account in policy consideration of the Bill. We would welcome the opportunity to address the Committee. Please do not hesitate to contact David Love, Director - Policy, at dlove@afma.com.au or (02) 9776 7995 if further assistance or clarification is desired.

Yours sincerely

Duncan Fairweather
Executive Director

1. Executive Summary

The PPS Bill represents an important policy initiative and opportunity for the nation that is worth getting right. The PPS Bill has two main policy objectives:

1. It establishes a national system for the registration of personal property securities.
2. It radically changes the established Australian law on securities by attempting a codification based on modified foreign law models.

As a subordinate policy objective, the Government is also consulting on implementing an international convention on private international law for securities through the legislation.

The central point made in this submission is that establishment of a national register for personal property securities is a welcome initiative supported by AFMA. This first policy objective needs to be distinguished from the second objective which is a wholesale reform of the substantive law on securities in Australia.

There are still serious flaws in the reform of substantive law on securities as proposed in the PPS Bill, which require substantial effort and time to put right. AFMA believes that the PPS Bill reforms to securities law are insufficiently developed at present and do not harmonise effectively with existing Australian law. This will result in significant legal uncertainty being created. This uncertainty is likely to take a number of years of litigation to settle in order to establish new case law. It is anticipated that the PPS Bill will increase regulatory uncertainty and consequently create more commercial risk at a time when credit providers are dealing with a difficult and fragile market environment.

As part of the draft legislation package, the Government has been consulting on implementing international private law rules of the Hague Convention on Securities under Australian law through the PPS Bill. It is desirable that Australia sign the Convention as a first step in the domestic implementation of the rules.

AFMA Recommendations

AFMA recommends that:

1. The PPS Bill should implement a national system for the registration of personal property securities in accordance with the decision in the Council of Australian Governments (COAG) Intergovernmental Agreement.
2. The broader reform of the substantive law on securities based on the current unsatisfactory proposals put forward in the PPS Bill should be separated from this current PPS Bill package. The broader reform to securities and related law requires considerably more work and time to get right and should be dealt with through separate legislation.
3. Australia sign the Hague Convention on Securities and implement its principles as part of reforms to Australian law on securities.

2. Objectives of the PPS Bill

This submission addresses the broad policy objectives and commercial implications for industry of the PPS Bill and recommends how law reform in this area can best be handled. It does not attempt a detailed technical critique of the substantive law reform in the PPS Bill, which is best left to expert opinion. AFMA has had the benefit of discussing the jurisprudential implications with representatives of law firms expert in the area of Australian securities law over the course of recent months. AFMA concurs with the detailed legal analysis being provided separately to the Committee by the specialist legal advisers and shares their concerns with the law reform process surrounding the PPS Bill.

Personal property is any form of property other than land or buildings and fixtures which are legally treated as forming part of land. Personal property can include tangibles (such as cars, boats, machinery, crops) and intangibles (such as shares, intellectual property, receivables and contract rights). Personal property is used to secure financial transaction agreements which range from loans, general security agreements, chattel mortgages, conditional sale agreements, debentures, trust deeds, assignments of book debts or accounts receivable, equipment leases, consignments by way of security, share mortgages and assignments of rents. Given the importance of collateral in providing security to lenders, a sophisticated body of law has developed over the last two centuries to deal with disputes over personal property securities which rely on principles fundamental to the Australian jurisprudence from contract law, property law and equity. Much of the law on securities and related principles addresses whether interests exist and priorities between collateral takers and others when borrowers default. This body of law has evolved independently in Australia and differs from foreign law statutory models, particularly in the US, which evolved along different paths in responding to problems with securing lending.

Australia's federal system has complicated rules for registering and obtaining priority for an interest in personal property that vary widely and leave gaps. The Commonwealth, States and Territories have separate personal property security schemes with separate registers and legislation relating to those registers. The current requirements for registering a security interest in personal property vary depending on the type of personal property, where it is located and whether the property belongs to an individual or a corporation. There has been a longstanding recognition that Australia's incomplete patchwork of registration systems is less than satisfactory and detracts from the nation's economic efficiency. The PPS Bill would create a national system for the registration of personal property securities. Policy descriptions of the PPS Bill focus attention on this aspect of the legislation.

However, the Bill is also proposing changing broader Australian law on securities and assignments and other dealings in contract and with property quite radically. This is the substantive law that deals with whether interests exist and rights between collateral takers and other parties when borrowers default.

It is important to understand that the PPS Bill is doing two things, the first of which is highly desirable in the near term, and the second which may be a

worthy law reform goal but very complex in execution and which needs significantly more work to complete satisfactorily, namely:

1. Establishment of a national system for the registration of all personal property securities.
2. Radical change to established Australian law on securities by attempting a codification of "in substance" security and assignments and other dealings based on modified foreign law models.

3. National System for Registration is Desirable

AFMA welcomes the effort of the Government through the COAG to bring about agreement with the States and Territories to establish a national system for the registration of personal property securities to be implemented by Commonwealth legislation, supported by a State text-based referral of certain matters to the Commonwealth Parliament.

The implementation of a national system for the registration of personal property securities is a significant regulatory reform that promotes business efficiency within Australia. Currently, personal property security arrangements are regulated by inconsistent and duplicate laws and registers. A streamlined national system should deliver greater certainty and efficiency for business by reducing legal complexity and improving administrative procedures. Implemented in the right way, this would benefit a wide range of stakeholders in the current system, especially participants in the financial services sector.

AFMA recommends that the Government confine the current PPS Bill to the policy objective of establishing a national system for the registration of personal property securities in accordance with the decision in the COAG Intergovernmental Agreement.

4. Substantive Securities Law Reform

A streamlined national system should deliver greater certainty and efficiency for business by reducing legal complexity and improving administrative procedures. Implemented in the right way, this would benefit a wide range of stakeholders in the current system, especially participants in the financial services sector.

An important policy objective for the PPS Bill is to improve legal certainty. AFMA members would welcome reform that achieves this end. The PPS Bill instead increases legal uncertainty to a significant degree. Based on expert legal opinion, the PPS Bill reforms to personal property securities and other law are inadequately developed and do not harmonise effectively with existing Australian law.

The changes to the law are likely to produce a significant degree of legal uncertainty that will result in a negative impact on business and detract from the commercial benefits flowing from the national registration system. This impact is likely to be more significant in relation to more complex lending transactions rather than the straightforward retail consumer credit part of the market. Re-establishing legal certainty may need a number of years of litigation to occur to establish new case law. The result is that the PPS Bill will lead to uncertainty over basic law that in turn will increase commercial risk.

Legislation should not increase uncertainty at a time when credit providers are seriously challenged by a difficult and fragile market environment.

It is counterproductive for legislation which is primarily intended to produce better regulation and micro-economic benefits to go forward in a flawed state.

The drafting problems with the reform of substantive law on personal property securities as proposed in the PPS Bill will require substantial time and effort by the Government and stakeholders in consultation to put right. AFMA does not believe it is realistic for the Government to remedy the manifest jurisprudential shortcomings of the PPS Bill being identified by expert legal opinion on its present timetable, which would see the PPS Bill finalised early in 2009.

This criticism of the PPS Bill is not meant to reflect poorly on the drafters. The task they have been set by the Government is an overly ambitious one of radically revising a complex area of substantive law in too short a time period. This is a task which realistically requires the attention of many skilled minds working together over a considerable period of time in a methodical manner.

While it may be argued that imperfect law can be amended later, the rigid nature of the COAG Intergovernmental Agreement will make future changes to the legislation a long and difficult process for the Commonwealth to embark upon. It is therefore important to get the legislation as right as possible the first time around without the encumbrance of artificial deadlines.

Accordingly, AFMA recommends that reform of the broader substantive law on personal property securities and related matters should proceed on a more measured separate legislation track with extensive public consultation on iterations of draft legislation with the object of achieving an optimal outcome for all stakeholders.

5. Governing Law Provisions – Hague Convention

As part of the legislation package the Government has been consulting on measures which would give effect to the international private law rules of the Hague Convention on Securities under Australian law.

The Hague Convention on Securities, which is fully titled '*Convention on the law applicable to certain rights in respect of securities held with an intermediary*', deals with the applicable law applying to mortgages and dispositions of securities held by intermediaries. It provides cross border certainty to the law applicable to clearance, settlement and secured credit transactions thereby reducing systemic risk with international transaction and intermediary holdings. The Convention does not change substantive domestic law (except marginally) or choice of law provisions in custodial agreements but points clearly to which country's law should apply to a dispute. There is strong support among global financial institutions for adoption by countries of the Convention which was concluded on 5 July 2006. The United States was one of the first countries to sign the Convention in late 2007.

The advantages of the Convention to Australian based financial institutions are that it:

- Provides practical rules to achieve needed legal certainty and predictability as to the law governing crucial aspects of the holding, transferring and mortgaging of securities held through intermediaries;
- From a domestic law viewpoint, is a conflict of laws instrument with little impact on existing or future substantive law;
- Offers a solution at the global level and for all dispositions whether a transfer of title or grant of security interest;
- Will reduce legal risk, systemic risk and costs of cross-border securities transactions, thereby facilitating flow of and access to capital; and
- Has no impact on regulatory schemes relating to the issue or trading of securities, regulatory requirements placed on intermediaries, or enforcement actions taken by ASIC.

In the context of the global financial crisis, the widespread adoption by major economies of the Convention would be a further confidence building measure in updating the global financial architecture to address the uncertainty regarding what law should apply in cases where creditors and collateral takers are in legal dispute over rights to securities held by intermediaries. The current economic climate has intensified the strong desirability for the choice of law principles set out in the Convention to govern legal disputes arising out of insolvencies of financial institutions and other market participants.

The Convention should be adopted into Australian law without revision as this would defeat the purpose of providing legal certainty across borders. Such an approach is compatible with Australian legal principles because in essence the Convention points to the appropriate choice of law to apply but does not change substantive domestic law on securities. Where necessary, appropriate definition clarification can be included in implementing legislation to allow the Convention to be easily applied in the Australian context.

AFMA therefore recommends that Australia sign the Convention as soon as possible and move to adopt it into Australian law as part of wider reforms to the law on securities.

6. Conclusion

In summary, the PPS Bill represents an important policy initiative and opportunity for the nation that is worth getting right. It would be quite counterproductive for legislation which is primarily intended to produce better regulation and micro-economic benefits to go forward in a flawed state. AFMA is recommending a realistic process to address this problem, which is consistent with the COAG Intergovernmental Agreement on Personal Property Securities.

This process involves proceeding early next year with an abbreviated PPS Bill which is confined to establishing a national system for the registration of personal property securities. Reform of the substantive law on personal property securities should proceed on a more measured separate legislation track with extensive public consultation on iterations of draft legislation with the object of achieving an optimal regulatory outcome for all stakeholders.