IFD SUBMISSION

TO SENATE STANDING COMMITTEE ON LEGAL AND CONSTITUTIONAL AFFAIRS

PERSONAL PROPERTY SECURITIES BILL 2008

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IFD SUBMISSION TO SENATE STANDING COMMITTEE ON LEGAL AND CONSTITUTIONAL AFFAIRS - PERSONAL PROPERTY SECURITIES BILL 2008

Executive Summary

The Institute for Factors and Discounters (IFD) is the association of the major receivables financiers in Australia and New Zealand, and appreciates the opportunity to proivde comments on the draft Personal Property Securities Bill to the Senate Standing Committee on Legal and Constitutional Affairs. IFD supports the inclusion of receivables finance within the PPS framework and, subject to the comments below, the approach taken in sections 111 and 33 of the Personal Property Securities Bill 2008 ('the Bill') for determining priorities. It is an equitable and commercially logical approach, and recognises the fundamental distinction between receivables financiers who claim accounts as original collateral, and inventory financiers who claim accounts as proceeds. It is pertinent to note that the New Zealand PPS regime does not achieve this outcome, and the development of receivables finance in that market has been stultified, whereas turnover in Australia in 2008 will reach $65 billion.

The requirement under section 111 for the receivables financier to provide notice enables the inventory financier to take appropriate action (if any) in relation to its priority. However, we suggest that a potential ambiguity should be addressed, and recommend that section 33 of the Bill be amended to put beyond doubt that the receivables financier takes a purchase money security interest ('PMSI') in the account assigned to it under section 111. In this regard, IFD appreciates it is important for a party holding a security interest in circulating assets to be able to manage its risk and exposure, and suggests that section 111 should require the receivables financier to also give notice to any registered party with a security interest in circulating assets.

Additionally, IFD strongly supports the approach of the Bill in relation to anti-assignment clauses, which reflects the now almost universal trend in this regard.

The Institute for Factors and Discounters

As noted the Institute for Factors and Discounters of Australia and New Zealand is the association of factors and discounters (receivables financiers), and a list of members is attached. IFD members have a particular interest in the proposal to introduce PPS law in Australia, as they currently purchase accounts receivable, thereby acquiring title. However, under PPS law title becomes irrelevant, and the current distinction between ownership and taking security over personal property ceases to apply. Instead, a receivables financier's claim to accounts will be determined by the statutory framework under the PPS law rather than by title considerations.

The treatment of receivables finance under the Bill

Proposed section 111 of the Bill provides rules for determining priority between an inventory financier and a receivables financier. In essence, the receivables financier will have priority where it has registered against the grantor (client) for the transfer of the account before the PMSI is registered by the inventory financier, or by giving notice to each holder of a registered interest in the inventory at least five business days before the earlier of the day that the collateral is registered or the priority interest attaches to the collateral. The requirement for five business days notice enables the inventory financier to take appropriate action in relation to its priority. The inventory financier would have a PMSI in the proceeds of the inventory and the new value received by the grantor on the transfer of the account.

IFD believes this is an equitable and commercially logical outcome, and entirely consistent with the PPS framework in relation to priorities and the injection of new value. Inventory financiers themselves are given the protection of a PMSI when injecting new value, to enable them to keep their security interest quarantined from an existing security interest over ‘present and after acquired property’ (currently fixed and floating charges). The Bill provides receivables financiers with an equal ability to protect the new value they provide to a business by way of a similar quarantining mechanism.

IFD members support the need for inventory financiers to have their security interests protected, and the Bill puts them in a significantly enhanced position compared to present arrangements: they receive the PMSI super priority; the security agreement itself need not specifically extend to or describe the proceeds; the inventory financier is not required to re-register against the proceeds; the PMSI super-priority will also extend automatically to the proceeds, and be effective from the time of the original registration. We believe that these protections should be available to the inventory financier, and in turn the receivables financier should take priority where it purchases accounts receivable, as provided in the Bill.

We believe this is also consistent with the overall outcome produced by the extinguishment rules. The inventory financier’s interest in the goods is extinguished when the goods are sold in ‘the ordinary course of business of the seller’. The inventory financier then acquires an interest in the proceeds, initially in the account and in turn the proceeds received from the purchaser. That is, the inventory financier’s security interest is successively transferred from the goods to the account, to the cash/cheque proceeds.

The purchase of the account enables the inventory financier to be repaid, in the same manner as the sale of the goods enables payment to be made to the inventory financier. The Bill accordingly acknowledges that extinguishment of the inventory financier’s interest in the account should occur irrespective of the source of the new value; it is irrelevant whether new value is received from the purchaser or the receivables financier, and the Bill reflects this commercial reality.

To do otherwise would also create two classes of inventory financier. Where the account had been sold the inventory financier would have a security interest in the account **and** access to the new value that flows from the sale of the account, but where they have not been sold the inventory financier would have an interest in either the account **or** the cash/cheque proceeds; the former will have done nothing to merit this ‘doubling up’.

This outcome also recognises the fundamental distinction between receivables financiers, who claim the accounts as **original** collateral, and inventory financiers who claim accounts as **proceeds**. It also places receivables finance on an equal footing with chattel paper. We submit that receivables finance is equally as important as chattel paper (and inventory finance), and receivables financiers merit equal treatment in being able to quarantine their security interest.

As observed above, the practical effect of section 111 is to substitute the inventory financier’s PMSI in the proceeds of the inventory for a security interest with the same priority in the proceeds of the inventory or new value received by the grantor.

However, we suggest the legal effect of the Bill is perhaps unclear in relation to the receivables financier, unlike the certainty that section 33 provides to the inventory financier. Consistent with the overall policy position evinced by section 111, we suggest the Bill should remove any interpretational ambiguity to ensure the receivables financier takes, for all purposes, the benefit of the priority afforded to the PMSI over the proceeds. It has been suggested that, despite the policy intention of the Bill in section 111, the priority of the receivables financier is only against the inventory financier, and not any other general security interest perfected earlier in time. Under this interpretation, for example, the receivables financier’s priority under section 111 would be subject to a prior perfected security interest in circulating assets (the Bill's equivalent to the current floating charge). The commercial certainty the Bill is intended to provide would be undermined if this ambiguity remained to be resolved by litigation in the future.

To resolve this potential ambiguity, we suggest an approach consistent with the treatment of accounts as circulating assets in sections 51 and 52. While, as a general rule, an account will be regarded as a circulating asset, it will not be so if the secured party has the control of an account which is the proceeds of inventory and who has registered the fact it has control.

Similarly, a PMSI over inventory is not a circulating asset (section 51(3)), as is the case currently under the equivalent arrangements. Given a PMSI over inventory is not a circulating asset, it would seem incongruous for a receivables financier who acquires an account that is the proceeds of such a PMSI to be subordinated to a prior registered security interest in that account which had lost its priority to the PMSI holder.

Accordingly, IFD recommends section 33 of the Bill be amended to put beyond doubt that the receivables financier takes a PMSI in the account assigned to it under section 111.

However, IFD appreciates the importance for a party holding a security interest in circulating assets to be able to be aware of which assets fall within that category in relation to a particular grantor, to enable it to monitor and manage its risk and exposure. Accordingly, we recommend that when notice is given to an inventory financier under section 111, the Bill should also require the receivables financier to give similar notice to any registered party with a security interest in circulating assets.

Rights on transfer of account or chattel paper

The Bill provides that a term in a contract which prohibits or restricts the transfer of an account that is the proceeds of inventory or, inter alia, chattel paper, would be binding on the transferor, but only to the extent of making the transferor liable in damages for breach of contract, but would be uneforceable against third parties (section 126). The commentary accompanying the original draft Bill noted that the purpose of this rule is to recognise that it would be impractical for transferees of accounts and chattel paper to examine each contract for anti-assignment clauses.

IFD members are very supportive of this approach. The existence of anti-assignment clauses may result in a business being denied access to receivables finance, or funding not being provided against the debts whose assignability may be challenged. Both are unsatisfactory outcomes, as the business does not obtain the required funding, and the latter outcome results in extra administration to the facility and involves extra risk.

As most of the receivables finance market in Australia is 'confidential' invoice discounting, the debtor will normally be unaware that the debt has been assigned. The business is generally reluctant to approach the debtor to seek removal of the anti-assignment clause (or some wording from the debtor to acknowledge that the clause is not intended to restrict the assignment of debts). This is because of the possible stigma of such disclosure, or a request for removal is used as a trigger to negotiate a faster payment of the debt at a significant discount (often the business is the weaker party to the contract); alternatively, such action may delay payment beyond the usual terms, on the basis that the business has received finance against the debt and accordingly there should be no pressure for the debtor to pay in a timely manner.

An important objective in developing a PPS regime in Australia is to encourage cheaper finance and more competition in the financial services sector. An efficient PPS regime will be of no help to businesses that cannot obtain receivables finance because of assignment prohibition. IFD strongly supports the approach of the Bill, which reflects the now almost universal trend in relation to anti-assignment clauses.

Conclusion

Receivables finance has grown very rapidly in Australia in the last decade. In 1998 total turnover was $7 billion, whereas in 2008 it will reach $65 billion. This growth highlights that this form of finance is well suited to the needs of small-medium size businesses.

Receivables finance in Australia has undergone a transofrmation in this period, and has been one of the most rapidly growing sectors of the financial services market. This growth has been accompanied by a substantial increase in the number of participants in the market. All major banks now operate a receivables finance division in their own right, whereas in the past these operations were conducted by separate entities or were not offered. Most of the regional banks now provide receivables finance, generally entering the market by way of acquisition of existintg operations, and international banks are also represented. In addition, there are a number of international and local finance specialists who mainly operate on a national basis, and a number operate in limited geographical locations.

Current turnover of $65 billion in Australia also compares to turnover in New Zealand of only NZ$125 million when PPS law became operational in that country in 2002. These comparisons highlight that the PPS reform process needs to recognise the legitimate interests of receivables financiers and, subject to the suggested changes in this submission, we believe the Bill strikes an equitable balance in this regard.

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