(Australian Branch)

10 February 2021

Committee Secretary
Parliamentary Joint Committee on Intelligence and Security
PO Box 6021
Parliament House
Canberra ACT 2600

By email:
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Dear Sir or Madam

Review of the Security Legislation Amendment (Critical Infrastructure) Bill 2020 (the *Bill*) and Statutory Review of the Security of Critical Infrastructure Act 2018 (the *Act*)

Reference is made to the above reviews by the Committee. This submission relates primarily to the operation of the Act, and so to the Statutory Review of the Act. It also relates to the Committee's Review of the Bill insofar as the Bill fails to deal with the issues we have raised concerning the operation of the Act in previous submissions to the Critical Infrastructure Centre.

The Asia Pacific Loan Market Association (the ***APLMA***) is grateful for the opportunity to comment on the Bill and the operation of the Act. Our principal concern is with the failure of the Bill to rectify the deficiencies in the drafting of the moneylending exemption in section 8 of the Act, as a result of which deficiencies the Act does not operate as intended. The Bill proposes a significant expansion of the category of 'critical infrastructure assets' under the Act, and so will result in serious exacerbation of the problems with the Act. The Minister responded to earlier submissions by us, and in that response confirmed that the difficulties with the moneylending exemption were not intended, so we urge the Committee to recommend rectifying them in the Bill. As noted below, the changes required are not extensive.

The Australian loan syndication markets generate over A$100 billion in loan financings every year, and a substantial portion of that funding is secured over critical infrastructure assets. The moneylending exemption deficiencies outlined below will result in unwarranted red tape and may deter banks from participating in such financings, so restricting the availability of credit for key nation building projects.

Background on the APLMA

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. 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.

Background on typical secured syndicated financings for critical infrastructure

It is very common for businesses (including infrastructure projects) that would be 'critical infrastructure assets' under the Act to be developed or acquired (e.g. on privatisation) by private sector investors using syndicated debt finance which is secured over the critical 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.

The security over the critical 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 (leaving aside the moneylending exemption under s8(2) of the Act (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 critical infrastructure assets. Accordingly, for the purposes of the Act, each would be a 'direct interest holder' and hence a 'responsible entity' in relation to those assets, with registration and reporting obligations under the Act.

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.

Although the APLMA's focus is on syndicated loans, many of the issues canvassed in this submission will also be relevant to debt capital markets financings and refinancings (eg in the form of secured bond issues) of major projects. It is common for 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 Moneylending Exemption in the Act

In a typical secured syndicated financing of a critical infrastructure asset both the Security Trustee and any financier with an interest of at least 10% under the Security Trust will be a 'direct interest holder' in the critical infrastructure asset. Under s8(2)(b) and (c) of the Act the Moneylending Exemption does not apply if:

- under para (b), the holding of the interest puts the entity 'in a position directly or indirectly to influence or control the asset'; or
- under para (c), enforcing the security would put the entity 'in a position directly or indirectly to influence or control the asset'.

These limitations mean that the Moneylending Exemption will never apply to the typical secured syndicated infrastructure financing. The reason is that the whole point of taking security is to be put 'in a position directly or indirectly to influence or control the asset' by enforcing the security.

Any asset security taken in the ordinary course of moneylending business allows the holder of the security to take control of the asset by enforcing the security – that is why financiers take, and why on default they enforce, security: to get control over the asset and protect it pending sale or other realisation. By holding security (and by related undertakings in the facility agreement) a secured financier will necessarily be 'in a position to control or influence the asset', and by enforcing the security the secured creditor would directly or indirectly influence or control the asset.

The Explanatory Memorandum to the Act (para 186) confirms that there was no intention to catch the typical secured financier.

> 'The moneylending exemption applies where the security interest in the asset is held as part of a security interest for the purposes of a ***moneylending agreement*** (sub-subclause 8(2)(a)(i)) and enforcing the security would not put the moneylender, its subsidiary or holding entity, in a position to directly or indirectly influence or control the asset (sub-subclause 8(2)(c)). The moneylending exemption still applies if the security is enforced as a result of a default, and the [security] holding entity enforces the security over the critical infrastructure asset and holds an interest in the asset (sub-subclause 8(2)(ii)[*sic*]). However, the exemption only applies where the interests are held in the ordinary course of a moneylending business, and the entities are not in a position to directly or indirectly influence or control the asset (sub-subclause 8(2)(b)).'

The Example set out in the Explanatory Memorandum immediately following that statement confirms that the grant and enforcement of the security in the ordinary course of moneylending business will be exempt. Unfortunately the Example also implies a view that a security interest is not an 'interest' until it is enforced - this is not correct as a matter of law, as the grant of security will confer on the secured financier an immediate interest in the asset. But there is a clear implication from the Example that so long as enforcement is not for purposes outside the usual business of moneylending, it will be exempt.

> 'Company A, a moneylender, holds a security interest over a critical infrastructure asset. Company B, the borrower, defaults on the loan and Company A is required to enforce the security interest. This results in Company A acquiring an interest in the critical infrastructure asset.
>
> Company A, after acquiring the interest [*ie after commencing enforcement of the security*], obtains control and influence over the critical infrastructure asset, and begins to control the asset for purposes outside the usual business of a moneylending agreement.
>
> The moneylending exemption would no longer apply and Company A would be considered a ***direct interest holder*** and would be required to report on interest and control information in respect of the asset.'

This intention is not fully reflected in the legislative drafting.

When we raised this issue with the Critical Infrastructure Centre, the Minister responded (on 29 January 2019) confirming that the intention was that a security interest should not be considered an interest for the purposes of the Act 'until the financier takes steps to enforce the security and through that obtains influence and control over the asset'. **Our request is simply that the Act be amended to reflect this stated intention**.

The unavailability of the Moneylending Exemption will deter financiers from participating in secured infrastructure financings because of the uncertainty and expense of the application of the 'responsible entity' provisions of the Act. Foreign lenders, in particular, will be concerned with the registration and reporting obligation.

Failing to rectify this drafting oversight will needlessly burden participants in the loan syndication markets with bureaucratic red tape, and there is a real risk that it will deter lenders from providing credit for vital infrastructure projects.

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 critical infrastructure asset without the consent, knowledge or approval of the lenders or security trustee - in those cases, a lender or security trustee could be involved in a contravention of the Act without knowing.

Simple drafting solutions

There are already strict limitations embodied in the terms of the definition of moneylending agreement in s8(3) of the Act. To be eligible for the Moneylending Exemption the security interest must be held solely by way of security for a moneylending agreement (or by way of enforcing a security for the purposes of a moneylending agreement) and, under s8(3):

(a) 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"; and

(b) 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. Those provisions are closely modelled on the equivalent provisions providing for the moneylending exemption the *Foreign Acquisitions and Takeovers Regulation*. We suggest following the same approach as in s27 of the Regulation, which would have the benefit of consistency. This would mean replacing s8(2)(b) and (c) with:

(b) the entity that holds or acquires the interest is:

(i) the entity (the ***first entity***) that entered the moneylending agreement; or

(ii) a subsidiary or holding entity of the first entity; or

(iii) a person who is (alone or with others) in a position to determine the investments or policy of the first entity; or

(iv) a security trustee who holds or acquires the interest on behalf of the first entity; or

(v) a receiver, or a receiver and manager, appointed [in relation to][*we suggest these words are not quite apt, and should be replaced with*: by or on instructions from] a person or entity mentioned in any of subparagraphs (i) to (iv).

This effectively limits the banks to an enforcement 'safe harbour' of appointing receivers, which is the usual course. The square brackets in subparagraph (v) identify a drafting glitch in s27 of the Regulation; it would be ideal to fix it but that is not essential.

An alternative would be to amend s8(2) of the Act to read as follows, so as to be consistent with ordinary secured moneylending practice and the Explanatory Memorandum [*suggested changes underlined*]:

Subsection (1) does not apply to an interest in an asset held by an entity if:

(a) the entity holds the interest in the asset:

(i) *solely* by way of security for the purposes of a moneylending agreement; or

(ii) *solely* as a result of enforcing a security for the purposes of a moneylending agreement; and

(b) the holding of the interest does not put the entity in a position to directly or indirectly influence or control the asset otherwise than as a result of the moneylending agreement and the holding and if applicable enforcing of security for the purposes of a moneylending agreement, all in the ordinary course of a moneylending business; and

(c) if the entity is holding the interest solely by way of security—enforcing the security would not put the entity in a position to directly or indirectly influence or control the asset otherwise than as a result of enforcing the security for the purposes of a moneylending agreement in the ordinary course of a moneylending business.

We have canvassed these (among other) options with the Critical Infrastructure Centre, but at this stage we are not sure which approach is preferred.

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

Yours faithfully

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Andrew McDermott | Chair
Australian Management Committee
Asia Pacific Loan Market Association
Australian Branch

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