(Australian Branch)

27 November 2020

Critical Infrastructure Centre
National Resilience and Cyber Security Group
Department of Home Affairs

By email: ci.reforms@homeaffairs.gov.au

Dear Sir or Madam

Exposure Draft of the *Security Legislation Amendment (Critical Infrastructure) Bill* 2020

Reference is made to the Exposure Draft of the *Security Legislation Amendment (Critical Infrastructure) Bill* 2020 (the ***Draft Bill***) and to our letter to the Minister for Home Affairs dated 20 December 2018 (copy attached, the ***First Submission***).

The Asia Pacific Loan Market Association (the ***APLMA***) is grateful for the opportunity to comment on the Draft Bill. Our principal concern is with the failure of the Draft Bill to rectify the deficiencies in the drafting of the moneylending exemption in section 8 of the *Security of Critical Infrastructure Act* (the ***Act***). The Draft 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 outlined in the First Submission. The response from the Minister to the First Submission indicated that the difficulties with the moneylending exemption were not intended, so we urge the Government to rectify 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 in the First Submission 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 (eg 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.

For more detail on this issue, and an explanation of how the drafting conflicts with the purpose of the provision as outlined in the Explanatory Memorandum to the Act, please see the First Submission. The reply from the Minister

dated 29 January 2019 confirmed 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.

A simple drafting solution

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.

The drafting solution set out in the First Submission remains a good option. On reflection, we suggest a simpler approach would also suffice - that paragraphs (b) and (c) of s8(2) of the Act be replaced with:

'(b) the entity does not take steps to enforce the security and through that to obtain influence or control over the asset.'

Further technical issues

There are also some unresolved technical issues.

It is not clear how the provisions apply to small (below 10%) participations in loan facilities secured over a critical infrastructure assets where the security is held by a security trustee for the benefit of a number of financiers. Is any interest (held through a security trust) in a security interest over an interest of 10% or more in a critical infrastructure asset a 'direct interest'? If so, should there not be a *de minimis* exclusion for small participations? 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?

In addition, if the threshold loan facility participation is 10% 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. Would that be a direct interest if the borrower's action results in the threshold being crossed?

The security trustee is unlikely to have sufficient information about each member of the syndicate to be able to register and report under the Act on behalf of the syndicate. If the security trustee has to do this on behalf of other entities this will considerably increase the security trustee's workload, for which they are likely to charge increased fees.

Some clarification of these technical issues, by way of formal guidance from the Centre, would be welcome.

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

Yours faithfully

[redacted]

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

Phone [redacted]
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Encl.

20 December 2018

The Hon. Peter Dutton, MP
Minister for Home Affairs
Australian Parliament House
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minister@homeaffairs.gov.au

Dear Minister

Security of Critical Infrastructure Act 2018 (Cth)

We refer to the *Security of Critical Infrastructure Act 2018* (Cth) (***SICA***), which commenced on 11 July 2018.

The Asia Pacific Loan Market Association 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. I

It is headquartered in Hong Kong and has a flourishing Australian Branch. The organisation has 319 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.

Introduction

This new legislation imposes on, among others, direct interest holders, an obligation to register, to provide extensive information and to become subject to reporting obligations. These obligations may deter financiers from financing critical infrastructure assets, or at least needlessly increase the cost of doing so. Secured financiers (*moneylenders*) of critical infrastructure assets would be direct interest holders under SICA but are clearly intended to be exempt under a moneylending exemption (section 8(2) of SICA). However, the drafting of the exemption does not work.

We are respectfully seeking amendment of the exemption to ensure that it achieves its aim of avoiding imposing unnecessary financial and regulatory burdens on financiers conducting their usual business of moneylending.

The source of the problem

Entities subject to registration and reporting obligations under SICA are defined as *reporting entities* and they include, relevantly, direct interest holders. An Interest is defined in SICA as a legal or equitable interest, and direct interest holder is defined in s8(1) of SICA as follows.

> An entity is a ***direct interest holder*** in relation to an asset if the entity:
>
> (a) together with any associates of the entity, holds an interest of at least 10% in the asset (including if any of the interests are held jointly with one or more other entities); or

(b) holds an interest in the asset that puts the entity in a position to directly or indirectly influence or control the asset.

Financiers of a critical infrastructure asset will commonly take security over the assets, and it is clear that security will confer an *interest* in the asset on the security holder. Where there are multiple financiers, that security will normally held by a security trustee on trust for the benefit of the financiers, but the financiers will still, under such an arrangement, ordinarily have an interest in the secured assets by being beneficiaries under the security trust. As a result each financier and the security trustee will be direct interest holders as so defined, and so reporting entities subject to SICA, unless the moneylenders exemption (s.8(2)) applies. That exemption reads as follows.

> 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; 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.

Moneylending agreement is defined in s8(3) of SICA in a helpfully broad way. But the requirements of sub-section (2), which appear to be cumulative, are impossible to satisfy. Although a typical secured financier (and its security trustee) would readily tick the box for s8(2)(a), paragraphs (b) and (c) are problematic. It is very hard to see how a secured financier or security trustee would ever satisfy paragraph (b) or (c). The reason is that 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 (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 is 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 regrettably not fully reflected in the legislative drafting.

A suggested solution

This problem requires legislative amendment, for example by revising s8(2) 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 <u>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</u>; 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 <u>otherwise than as a result of enforcing the security for the purposes of a moneylending agreement in the ordinary course of a moneylending business</u>.

Alternatively, there are workable moneylending exemptions in the *Corporations Act* and the *Foreign Acquisitions and Takeovers Act*, either of which could be adapted for the purpose.

We would be happy to meet to discuss the issues further.

Yours sincerely,

[redacted]

Judy Busljeta | Chair
Documentation Committee
Asia Pacific Loan Market Association
Australian Branch
Phone [redacted]
email

THE HON PETER DUTTON MP
MINISTER FOR HOME AFFAIRS

Ref No: MC18-067054

Ms Judy Busljeta
Asia Pacific Loan Market Association
[redacted]

Dear Ms Busljeta

Thank you for your letter regarding the *Security of Critical Infrastructure Act 2018* (the Act). I note the Asia Pacific Loan Market Association's (APLMA) concerns regarding section 8 of the Act and its view of the impact of these provisions on current and future investment in Australia's critical infrastructure.

The Australian Government recognises the importance of balancing Australia's national security interests and fostering our economic prosperity in a global market. This is why during Parliamentary consideration of the legislation, the provisions relating to finance arrangements, as referred to in your letter, were included.

Advice from the Department of Home Affairs confirms that the intent of the moneylender exemption is as set out in the Explanatory Memorandum to the legislation, as referred to in your letter. That is, whilst secured finance may provide a financier an 'interest' in the asset, it is not 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. It is at this time that the financier may meet the definition of direct interest holder, depending on the percentage of interest in the asset, and have registration obligations under the Act.

The Australian Government remains committed to working with industry to meet its obligations under the Act to safeguard Australia's critical infrastructure. As such, the Department will contact you to discuss this matter further. The contact officer within my department is [redacted] at [redacted] or [redacted].

Thank you for raising this matter.

Yours sincerely

[redacted]

PETER DUTTON 29/01/19

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