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Changes to moneylending exemptions in FIRB Legislation to put FIRB approvals back on lenders' radar

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CHANGES TO MONEYLENDING EXEMPTIONS IN FIRB LEGISLATION TO PUT FIRB APPROVALS BACK ON LENDERS' RADAR

IN BRIEF

After a 5 year reprieve, proposed changes to the existing moneylending exemption under the Foreign Acquisitions and Takeovers Regulation 2015 (**FATR**) and Foreign Acquisitions and Takeovers Act 1975 (**FATA**, and together with FATR, the **FIRB Legislation**) mean that secured lenders (and their security trustees) which are "foreign persons" will (in certain circumstances) need to notify the Foreign Investment Review Board (**FIRB**) and obtain no objection notices (loosely called "FIRB approval") in order to take security interests in certain securities, assets, land or tenements with national security significance (**National Security Assets**). These changes will increase costs and timelines for such transactions, and it is also possible that a covered transaction could be prohibited. There are also severe penalties (including criminal penalties and large fines) for non-compliance.

As a practical matter, lenders and security trustees will need to consider carefully whether they fall within the definition of a "foreign person" for the purposes of the FIRB Legislation. If they do, they will then need to determine whether their security packages involve National Security Assets; and if so, determine whether the acquisition of the interest conferred by such security packages is the type of transaction that requires FIRB approval.

It may be possible for lenders and security trustees that are "foreign persons" that frequently take security over National Security Assets to obtain a standing exemption certificate from the Treasurer which would mean that they would not be required to obtain a FIRB approval each time they take a security interest over such assets (though the parameters around the grant of these exemption certificates are still to be confirmed, and in any event will be subject to the Treasurer's discretion).

Sponsors and borrowers should also consider the impacts that the proposed changes may have on their transaction timeline and expenses if their lenders and security trustees will be required to seek FIRB approval before entering into the transaction.

The proposed changes to the FIRB Legislation are currently in draft form, but are expected to commence from 1 January 2021. In this update we consider the effect and implications of these proposed changes for lenders and secured parties.

IMPORTANT NOTE

+ We note that this update focuses only on the proposed changes to the moneylending exemption in the FATR. Other changes have been mooted to the FIRB Legislation which we have not endeavoured to cover here. For a more detailed summary of the FIRB Legislation (current as of 4 June 2020 – ie, excluding the proposed Tranche 1 Amendments, the Tranche 2 Amendments (each, as defined below) or any other proposed amendments after such time), please refer to our separate Foreign Investment in Australia brochure available here (**G+T FIRB Brochure**).

+ The content of this article is general and based on draft legislation which is still subject to consultation, is not in force and is subject to change. It is also unclear how FIRB and Treasury will interpret, apply and enforce the amendment FIRB Legislation. It should not be considered definitive advice on the subject matter. Australia's foreign investment rules are complex, and specific legal advice should be sought in relation to them before taking any step or action which may fall within their scope. If you have any further queries, please contact our team at the conclusion of this update.

BACKGROUND: FOREIGN INVESTMENT RULES

- Under Australia's foreign investment rules, the Treasurer has powers to make orders in relation to certain transactions – to block them, require persons to make divestments or impose conditions – if he considers them to be contrary to the national interest. These transactions are called "significant actions", a subset of which (called "notifiable actions") must be notified and approval sought (with failure to do so an offence). "Significant actions" which are not "notifiable actions" do not strictly speaking have to be notified, but doing so and obtaining a notice of no objection cuts off the Treasurer's powers in relation to such action.
- In addition, as a result of the proposed changes to the FIRB Legislation, the Treasurer will acquire similar powers in relation to a further category of transactions (called "notifiable national security actions"), if he considers them to be contrary to Australia's national security. These transactions must be notified to FIRB, and FIRB approval must be sought.
- Under the FIRB Legislation, a person is deemed to acquire an interest in securities, assets, land or a trust as soon as they enter into an agreement to do so, regardless of how remote the actual acquisition of the interest is, unless the agreement is subject to appropriately worded conditions. For this reason, the grant of security alone to a lender (or its security trustee) in connection with a lending transaction could trigger FIRB approval requirements, assuming all materiality thresholds (if any) are met.
- However, since 2015 the moneylending exemption in the FATR has meant that lenders (and their security trustees) have not needed to concern themselves with the FIRB Legislation for most of their secured lending transactions (particularly where residential real estate is not part of their security package).
- The changes currently proposed to the FIRB Legislation will mean that this exemption is no longer available to lenders (and their security trustees) where the security is granted over a National Security Asset.

THE PROPOSED CHANGES TO THE FIRB LEGISLATION

Following the announcement of comprehensive changes to the FIRB Legislation on 5 June 2020 (as summarised in our update 'New changes to Australia's foreign investment framework') and the release of the exposure draft of the first tranche of FATA reforms on 6 August 2020 (**Tranche 1 Amendments**) (as summarised in our update 'Exposure draft legislation for changes to Australia's foreign investment framework released'), on 18 September 2020, the Treasury released for public consultation the exposure drafts of the Foreign Investment Reform (*Protecting Australia's National Security*) Regulations 2020 and the *Foreign Acquisitions and Takeovers Fees Imposition Regulations 2020* (**Tranche 2 Amendments**).

Among other changes to the regulations governing foreign investment, the Tranche 2 Amendments include a new carve-out to the moneylending exemption under the FIRB Legislation. The proposed carve-out will exclude from the moneylending exemption a money lender (or its security trustee) taking security over National Security Assets, which include an interest in securities, assets, land or tenements that is:

(a) Australian land that is "national security land" (or a tenement that is an exploration tenement in respect of "national security land"); or

(b) an asset of a "national security business".

The effect of this change, should it become law, would be that a "foreign person" seeking to take a security interest over a National Security Asset would require FIRB approval where the transaction is a "notifiable action" or a "notifiable national security action" (and would have the option of seeking FIRB approval where the transaction is a "significant action", but not a "notifiable action" or "notifiable national security action").

It is expected that the person taking a security interest for the purposes of the above approval requirements will be the legal holder of such interest, which for the purposes of a syndicated loan transaction, or a secured financing transaction including a security trust structure, means the security trustee, rather than the individual lender beneficiaries of the security trust.

To assist lenders and security trustees in understanding, and planning for, the impact that the current form of the Tranche 2 Amendments, once in force, may have on them and their future transactions, we have prepared a Q+A section below dealing with some of the issues and concerns we would expect to be key considerations for them. For further detail on the FIRB Legislation generally, please refer to the G+T FIRB Brochure.

9 KEY QUESTIONS FOR LENDERS AND SECURITY TRUSTEES

If the Tranche 2 Amendments become law in the form of the current exposure draft, will my moneylending transaction require FIRB approval?

Whether FIRB approval is required for a moneylending transaction after the Tranche 2 Amendments come into force will depend on whether:

(a) the person proposed to be the holder of the security interest is a "foreign person";

(b) the security package for the moneylending transaction includes a National Security Asset; and

(c) whether the acquisition of the interest in the National Security Asset amounts to a "significant action", a "notifiable action" or a "notifiable national security action".

Who are "foreign persons" for the purposes of the FIRB Legislation?

(a) A "foreign person" includes (among others):

(i) a corporation in which an individual not ordinarily resident in Australia, a foreign corporation or a foreign government holds a substantial interest (generally, 20% or more), or 2 or more persons, each of whom is an individual not ordinarily resident in Australia, a foreign corporation or a foreign government, hold an aggregate substantial interest (generally, 40% or more); and

(ii) the trustee of a trust, where in respect of the trust an individual not ordinarily resident in Australia, a foreign corporation or a foreign government holds a substantial interest (in this context, has the rights to 20% or more of the income or property of the trust), or 2 or more persons, each of whom is an individual not ordinarily resident in Australia, a foreign corporation or a foreign government, hold an aggregate substantial interest (in this context, has the rights to 40% or more of the income or property of the trust).

Refer to section 3 of the G+T FIRB Brochure for a detailed summary of all "foreign persons".

(b) In the case of moneylending transactions, it is expected that the relevant person (in respect of whom the "foreign person" definition will need to be applied) will be the legal holder of the security interest, which for the purposes of a syndicated loan transaction, or any other secured financing transaction including a security trust structure, means the security trustee, rather than the individual lender beneficiaries of the security trust.

(c) Notably, for lenders and security trustees, this would mean that:

(i) local branches of banks that would otherwise meet the "foreign person" test will still be considered "foreign persons";

(ii) Australian institutions and banks listed on the Australian Stock Exchange could be considered "foreign persons" for the purposes of the FIRB Legislation if an offshore person holding a "substantial interest" appears on its share register. Listed lenders and institutions will need to be alive to this issue over time as the make-up of its ownership may change; and

(iii) an Australian security trustee may be deemed to be a "foreign person" if "foreign persons" have rights to sufficient distributions from a security trust (ie, beneficiaries under the security trust).

(d) When seeking FIRB approval in connection with a secured moneylending transaction, a security trustee will have to disclose all the beneficiaries under the security trust with secured moneys exceeding 5% of the aggregate secured moneys secured under the security trust. Each lender or beneficiary to the security trust does not need to seek approval, unless the security trust is a unit trust where different rules apply (however this would be unusual in Australian finance documents and we would suggest this is unlikely to be relevant).

9 KEY QUESTIONS FOR LENDERS AND SECURITY TRUSTEES (CONT)

What are National Security Assets?

The key terminology in the Tranche 2 Amendments is "national security land" and "national security business" (which are referred to as National Security Assets for the purposes of this update only):

(a) What is "national security land"?

National security land is expected to include:

+ land that is defence premises (within the meaning of section 71A of the *Defence Act 1903* (Cth), subject to certain exclusions;
+ land in which an Australian national intelligence agency has or will have an interest if at the time of the acquisition, the "foreign person" could reasonably be expected to be aware of the agency's interest or prospective interest; and
+ land declared by the Treasurer, by legislative instrument, to be national security land.

(b) What is a "national security business"?

The definition of "national security business" is still under consideration by Treasury and remains to be confirmed, however it is expect to include:

+ a business covered by the *Security of Critical Infrastructure Act 2018* (Cth) (**SOCI Act**) (ie, it is a responsible entity for an asset or a direct interest holder in relation to a critical infrastructure asset, including, without limitation, electricity assets, port assets, water assets and gas assets) – note the SOCI Act itself is undergoing consultation, which may impact the coverage of this limb of the definition of national security business;
+ the business is a carrier or carriage service provider to which the *Telecommunication Act 1997* (Cth) applies;
+ the business develops, manufactures or supplies critical goods or technology that is intended for military use by defence and intelligence personnel in activities relating to Australia's national security or the defence force of another country in activities that may affect Australia's national security;
+ the business stores or has access to information that has a security classification; and
+ the business stores or maintains personal information of defence and intelligence personnel that is collected by the Australian Defence Force, the Defence Department or an agency in the national intelligence community (**Security Agencies**), or collects it as part of an arrangement with the Security Agencies, or stores, maintains or has access to information collected as part of such an arrangement with the Security Agencies, which if accessed or disclosed could compromise Australia's national security.

If my moneylending transaction is not exempt under the moneylending exemption, what does that mean in terms of needing FIRB approval?

(a) Where a moneylending transaction that is not exempt under the moneylending exemption involves:

+ the grant of a security interest to a "foreign person" over an interest of 10% or more, and in some cases less than 10%, in a 'national security business' (as discussed above); or
+ the grant of a security interest to a "foreign person" over "national security land" (as discussed above),

this will be a 'notifiable national security action' for which the "foreign person" must seek FIRB approval regardless of the value of the security interest or the secured asset.

(b) When notified to FIRB (and when they don't also constitute "significant actions" / "notifiable actions", see below), these "notifiable national security actions" will be assessed in terms of whether they would be contrary to Australian national security.

(c) Note that the grant of security may also constitute a "significant action" or "notifiable action" if it meets the requirements to do so under the FIRB Legislation, including percentage interest, monetary thresholds and other requirements (see detailed summary of application of FIRB Legislation in section 4.1 of the G+T FIRB Brochure and applicable monetary thresholds in section 5 of the

G+T FIRB Brochure). Where this is the case, the moneylending transaction will be subject to the general regime, which means they will be assessed against the broader national interest test (which includes national security, as well as any other factors the Treasurer considers appropriate, such as competition, impact on the community and economy, impact on other government policies like tax and character of the investor).

What is the process for obtaining approval if the FIRB Legislation applies to my moneylending transaction, and what are the possible outcomes?

(a) Please see the summary of the approval process set out in section 8 of the G+T FIRB Brochure. We would hope that approval applications submitted in connection with moneylending transactions will be obtained more quickly and easily (relative to applications by "foreign persons" for other interests – eg, equity interests), however we cannot confirm with certainty at this stage whether that will be the case.

(b) If a "significant action" (including a "significant action" that is a "notifiable action") or a "notifiable national security action" is proposed to be taken, the Treasurer has the power to prohibit the action if she or he considers it to be contrary to the national interest (or national security in the case of a "notifiable national security action"). The Treasurer may also determine that she or he has no objection to an action, or no objection subject to certain conditions. If an action has been taken with no FIRB approval having been obtained, the Treasurer will have the power to make divestment orders in relation to the business or asset acquired (which may include requiring the moneylender to sell its loan and transfer its security interest, or unwind the moneylending transaction), if she or he considers that the action was contrary to the national interest (or national security in the case of "notifiable national security actions").

(c) For completeness, we note it is currently proposed that (i) any investment not otherwise subject to the existing national interest or the new national security notification process will be able to be called in before, during or after the investment if the Treasurer considers that the investment raises national security concerns (**Call-in Power**) and (2) the Treasurer will be granted a "national security last resort review power" to reassess approved foreign investments that were previously reviewed (including under the Call-in Power) but where subsequent national security risks emerge (**Last Resort Review Power**). For additional information on the proposed Call-in Power and the Last Resort Review Power, refer to our updates from June '[New changes to Australia's foreign investment framework]' and August '[Exposure draft legislation for changes to Australia's foreign investment framework released]'.

If I'm a secured moneylender (or a security trustee) which is a "foreign person" under the FIRB Legislation, will I need to notify FIRB each time I take security over a National Security Asset?

(a) As noted above, it is necessary that a transaction meet the parameters for a "significant action", "notifiable action" or "notifiable national security action" before any FIRB approval would be required.

(b) In addition, moneylenders (and security trustees) which regularly take security interests over National Security Assets will have the ability to apply for a new exemption certificate which, if obtained, would mean that a new FIRB notification would not need to be made each time that moneylender or security trustee was granted a security interest over a National Security Asset. However, we note there is still uncertainty over the availability, conditions and parameters of these exemption certificates.

What fees will I have to pay in connection with my application to FIRB?

(a) Fees are payable in connection with each FIRB application. For business transactions, fees will be charged on a sliding scale based on consideration paid in the transaction and will range from approximately A$2,100 to A$500,000.

9 KEY QUESTIONS FOR LENDERS AND SECURITY TRUSTEES (CONT)

(b) In a moneylending context, it remains unclear whether the fee payable in connection with the notification of a moneylender's interest will be calculated based on the value of the asset, the value of that moneylender's debt secured against the asset, or some other measure, however we expect this to be clarified before the commencement of the legislation.

(c) Lenders, security trustees and borrowers should consider the appropriate allocation of these fees where a FIRB notification is required in respect of a moneylending transaction. Depending on their construction, Australian finance documents may require a borrower to reimburse a finance party for any such fees (and potentially a lender to indemnify a security trustee for such fees – subject to a back to back indemnity from the borrower). These fee allocations may not be commercially appropriate in all circumstances.

What are the penalties if I fail to comply with the FIRB Legislation?

(a) For completeness, we note the current penalties for individuals, corporations and officers of corporations who fail to comply with the FIRB Legislation are significant (and are summarised in section 9 of the G+T FIRB Brochure) and will increase substantially from their current levels on 1 January 2021. Third parties who knowingly assist a breach may also be subject to civil and/or criminal penalties.

(b) Under the amended FIRB Legislation, the maximum criminal penalties could be up to 10 years imprisonment or 15,000 penalty units for an individual (currently $3.3 million) / 150,000 penalty units (currently $33 million) for a corporation; and the maximum civil penalties would go up to the greater of 5000 penalty units for an individual (currently $1.1 million) / 50,000 (currently $11 million) for a corporation; or 75% of the value of the consideration or the market value of the interest or benefit obtained capped at 2.5 million penalty units (currently $550 million).

What about moneylending transactions I have already entered into – will the changes apply retrospectively?

The changes to the FIRB Legislation contemplated by the Tranche 2 Amendments are not expected to affect security interests which have already been granted prior to the commencement date of such changes, however any new security interest granted in favour of a "foreign person" which attaches to a National Security Asset after such commencement date (including in connection with a moneylending transaction entered into prior to the commencement date) would need to be assessed according to the new regime.

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