AUSTRALIAN INVESTMENT COUNCIL

31 August 2020

Manager
Policy Framework Unit
Treasury
Langton Cres
Parkes ACT 2600

By email: FIRBStakeholders@treasury.gov.au

Dear Sir/Madam,

Major reforms to the Foreign Investment Review Framework

The Australian Investment Council welcomes the opportunity to contribute to Treasury's consultation process on the exposure draft of the *Foreign Investment Reform (Protecting Australia's National Security) Bill 2020*.

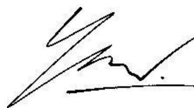
As a net importer of capital, Australia's economy relies on a dependable and steady flow of foreign capital to drive economic growth and job creation. At this critical juncture in our national response to the COVID-19 pandemic, it is vitally important for our economic recovery, and Australian jobs, that businesses are able to quickly and efficiently access capital from domestic as well as offshore investors. Any changes to Australia's foreign investment review regime must be made with the current state and future economic needs of our economy as a central guiding principle.

A strong and robust foreign investment review regime aligns with this policy lens and is important for maintaining the confidence of the Australian public and to protect our national interests. The Australian Investment Council remains supportive of a comprehensive clear and predictable framework and is broadly supportive of the recent proposals. However, in our view some aspects of the current proposals remain unclear, while others introduce new uncertainties. These uncertainties have the potential to dampen foreign investment into Australian businesses and increase funding costs, at a time when investment capital is of critical importance to the nation's economy. The potential impact of these reforms should not be underestimated – early evidence exists of delays in the flow of investment capital and increased concern amongst investors in relation to perceptions of increased sovereign risk in dealings with Australia.

The private capital industry's key recommendations in respect of the exposure draft legislation are set out below. The Council encourages Treasury, and the Government, to carefully consider all elements of the feedback at both a high level and a more granular transactional level. It is vitally important that policy changes in this area are calibrated to deliver the right long-term outcomes for the nation.

We look forward to participating in future discussions about the proposed reforms to Australia's foreign investment policy framework. If you have any questions about the recommendations or any specific points outlined in this submission, please do not hesitate to contact me or Brendon Harper, the Australian Investment Council's Head of Policy and Research, on 02 8243 7000.

Yours sincerely



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Overview

The Australian Investment Council is the voice of private capital in Australia. Private capital investment has played a central role in the growth and expansion of thousands of businesses and represents a multi-billion-dollar contribution to the Australian economy. Our members are the standard-bearers of professional investment and include: private equity (PE), venture capital (VC) and private credit (PC) funds, alongside institutional investors such as superannuation and sovereign wealth funds, as well as leading financial, legal and operational advisers.

Private capital fund managers invest billions of dollars into Australian companies every year. Funds under management of Australian-based private capital funds topped $33 billion in 2019, testament to the growth in available capital to support investment into businesses across every industry sector of the economy. Private capital investment offers smart, patient capital to privately backed companies along with expert guidance and strategic support.

More and more businesses are choosing to raise capital from private investors, rather than through public markets, because of the benefits of partnering with venture, private equity and private credit firms. Private capital investors can help unlock the growth and expansion opportunities of businesses through active asset management in a way that public markets simply cannot. This is evidenced by the fact that private capital-backed Australian businesses generate 1 in 9 new Australian jobs and contribute 2.6 per cent of Australia's GDP.[1]

Efficient access to foreign capital is a vitally important ingredient in enabling billions of dollars of investment capital to flow into Australian businesses. The industry's ongoing capacity to continue to invest greater amounts of capital into Australian businesses, leading to the creation of new high-value Australian jobs, cannot be assumed – policy must support must enable and encourage capital investment into the domestic market. While the private capital industry currently has more than $13 billion in available capital to support current portfolio companies, the sector's ability to fund new investments, now and over the coming years, will be increasingly dependent on inbound capital from offshore investors. There are four main drivers underpinning the flow of private capital investment into the medium-term:

1) History shows investment into innovation and research falls after a crisis, despite being a key economic driver;
2) Early evidence of 'capital rationing' and some risk aversion materialising;
3) Constraints on access to institutional investment from superannuation funds due to a heightened focus on maintaining liquid positions and uncertainty in relation to future valuations; and
4) COVID-19 restrictions hampering the ability of fund managers to connect with (potential) investee businesses and institutional investors. This is particularly acute for new funds that do not have established relationships.

Uncertainty regarding Australia's foreign investment review regime has added additional pressure in the already challenging current environment. The potential impact of this drag on investment and growth should not be downplayed. Nor should the impact on dampening collaboration and cross-pollination within Australia's economy. The Council is aware of a number of investments that have been delayed and an increase in offshore (and domestic) investor perceptions of sovereign risk in Australia as a result of the changes and ongoing uncertainty surrounding Australia's foreign investment review framework. In considering Australia's future foreign investment review framework, it is imperative that Treasury carefully balance the current and future needs of Australia businesses against need to maintain public confidence in the system and to safeguard the nation's collective interests.

The uncertainties generated by the recent changes and current proposed changes are amplified by the Department of Home Affairs' consultation on Protecting Critical Infrastructure and Systems of National Significance which includes changes to the *Security of Critical Infrastructure Act 2018* (SOCI Act). How Treasury (or the Department of

[1] Deloitte Access Economics (2018) *Private Equity: Growth and innovation*, April

Home Affairs) envisage the dual changes interacting is still unclear in our view. Details set out in the Department of Home Affairs' consultation document, including increased scope and a broader definition, suggests the changes to the SOCI Act could materially increase the reach and impact of the proposed foreign investment review framework.

A number of recommendations relating to specific aspects of the consultation are included in the submission below. These recommendations are largely aimed at reducing uncertainties and drafting concerns. In addition to these specific recommendations, the Council urges Treasury to consider the four options below to reduce the impact of the proposed changes on early-stage Australian innovation businesses.

1) **Exemption for early-stage businesses from the definition of "national security businesses"**: Early-stage businesses are often resource poor so are disproportionately impacted by increases in regulatory burden and delays in funding. Additionally, these organisations are the least likely to be of national security relevance. The burden on early-stage businesses could be reduced by providing an exemption from the definition of "national security businesses", such as by utilising the metric contained in the Income Tax Assessment Act definition of "eligible venture capital investments", or alternatively measured based on years of operation. As currently drafted, changes proposed in this area could have a material impact on Australia's fast growth early-stage innovation ecosystem, hampering their capacity to create thousands of high-value new jobs in the years to come. Typically, businesses impacted in this way could elect to relocate their operations to other jurisdictions.
2) **Exemption for certain sectors for investors from trusted jurisdictions** (for example, the Five Eyes nations): In certain sectors such as defence, rigorous analysis has been conducted by specialist Government departments to determine the bona fides of certain 'trusted' jurisdictions. This analysis can be leveraged in relevant sectors to reduce the impact of the proposed changes. Considering defence exports as an example, certain nations are generally granted special permissions for Australian exports. Foreign investment review for national security businesses should align with defence export processes and grant automatic exemption from review.
3) **Proportionate materiality threshold**: A business with an immaterial exposure or holding of another business interest considered to be a national security business would be captured by the proposed legislation as currently drafted. This creates a disproportionate burden and may inhibit investment and collaboration. Concessions should be granted where a minor part of a company's business is deemed to be a national security business by virtue of the new regime.
4) **Prioritisation of applications from early-stage businesses**: Due to the disproportionate impact of delays and limited resources, applications from early-stage businesses should be prioritised within the FIRB review process, and a dedicated team established within the FIRB secretariat to enable applications for review to be fast-tracked to the greatest extent possible.

1. Security of Critical Infrastructure Act

The uncertainties created by the recent changes and current proposed changes to the foreign investment review framework are amplified by the Department of Home Affairs' consultation on Protecting Critical Infrastructure and Systems of National Significance, which includes changes to the SOCI Act.

The Council understands that sector specific design and guidance is not due to be complete until into 2021. The Department of Home Affairs' consultation paper suggests there will be consideration of a material broadening of the industries subject to the SOCI Act and includes broad definitions which will likely lead to a wide range of businesses being captured within the regime. Currently, only electricity, gas, water and maritime ports (and other declared assets) are captured as 'critical infrastructure'. The expanded coverage may include: banking and finance; communications; data and the cloud; defence industry; education, research and innovation; energy; food and grocery; health; space; transport; and water. This type of change is material, and therefore there is a significant

interconnectivity between the proposed changes to the SOCI Act, and the proposed foreign investment policy reforms.

The definition of "national security business" (discussed in detail below) includes:

"(a) a responsible entity (within the meaning of the Security of Critical Infrastructure Act 2018) for an asset; or

(b) an entity that is a direct interest holder in relation to a critical infrastructure asset (within the meaning of those terms in the Security of Critical Infrastructure Act 2018);"

The practical implication of the proposed changes to the SOCI Act would be to capture a wider range of transactions that will require FIRB approval, over and above the requirements to comply under the SOCI Act. This would at least partially nullify the benefits of removing the $0 threshold limit currently in place, maintaining significantly high regulatory burdens, and transaction uncertainty for domestic and offshore investors.

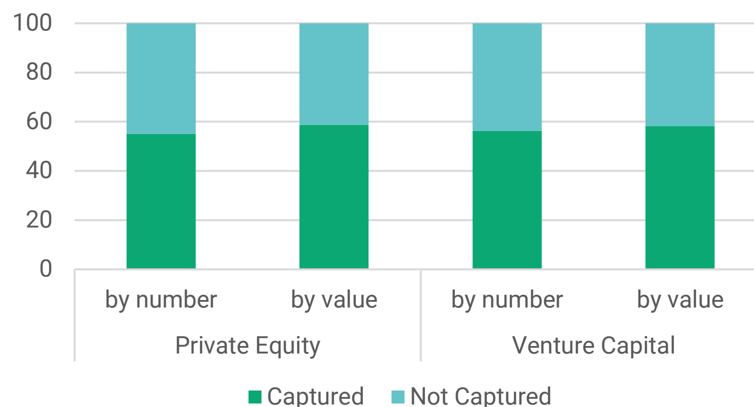
An analysis of Australian private equity and venture capital deals between 2010 and August 2020 shows that, conservatively:

- 55% and 59% of private equity deals, by number and value respectively; and
- 56% and 58% of venture capital deals, by number and value respectively,

would potentially be brought within scope of an expanded SOCI Act (Figure 1). This supports our view that there will likely be a material increase in private capital investment deals requiring FIRB approval in the future, based on current design features of the proposed changes.

Figure 1: Private Equity and Venture Capital deals captured by expanded SOCI Act

percent; deals from 2010 to August 2020



Source: Preqin and Australian Investment Council, 2020

Given the uncertainty regarding the potential changes to the SOCI Act and the interconnections with this current consultation process on the exposure draft legislation in respect of the definition of a 'national security businesses', it is not possible for the Council to offer an unqualified opinion on the potential impact of the Government's proposed changes.

Similarly, it is not possible for investors to make a confident appraisal of the regulatory and legal risks associated with potential investments in this context. Until these uncertainties are resolved, which appears unlikely until well into 2021, there will be a constraint on new investment and increased funding costs for Australian businesses.

The Council urges Treasury to work closely with the Department of Home Affairs to ensure there are no unintended consequences arising from the concurrent consultations and the interconnection between key principles under each regime. Potentially, the most efficient manner to remove this uncertainty is to decouple the Foreign Acquisition and Takeovers Act (FATA) from the SOCI Act by incorporating the appropriate definitions

directly in FATA itself (rather than by reference to the SOCI Act). At a later point in time, amendments to FATA could be brought forward to cross-reference definitions once the final make-up of the SOCI Act is known.

If decoupling in this way cannot be pursued, the Council recommends that the Government pause the proposed changes to the foreign investment review framework until completion of reforms to the SOCI Act, and relevant sector specific guidance is established.

2. Definition of a National Security Business

Beyond the issues highlighted above, the term "national security business" is broadly defined, which will make compliance difficult, costly and time consuming. A broad definition will also increase the (perceived) risk of certain investments, disincentivising investment and likely leading to increases in funding costs – detail on the flow through to increased funding costs is included below.

The definition includes several areas of ambiguity, including:

- the terms "critical goods", "critical technology" and "critical services" are not defined;
- the distinction between "for a military end use" (which applies to critical goods) and "for a military use" (which applies to critical technology) is unclear;
- the distinction between things that "is / are intended" (applies to development and manufacture of critical goods and critical technology) versus "is / are, or is / are intended for" (applies to supply of critical goods and critical technology) is unclear.

In addition, the definition requires a business partner and/or investor to make a determination as to whether something is, or is not, a national security business in circumstances where they may not have access to the relevant information. It is unclear how a potential business partner or investor could reasonably determine if a (target) business is a 'national security business' in a given situation. For example, where an investor proposes to acquire shares in a company without the benefit of a full and open due diligence process (which may often be the case in the acquisition of a minority interests or hostile takeover bid scenarios). Relevant information may be limited, for instance, in relation to:

- critical infrastructure – the Register of Critical Infrastructure assets is not public;
- telecommunications – carriage service providers do not require an operating licence so it is not possible to ascertain from public searches whether a person is a 'carriage service provider';
- data and personal information – it is unlikely to be public knowledge that a business has access to information with a security classification. Additionally, it seems unlikely that a target would be able to disclose this in due diligence.

The definition also requires potential acquirers to make determinations that will not always be reasonable to expect a business person to make, in that they must determine whether activities are "relating to Australia's national security" or "may affect Australia's national security" – while in some cases this will be obvious, there are a number of ways that Australian national security can be implicated which will not be obvious to a person without a security clearance who does not deal with questions of Australian national security on a day-to-day basis. Foreign investors almost certainly will not generally be qualified in this area.

Another concern is that under s10A(2)(b) of proposed changes to FATA the business of the holding (and buying and selling) by a bank or other financier of debt secured over critical infrastructure will itself be a 'national security business'. This is the unintended consequence of a defect in the drafting of the 'money lenders exception' in the SOCI Act, which is explained in Attachment A. The legislative drafting should be revised to better align with the intent articulated in the Explanatory Memorandum on this matter.

These information deficiencies are further exacerbated by the fact that the definition does not include any proportionality – a business will be a national security business even if less than one-tenth of one percent of its

business can be said to involve any elements in the definition (in contrast to, say, the definition of agribusiness or the definition of Australian land entity, which both have threshold tests that must be met before the business would be considered to be caught by either of those definitions). This issue could be resolved by including materiality thresholds into the legislation and reflecting this in the Explanatory Memorandum.

Furthermore, in relation to the definition of "notifiable national security action", the companies into which funds invest are often dynamic and growing. As such, the issue of when a (portfolio) company starts conducting a national security business (which is notifiable to FIRB) is highly relevant. Unlike the position in the current FATA with respect to foreign Government investors starting an Australian business, there is no carve-out for undertaking an activity that is incidental to an existing business and is within the same division under the ANZSIC code. Separately, it is not clear whether a company is taken to start a national security business merely because it submits (or proposes to submit) a bid to acquire a direct interest in such a business.

If this issue is not addressed, an approach of "if in doubt, lodge" is likely to emerge from a market perspective. Such an approach would likely increase the costs and timing of doing deals for, at times, very marginal benefits to Australia's national security. In our view, there are certain measures which could be put in place to alleviate these concerns without compromising the protection that the changes are designed to achieve:

- Flexibility is important to enable the Government to be nimble in the face of changing threats. As a result, it may not be possible to specifically define "critical goods", "critical technology" and "critical services" in the legislation. However, a Guidance Note which provides examples of what would be included (or perhaps more relevantly, what would not be included) would be highly beneficial. The Guidance Note could also address some of the other definitional issues highlighted above.
- Introduce proportionality into the definition of national security business, as noted above (particularly in relation to paragraphs (d), (e), (f), (g) and (h)), so that some meaningful proportion of a company's business must consist of the elements set out in those paragraphs in order for the business to be considered a national security business. This would reduce the need for foreign investors to search into very specific areas of detail in order to determine whether the target business is a national security business. It would also assist companies to establish whether they have started a national security business (for purposes of the definition of notifiable national security action).
- The concept of starting a national security business should include the kinds of carve-outs that apply to foreign Government investors starting a new business, in addition to the carve-outs currently contained in proposed new section 8A.
- Under proposed section 98A of the FATA, a person is liable for a civil penalty or an infringement notice if a person makes a false or misleading statement or omitted an important piece of information in a FIRB application. There is no reasonable inquiries concept or intention to mislead, it is a strict liability approach. The result is a requirement to submit more FIRB applications, with potentially limited access to information, but applicants are strictly liable if there are any omissions. The drafting should be amended such that an applicant is not subject to penalties if they have made reasonable enquiries as to whether a busines is a national security business.

3. Call-in and last resort powers

The private capital industry has concerns about the material risks that would be imposed by the call-in and last resort powers, and the potential impact of these largely risks on investment flows and the cost of capital.

Additionally, the imposed risks will likely lead to investors erring on the side of caution and therefore submitting applications to FIRB as a precaution, which will likely lead to significant review volumes and delays to the investment approval processes.

Call in powers

The Council understands that the call-in powers will permit the review of transactions that are not otherwise caught by FATA (reviewable national security actions) or that are significant (but not notifiable) actions which were not notified, where the Treasurer considers that these actions may pose a national security concern.

Given the information asymmetry between potential acquirers and the Government, it will be difficult for foreign investors to predict where an action "may pose a national security concern", leaving foreign investors with little choice other than to lodge an increasing number of applications in order to achieve transaction certainty. The Council suggests that:

- A Guidance Note be introduced which provides examples of the sorts of transactions that may pose a national security concern; and
- That the proposed time limit for exercising the call-in powers after the relevant action has been taken be no more than three months, so that foreign investors can achieve certainty (subject to the last resort powers) as to their investments.

Last resort review powers

In relation to the last resort review power, the industry is particularly concerned about section 73A(1)(b)(iii), which provides that the Treasurer may review a previously approved (or deemed approved) action if the circumstances or market in which the action was taken have 'materially changed' since the time of the approval or deemed approval.

Further, the time until which an investment could become a national security business is unclear – potentially indefinitely. While this is a risk that investors would be willing to take where the circumstances that trigger review are in their control (for example, by ensuring information provided is accurate), the inability to achieve investment certainty as a result of unforeseen potential future changes in the market could be a major challenge in practice. Further clarification is required regarding the potential application of the last resort review power in this context. For example, what are the parameters for 'market changes' that would trigger the Treasurer's call-in powers?

Additionally, the ability to seek AAT review is restricted to reviewing the Treasurer's decision on whether a national security risk exists rather than on the appropriateness of the Treasurer's decision. The Council believes the appropriateness of the Treasurer's decision should also be subject to AAT review, given that the ramifications for investors of such decisions can be highly significant from a reputational perspective and financially material from a commercial perspective.

4. Banking and finance implications

The risks and uncertainty described above will have material impacts on both investment flows and, the costs and conditions around investments. Feedback from a range of market participants indicates that the proposed changes will significantly increase the perceived 'FIRB risk' or 'sovereign risk' for a range of investments. The risk allocation and assessment of the various participants – vendors, bidders and financiers – will be critical in determining the impact on funding flows and costs for Australian businesses if the proposed changes remain ambiguous.

As an example, lenders are unlikely to accept 'call-in power risk' on a transaction and are likely to require that bidders 'cleanse' this risk by voluntary reporting. Transaction costs will therefore increase, and transaction timelines will be extended, in order to incorporate FIRB review and assessment processes into account. The cost of capital from lenders is also likely to increase as lenders will have to carry contingent capital for a longer period.

Additionally, lenders are likely to introduce additional conditionality in financing commitments. This will impact fund certainty, which is a key sell side focus point for private capital bidders.

Lending appetite for 'at risk' transactions may also fall – preferred equity/debt funding mix for private capital bidders may become unattractive for some bidders to pursue such transactions. This would reduce the flow of funds into Australian businesses and potentially impact asset valuations (due to decreased competition).

Additionally, it is unclear if any safe harbours for the call-in or last resort powers will be afforded if a (foreign) lender exercises default or enforcement rights in respect of a loan for a transaction otherwise cleared. This matter should be considered further in connection with the proposed changes to the moneylending exception.

There are, as yet, no guidelines on what an asset disposal order would require in terms of process and timing. For example, as risk of divestiture post-closing will be very complicated, lenders will seek debt reduction from any proceeds. It is unclear if lenders will be committed to continue to fund the target post-divestiture or seek to exit entirely due to, for example, reputational risks or because the business case that they funded against can no longer be realised. It is also possible that minimum hurdles will be imposed by lenders as to price and timing of divestiture.

5. Changes in shareholdings

There are significant concerns with the proposed new share buy-back provisions, which mean that an investor could be deemed to have undertaken a significant action or notifiable action simply for having taken no action at all.

While it is reasonable to assume that a foreign person will seek advice as to their obligations under a variety of Australian laws, including FATA, when they take steps to acquire interests in an Australian company (or an offshore company that has an Australian subsidiary), it is not reasonable to expect a person to seek the same advice when no action is taken.

Further, certain buybacks do not require shareholder approval. As such, this may not be within the control of, or even with notice to, shareholders. From a timing perspective, it is not practical, and in many cases not possible, for an investor to stop a company from undertaking a share buyback until the investor has obtained FIRB approval to (effectively) *decline* to participate in the buyback. Additionally, the investor would have to wait until all offers of the buyback had been accepted or rejected before it could apply for approval, as it would not know what percentage interest it would ultimately hold until this process was completed, which would significantly increase the length of time necessary for undertaking the buyback. While the Government has a legitimate interest in ensuring that the provisions of FATA are not circumvented by implementing a selective buyback or capital reduction, the anti-avoidance provisions of FATA would already cover this kind of behaviour.

Further, industry understands that the current application of the law is that share buybacks may be caught as significant actions, if 1) the company bought back securities, 2) the company was above the relevant monetary thresholds, and 3) there was a change of control as a result. Putting the burden on the company to make the application is a fairer way to regulate these transactions given the company is in possession of the relevant information as to the potential outcomes of the buyback and could apply before the buyback process is started. The legislation could be drafted to include capital reductions in this same process.

If share buybacks and capital reductions are to be regulated in the way proposed in the draft legislation, then it would be appropriate for the Government to treat these kinds of passive increases differently to an active increase – for example, by only requiring notice if the person's shareholding were to increase by more than a certain *de minimis* amount. The exemption in the Corporations Act (item 19 of section 611) to the 20% takeover prohibition for share buybacks may be worth considering in this context.

6. Streamline reporting

It is commonplace for private capital investments to be subject to standard tax conditions being imposed, which means they may be subject to reporting obligations in relation to a number of different portfolio companies. The proposed new sections 98D and 98P impose further reporting obligations, as does the new register of foreign

ownership. The Council considers that all reporting obligations should be streamlined, so that foreign investors can combine all of their reporting into a single report lodged at a single time within, for example, 90 days after the end of a financial year.

Furthermore, reporting 30 days after completion of a transaction is a narrow window for compliance, particularly on global transactions, where there may be a number of post-completion matters that may take months to complete. The Council recommends that a period of 90 days would be more appropriate from a practical markets perspective.

7. Communication on legal obligations

Given the extent of changes to enforcement and the consequences of non-compliance contained in this first tranche of the reforms, there is a need to communicate to the various stakeholders within the private capital investment ecosystem on what measures need to be taken to comply with Australia's new foreign investment policy framework. The Australian Investment Council will continue to engage with Treasury on actions and initiatives that will assist in providing clear and consistent communication across our industry in order to socialise the design changes and implications of reforms to the framework.

Attachment A

Entities subject to registration and reporting obligations under the SOCI Act are defined as reporting entities and they include, relevantly, direct interest holders. An Interest is defined in the SOCI Act as a legal or equitable interest, and direct interest holder is defined in s8(1) of the SOCI Act 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 be 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 the SOCI Act, 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*
> *(i)i 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 the SOCI Act 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 satisfy the requirements for s8(2)(a), paragraphs (b) and (c) are problematic. It is very hard to see how a secured financier or security trustee would realistically satisfy paragraph (b) or (c), as 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 (paragraph 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 granting 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 *[i.e. 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 does not appear to be fully reflected in the legislative drafting.