Australian Banking Association

28 February 2023 Joint Parliamentary Committee
Answers to Questions on Notice. Australian Banking Association (ABA)

1. **Question from Senator O'Neill: 'Can the ABA provide the number of firms appointed as Investigative Accountants (IA) who are then subsequently appointed as a receiver by banks'?**

   Answer: For the twelve (12) months to February 2023, where data is available and as far as we are aware, no ABA member bank subsequently appointed any receiver that had been previously appointed as an Investigative Accountant (IA).

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2. **Question from Senator O'Neill: 'Can the ABA provide evidence of costs to engage insolvency practitioners in accessing the Small Business Restructuring Reforms and, what the ABA view is on what these costs should be'?**

   Answer: The ABA notes that its member banks are unlikely to be party to Small Business Restructuring arrangements and are therefore not qualified to appropriately estimate these costs and consequently, what an appropriate level may be. The ABA instead would defer to the testimony given by the Law Council on 14 December 2022 to this Committee, in which an assessment on insolvency practitioner costs was provided by them.

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3. **Question from Mr Hawke: 'Can the ABA provide specific examples of ASIC s533 reports that do not "add value" but are still required to be lodged'?**

   Answer: The ABA's member banks note that s533 reports require a significant level of detail in relation to criminal or civil breaches of the Corporations Act, including the insolvency nature, its timing, and details of debts incurred after the date of insolvency.

   The ABA considers that s533 requirements could be simplified to provide a view on whether there are existing books and records covering the details requested and, whether there are any other potential actionable breaches and the indicative prospects for progressing these.

   Further, the ABA considers it premature to request the level of detail currently sought in the s533 reports. Such details should only be investigated and provided at a later date if ASIC indicates it has appetite to consider an action. While there may be a minimal level of information that ASIC will require to determine whether to bring any action, this initial view could be obtained with reference to the quantum of the shortfall to creditors in addition to the indicative view from the liquidator. If ASIC was then interested in pursuing a case the liquidator could provide supplementary information on request.

   Finally, the ABA also refers the Committee to Australian Restructuring Insolvency and Turnaround Association (ARITA) for their views on this issue, as its members have significant practical experience in this area.

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4. **Question from Senator O'Neill: 'Can the ABA provide data on the "intersection" between related Corporate / Personal insolvencies based on members lived experience'?**

   Answer: While aggregate data is not readily available within the ABA or from its member banks, some banks have anecdotally observed a minimal level of personal insolvencies connected with corporate insolvencies. One reason for this is that directors generally only retain low residual assets following a corporate insolvency. Consequently, it is generally rare for banks to place director guarantors into personal insolvency given they normally have minimal to no assets remaining.

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5. **Question from Senator Scarr: 'Can the ABA provide an industry view on how many schemes of arrangement are prevented at the current voting threshold of 75% and, its recommendation on what the threshold should be revised to'?**

   Answer: The ABA does not have access to this data and cannot provide an industry view on this question at the current time. Consistent with our submission and testimony, the ABA encourages the Committee to examine overseas jurisdictions such as Singapore and the United Kingdom in considering alternative voting thresholds.

   Further, the ABA also refers the Committee to previous submissions by the Turnaround Management Association of Australia (TMA), including its 17 September 2021 submission "Helping Companies Restructure by Improving Schemes of Arrangement" to Treasury for more detailed analysis in this area.

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6. **Question from Senator Scarr: 'Can the ABA provide a (de-identified) example of the competing rights to set-off when entitlements under the FEG are claimed'?**

   Answer: When a company goes into external administration and there are funds in the company's bank account, a bank will generally have a right of set-off to apply those funds in reduction of the debt owed by the company. The source of this right can be under contractual arrangements with the customer, under section 553C of the Corporations Act (if the company is in liquidation) or under general law.

   Section 561 of the Corporations Act provides priority for certain employee liabilities over circulating security interests. Where the property of the company available for payment of creditors other than secured creditors is insufficient to meet these employee liabilities, external administrators have challenged the right of set-off in different contexts, and threatened action or required greater justification for a bank applying those funds in set-off. In some of these cases, employee liabilities were advanced under the Fair Entitlements Guarantee (FEG), and FEG is subrogated into the position of those employees.

   The ability to exercise a right of set-off is an important assumption for credit decisions by banks and greater clarity (without disturbing this right) would minimise the need for court applications and legal advice. While there have been a number of cases dealing with section 556 and 561 of the Corporations Act, the position is relatively unresolved.

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7. **Question from Senator Scarr: 'What recommendations in the 2015 Whittaker Review regarding PPSA / PPSR does the ABA believe should be implemented'?**

   Answer: The ABA believes that recommendation 85 of the 2015 Whittaker Review be implemented. This recommendation states that the layout of the Register "be as simple and easy as possible to use, particularly from the perspective of an unsophisticated user". Additional feedback with respect to defective or ineffective registrations was provided in the ABA's first and second round submissions to the review (in June 2014 and July 2014 respectively) and, to the Attorney- General's Department in November 2016. These are provided at Appendix 1.

   We reiterate our concern that creditors' interests are often impacted by minor registration errors which require court action to rectify.

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8. **Question from Senator O'Neill: 'How do banks respond Small Businesses affected by natural disasters and, how many move to insolvency as a result of natural disasters'?**

Answer: The ABA's member banks play an active role in constructively responding to natural disasters to ensure a consistent, supportive, and timely response by the banking sector. Banks always encourage small business, and all, customers affected by natural disaster to contact their bank as soon as possible for assistance. Banks implement several steps to ensure those affected are supported in times of natural disaster.

This support is delivered in part through the ABA's Natural Disaster Response Protocol, which sets out how the ABA and member banks work together following a natural disaster event to support on-the-ground efforts. This collaboration between the ABA and banks ensures the ongoing provision of banking services to affected communities, early identification of any gaps in relief and communication and coordination between government, peak bodies and community groups who may be affected, as needed, to proactively address issues.

The ABA also publishes communications materials via online platforms and local news outlets to notify small business customers of support options available from banks which include:

- Deferral of scheduled loan repayments, on home, personal and some business loans;
- Waiving of fees and charges, including for early access to term deposits;
- Debt consolidation to help make repayments more manageable;
- Restructuring existing loans free of the usual establishment fees;
- Offering additional finance to help cover cash flow shortages;
- Deferring upcoming credit card payments; and
- Emergency credit limit increases.

Finally, ABA member banks may also consider moratoriums on commencing insolvency actions / enforcements in affected areas.

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9. **Question from Senator O'Neill: 'Which insolvency practitioners are on Bank panels'?**

   Answer: Insolvency practitioners / firms used by the ABA's member banks include Ernst & Young, Deloitte, FTI Consulting, Grant Thornton, BDO Australia, Korda Mentha, McGrath Nicol, KPMG, Heard Philips Lieberenz, Price Waterhouse Coopers, Cor Cordis, PKF International Limited, RSM Australia, HLB Mann Judd, Sellers Muldoon Benton and Rodgers Reidy.

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10. **Question from Senator O'Neill: 'What are bank staffing ratios in the current environment to support customers'?**

    Answer: The ABA's member banks have experienced and dedicated teams that support their customers who are experiencing difficulties and insolvency. Established processes and systems support these teams and customers. Banks continue to monitor and maintain appropriate staffing levels in order to support customers affected by insolvency, and in particular through the provision of support options for small business customers as detailed in Question 8. Staffing levels vary between banks and the ABA does not have individual bank staffing data relating to this question available.

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Appendix 1

A. June 2014

AUSTRALIAN BANKERS' ASSOCIATION INC.

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6 June 2014

Mr Bruce Whittaker
Reviewer
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PPSA Review Secretariat
Commercial and Administrative Law Branch
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3-5 National Circuit
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By email to: ppsareview@ag.gov.au

Dear Mr Whittaker,

Review of the Personal Property Securities Act 2009

The Australian Bankers' Association (ABA) congratulates you on your appointment as reviewer for this statutory review of the Act and is pleased to have the opportunity to respond to the first round invitation for submissions in this Review concerning the effect of the Act on small business. In particular, there is the question whether the Act has achieved clear and appropriate outcomes for small businesses.

As banks are key financiers to small businesses, this submission includes matters which bear on the impact of the Act for a bank in managing the relationship with certain small business customers.

It is noted that members of project teams within banks, including members of some invaluable special interest groups convened by the Attorney General's Department, to assist in the consultation process on the policy settings of the Act prior to its enactment have been dissolved, in the main, once the Act came into effect. Business units within banks have a sound working knowledge of the Act but possibly not all have the historical background to the policy development of the Act.

1. Small business awareness of the Act's effects

General feedback from member banks some of which might be considered to be anecdotal strongly suggests overall that small businesses have an insufficient understanding of the Act and its provisions.

This is despite efforts by the Government and by financiers themselves to try to inform the small business community about the Act and its possible implications for them.

One factor that seems to be prevalent is small businesses not coming to grips with the notion that title to personal property has become subordinated to the notion of a security interest. This has led to a consequential lack of knowledge by a business on how the Act is able to protect the business' interests where personal property moves beyond the control of the business. By comparison, REVS was well understood by businesses but this appears not to have happened with the Act.

This is further evident in situations where a business may have to understand the significance of the categories of personal property and the applicable rules applicable to each of those categories.

A case in point is the recent example of the need for an amendment to the application of the Act's PPS

lease provisions tor equipment hirers and their tendency not to be concerned with the registration of downstream sub-hiring transactions which consequentially creates risks for their head financiers.

For the Act to work as it is intended to work, these information and comprehension asymmetries should be addressed.

There are several options for dealing with this aspect including a targeted business information campaign by the Government and simplification of the Act to make it readily comprehensible to small businesses. Areas where this might be achieved include reducing the categories of goods and the rules relating to those categories and removing the possibly confusing variety of registration timeframes for security interests.

A targeted business information campaign, including coverage of the PPS Register website, should emphasise the impact of failing to register correctly, and provide more guidance about how to search, register and interpret search results. A concern is that small business awareness may increase only after they experience losses due to a failure to register properly.

Lack of small business awareness of the Act has been demonstrated by failure to register security interests correctly, or at all, and queries about search results and whether registrations are necessary.

Terminology used by the Act could be clearer and more intuitive (for example, 'secured party' and 'grantor' can be confused with each other).

There has been mention that the deeming of certain interests as security interests where they may not qualify under the primary concept of a security interest could be considered as one area for simplification.

Further, except for the experts, navigating the Act (and as a result, the PPS Register) is a challenge. A more logical sequencing of the Act's provisions with possibly a greater use of cross references to related provisions in the Act could be helpful.

2. Sub-hiring/leasing

Asset financier experience appears to exemplify the issue of the small business lack of awareness of the effects of the Act.

The ABA believes that this due largely to a lack of understanding of the full implications of the Act on the previously well understood concept that ownership of personal property is the determining factor and that now the Act has displaced this concept.

Despite the ease with which a small business could register a security interest on the PPS Register in cases where the business has created downstream leases of its own leased personal property, this seems to be the exception and not the rule. This then allows receivers or other administrators of a distressed business to take possession of goods that may have been leased to the distressed business, by a small business.

As a result, a bank that has financially accommodated the small business may need to take additional steps to protect its own interests. An example is that some banks have been engaging contractor consultants to monitor small business customers' registration activities.

This has militated against a key policy objective of the Act to reduce the cost of financing to small business.

A partial solution to this issue could be to abolish reliance on the vesting rules if any PPS registration (at the time of insolvency) is in place on serial numbered goods. This would directly help small businesses that had not made their own registrations while benefiting from the initial financier's registration.

These implications also can arise in intra-group leasing arrangements between entities within a corporate group where the group's leasing company leases goods in the ordinary course of its business to its related company in the group and fails to register its security interest.

Intra group leasing arrangements are common where small businesses have an asset holding entity and trading entity or service trust structure for asset protection purposes. That is, the asset holding entity/ service trust will borrow to acquire goods and grant a security interest in them to a secured party, and then on-lease those goods to a trading entity for use in the business. Under current PPS rules, that structure may not protect the assets of the asset holding entity if it fails to have a written agreement with the trading entity and register a security interest on PPS Register. Financiers may also require the asset holding entity to put a written agreement in place and register, adding cost and inconvenience to a small business.

These issues can be exacerbated where the financier is introduced by a broker because the secured party is less likely to have general security over the asset holding and trading entities. This may limit finance opportunities for small business by making it more difficult for financiers to accept applications introduced by brokers.

A further suggestion is to allow security interests to trace through on hires to on-hirees. This could be achieved by changes to the extinguishment/take free rules to preserve a financier's interest in goods that are on-hired (the preferred approach to simplify the Act) or allowing the financier to register directly against the on hiree.

From a policy perspective, it is unclear why a lease or bailment by a grantor should extinguish a secured party's security interest.

3. Purchase money security interests (PMSIs)

There is a concern with the uncertainty in determining the delivery date of equipment (i.e. not 'inventory') which also creates uncertainty for a small business.

Under the Act, a PMSI for a non-stock item must be registered within 15 business days of the grantor taking possession of goods. However, there is a question of when does the grantor take possession of the item? In some cases, a grantor may receive the goods before it has purchased them (e.g. on a demonstration or approval basis). Grantors may have the equipment readied for use (e.g. re-painted, or after-market enhancements added). Invoicing alone may not provide a sufficiently clear point at which possession is taken by the grantor.

The ABA recommends that this Review should seek to provide greater certainty for parties on this point.

Further, there is an opportunity to simplify registration timeframes by removing the two PMSI timeframes or aligning them with the registration timeframe for companies under the Corporations Act.

Some financiers with master agreements for asset finance now require master PMSI registrations to help them claim PMSIs in goods funded under subsequent contracts, adding cost to small business.

4. Simplifying the Act and the Register

Understanding the number of different collateral types and the investigation required to ascertain whether or not a piece of equipment is encumbered (or to take a security interest) is a complicated exercise for small business.

Because these searches can be extremely time consuming (some examples include where hundreds of existing migrated security interests may have had to be investigated), this can extend the time it takes a financier to provide funds to small businesses (and increase the cost of the transaction to the small business).

A question to consider is how many small businesses would be aware of what security interests are registered against them, and whether they are current? For example, the search options are quite specific. A policy decision for the Act was made with effect that a search by name of a grantor should only result in disclosing a PPS registration in that exact name, with no leeway for mistaken spelling or additional (or missing) words such as "(Aus)" for "(Australia)" or vice versa. The search will not extend to and include all registrations under the ACN or ABN of that named grantor. Similarly, a search by ACN will not give results of anything registered by name or by ABN. This makes it especially difficult for a small business to check what has been registered against it and for secured parties to have confidence that all prior registrations have been disclosed.

As a result of this, it has been said that some financiers may be less favourably disposed to provide buy backs and private sales transaction, being the transaction types most impacted by existing security interests. This has the potential to limit small businesses to dealing with suppliers of a financier's choice to guard the financier against undisclosed security interests.

There could be value in expressly excluding arrangements which may be considered 'in substance' security interests although that may have not been intended to be covered by the Act. For example, step in rights under construction contracts, powers of attorney which include a right to deal with the donor's property, or turnover trusts. Step in rights under construction contracts may be particularly relevant to small developers as we understand that most Australian Standards construction contracts include step in rights that may be considered a security interest.

Priority and take free/extinguishment rules should be simplified, and areas of uncertainty clarified. For example, areas such as priority between transitional security interests and non-transitional PMSIs, and agricultural enabler priorities should be considered. Complex priority and extinguishment rules contribute to a higher volume of priority and release documents between secured parties attempting to achieve a more certain security position. This adds cost and may delay finance for small business.

There are some other simplification opportunities in searching and registration. For example, including discharged registrations on a PPS Register search would make it easier to determine the registration time for registrations that have been renewed before they expired.

It is observed that the PPS Register itself is very hard to navigate (as opposed to the New Zealand and Canadian versions on which the legislation was modelled).

Finally, the ABA looks forward to the next stage of the review process with the prospect that you may find it valuable for a number of working groups to be established comprising interested parties to assist in resolving some of the more complex issues raised in submissions.

Yours sincerely,

Ian Gilbert

Australian Banking Association

B. July 2014

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25 July 2014

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Dear Mr Whittaker,

Review of the Personal Property Securities Act 2009

The Australian Bankers' Association (ABA) is pleased to have the opportunity to respond to the second round invitation for general submissions to your Review of the operation of the Act in accordance with the Terms of Reference for the Review.

Some of the matters raised in this submission are of general application and are also relevant in the small business context.

1. The concept of "apparent ownership"

A question has been raised whether the concept of "apparent ownership" which forms the basis for the registration of a security interest under the Act to protect third parties from assuming that the fact of possession is ownership, should be abandoned. The concept has relevance in asset financing situations where possession may move from the grantor to a third party.

On balance, the ABA believes that rather than entirely abandoning the concept (which goes to the heart of the "in substance" approach to securities underpinning the Act), the sections potentially relevant to a change in possession of assets, for example, sections 19(2)(a), 32, 34, 46 and 267, could be re-drafted so that the effect of a change of possession of asset on all interested parties (possessor, owner/lessor/licensor and its financier) is much clearer and the outcomes are fairer to the owner/lessor/licensor and its financier. This is especially the case for security interests perfected by a serial-numbered registration, where the potential existence of the financier's and the owner/lessor/licensor's security interests can be discovered, for example by an external insolvency administrator or potential purchaser without needing to know the identity of the financier or the owner/lessor/licensor.

As a principle, the vesting rule should not apply in a case of insolvency where there is a correct registration in place prior to the insolvency, even in cases of sub-hiring.

This would involve allowing security interests to be traced through on-hirers to on-hirees. This could be achieved by changes to the extinguishment or take free rules to preserve a financier's interest in goods that are on-hired (a preferred approach to simplify the Act) or allowing the financier to register directly against the on-hiree.

The impact of all the take free and extinguishment rules is not clear. If a secured party's interest is extinguished during the term of a lease or bailment by the grantor to a third party, it should be clear that, provided the secured party has registered effectively (and by serial number for serial numbered goods), the secured party remains entitled to proceeds and that the secured party's interest in the goods revives at the end of the lease or bailment.

On a related point, in paragraph 8 below it is suggested that a separate registration covering proceeds should not be necessary.

This discussion raises a policy question, why a lease or bailment by a grantor (as opposed to a disposition by sale) should extinguish a secured party's interest.

2. Categories of serial numbered goods

If it is seen there is a need to simplify the category of "serial numbered goods" by broadening it to goods that are able to be identified in other ways, ABA considers that some formality in the way an identifier is assigned to goods would be necessary. It would be uncommercial (with a flow-on additional cost for small business) for volume-financed low value goods bearing a manufacturer's serial number to be susceptible to "take free by serial number" risk unless the goods are registered by serial number.

There is some support for another category to be established for "serial numbered other goods" so that they are afforded the same protections as the current serial numbered goods. This would include high value goods such as printing presses and medical diagnostic equipment. This would be on the proviso that there are appropriate transitional provisions.

Some investigation would be necessary to see whether there are any categories of high value goods (other than motor vehicles, aircraft or watercraft) in addition to those mentioned above that are frequently financed and, if so, if it would be helpful for these goods to be introduced into the serial number regime.

On the other hand, a general broadening of goods that may be registered by serial number would add complication as it would add to search and registration costs and there may be duplication of certain "serial numbers" for example, if there is no clear single unique identifier like a VIN or HIN or registration number for each asset. The identifier would need to be a legitimate identifier such as a manufacturer's serial number as opposed to a serial number created by an organisation as a means of identifying its own property.

However, there may be specific additional categories that are appropriate and consistent with existing categories of serial numbered registrations – for example, it would be beneficial if vessel hulls could clearly be registered by their International Maritime Organisation (IMO) numbers.

A key issue if further categories are to be contemplated is to avoid a further layer of complexity (red tape) where possibly one general category could suffice.

If the Review intends to examine these options a further consultation step should be undertaken.

3. Are deemed security interests an avoidable complication?

Some argue that the Act should be amended to remove "deemed" security interests and rely on the general definition of a security interest in section 12 of the Act.

An argument against removing "deemed" security interests is there is a value to asset financiers and their hire company customers (including small businesses) in being able to register their respective interests under operating leases on a par with registering their interests in finance leases, on the public record?

However, there would have to be more clarity around what is and is not a security interest to remove some current uncertainties in the Act.

As stated above, as a matter of principle, the ABA contends that the vesting rule should not apply in an insolvency where a correct registration existed prior to the insolvency, even in cases of sub-hiring.

Ideally, security interests that are currently subject to debate as to whether they are security interests either should be expressly excluded from the Act or deemed (or declared) to be security interests.

For example, currently, in many cases, even if a particular lease is likely to be characterised as an operating lease, the practice can be for the financier to still register (and require its hire company customers to register) as a matter of caution, due to the risk that an external insolvency administrator of the hire company customer, or of an end user of the goods, may later challenge the arrangement as being an unregistered finance lease.

Further, it may be beneficial to expressly exclude arrangements which may be considered "in substance" to be security interests although these may have not been intended by the Act to be security interests, for example, step-in rights under certain contracts, including construction contracts where, for example, a developer's land may need to be cleared of a third party's equipment, powers of attorney which include a right to deal with the donor's property and turnover trusts. Finally, it is submitted that bailment should not be a "deemed" security interest unless it is in substance a "lease" (that is, an arrangement where the bailee has a right to use the bailed goods and pays the bailor for that right. This would exclude storage and agistment arrangements that currently may be considered a security interest.

4. Security interests in personal property not covered by the Act

There is a wide range of personal property interests that have been left out of the Act such as water entitlements and some States licences such as for taxis and fisheries.

In principle the Act should be, to a realistic extent, the sole source of protection for all personal property security interests.

It is recognised that in achieving a more comprehensive coverage of personal property securities under the Act, there is the difficulty to be overcome where statutory rights granted under Commonwealth, State of Territory laws can be declared by those jurisdictions not to be personal property for the purposes of the Act.

However and in particular, the Act should be expanded to cover water rights and security over those rights and entitlements. This has recently received attention by the Government's expert panel reviewing the Commonwealth Water Act.

This would help to overcome issues with taking security over water entitlements held through private irrigation companies (such as Murrumbidgee Irrigation), where no register is presently available and replace inconsistent State based registers for water access licences with one nationally consistent register.

A further reason to bring water entitlements under the Act is for increased legal certainty. There are views that despite the intention of section 8 of the Act to carve water entitlements out of the Act, there are other sections such as sections 138A and 138B that deal with "water sources", which suggest that "water sources" includes all "water rights" that may not have been excluded.

A suggestion has also been made that section 117(1) be amended to include " *(iii) an interest in water title however described,* with a consequential addition to Note 3 to the section presently reading - *The interest in land might be an interest to which this Act would otherwise not apply (see subsection 8(2)).*"

It is noted that the exclusion of some statutory licences (including water entitlements) from the Act was discussed a number of years ago. The States and Territories apparently had concerns with the possible wider impact of the Act on their sovereignty as independent states over these interests.

Despite this, there should be an endeavour for the Act to deal with all personal property and related security interests including those that are currently not covered, such as those mentioned above.

5. Fixtures on land

Whether fixtures on land that are financed should be given a priority in favour of the fixtures financier over the rights of an incumbent financier over the land is a question where differences of view will arise between, for example, a bank financing an agricultural or farming business and an asset financier financing the acquisition of plant and equipment for use by that enterprise.

From a commercial perspective alone, this suggestion has merit. However, legislative provisions would be required to protect the land financier such as "make good" clauses if the equipment is repossessed.

One relevant consideration is at what point in time a security interest sought to be claimed by the asset financier arises – either before or after the charge or mortgage in favour of the bank over the land (and fixtures) arises.

As the cooperation of the States and Territories will be required if changes to land titles laws are contemplated, at this stage, the ABA's view is that the current legal position should be maintained with the common law rules about what is a fixture continuing to apply to a fixture within the meaning of the Act.

However, it should be noted that credit providers are able to negotiate and agree on commercial and priority arrangements that facilitate the financing of fixtures on a case by case basis. This should recognise the principle that a secured party may take an effective security interest in fixtures on land that is subject to a mortgage or charge provided that the interests of the incumbent mortgagee or chargee of the land are not detrimentally affected.

6. Agricultural interests

The Act's agricultural provisions include the way in which the value of individual security interests in the whole are calculated, for example in processed or commingled goods (e.g. crops).

The application of the special agricultural priority rules under sections 85 and 86 of the Act is unclear.

This has made agricultural finance more complex and arguably of higher risk.

From a policy perspective, it should be clear that the interest of a party which has enabled development of stock or crops by providing finance should take priority over the interest of a supplier of inputs (e.g. fertiliser or feed) which are used to develop the crop or stock. This could be achieved by removing the special agricultural priorities, or amending them to confirm that a financier of the stock or crop as original collateral has priority over a supplier of inputs.

Anecdotally, it has been noted that a supplier of inputs tends not to take security over the relevant crop or stock to which the inputs are applied.

The commingling provisions in the Act seem tailored to a situation where different assets are mixed together in a manufacturing process rather than where fungible goods (like grain) are mixed (e.g. in a silo under a bulk storage arrangement).

There should be separate provisions for commingling of fungible goods.

The ABA believes that the commingling provisions should allow priority of security interests in fungible goods which are contributed to a bulk (and their proceeds) should be determined by parties which have contributed to the bulk (and its proceeds) effectively to share in that bulk according to the their respective contributions to the mass of that bulk, or otherwise as provided by any arrangement between those parties and the bulk storage operator. Under current PPS rules, parties' security interests in the bulk will be limited to the value of the commodity when it was contributed to the bulk, inconsistent with most bulk storage arrangements.

Further, the commercial view is that arrangements that avoid registration against the storage holder are preferable.

7. Chattel paper

Increasingly, there appears to be the view that this concept should be removed from the Act.

This view is based on that the notion of chattel paper does not have a place in the Australian market and as a result has added unnecessary complexity.

The ABA disagrees that this is the case. Any move to remove the term from Act may undermine a small, boutique but growing market niche and would be inconsistent with one of the objectives of the Act.

As the term "chattel paper" is understood in the Act, it is different to an account receivable with reservation of title clauses. With chattel paper, the rights to income that comprise an account receivable are bundled with a security interest in goods. Leases, hire purchase agreements, and contracts with reservation of title clauses and chattel mortgages of specific goods are all examples of chattel paper. There are business models today whereby originators on-sell portfolios of loans to investors or other wholesale financiers.

These arrangements may see the originator continuing to bill and collect, but pass on the collection proceeds. Neither accounts receivable registrations nor GSA agreements/ ALLPAP's will fully cover the desired security position of the ultimate financier because it will want security in the underlying assets (e.g. motor vehicles) by registering a security interest in chattel paper with the sale of receivables agreement or Principal and Agency Agreement evidencing this.

8. The Register and reducing "red tape"

There are some examples of registration or changes to registrations on the Register that could be categorised as unnecessary "red tape" which could be removed or modified.

The ABA considers that there are some modifications that could be made to simplify the operation of the Register:

- The ability to select "inventory" and "control" does not seem to add great benefit, but instead creates confusion due to the multiple potential meanings of both terms. The fields of "control" and "inventory" could be removed in favour of "control over inventory" and "control over property (other than inventory)".

- The need to claim "proceeds" as a separate step in the registration process should be removed.

- Secured parties should be able to adjust the collateral classes of existing registrations from a wider class to a narrower class without having to "re-register" and "de-register" (e.g. APAP to APAPE).

- Any value in having "subordination" as an optional field is questioned and should be removed. Consideration should be given to the effect that incorrectly claiming a PMSI has on a registration. The view is that this defect should only apply to any PMSI super-priority ranking claimed, not the effectiveness of the complete registration. This would reduce the practice of two registrations being made (one claiming the super priority and one not). However, balanced against this will be the need to measure the potential increased diligence costs and other costs arising from behaviour that this change might possibly drive – i.e., relatively more questionable or contestable PMSI registrations due to the lack of a "penalty" for selecting "PMSI" on every registration made.

- Secured parties will typically register against both trustee and the trust as the security agreement will often capture a trustee in its own capacity and as trustee of any trust. It may not be clear in which capacity the secured property is held. ABA members would consider removing the need to register separately against trusts in addition to trustees. However, this would need to be weighed against the benefits of separate trust registrations for securitisation arrangements.

- The Register currently does not detect (reject) and therefore allows incorrect registrations to be made, for example the name and ABN of a company. The functionality of the Register could be developed and improved to prevent these types of incorrect registrations.

- It is possible for a third party to release any registration on the Register if the third party possess either:
  - The secured party group number and its access code, or
  - The token number of the registration.

  As releases are free of charge, a third party may effect a release without logging on to the Register or identifying itself in any way. There is no audit trail on the Register to show who issued the release.
  While access codes need to be kept secret and changed regularly, there is still a significant risk they could be used to make an unauthorised and anonymous release.
  During the lead up to the PPS project (prior to RCT) a decision was made to move the checkbox for acceptance of Terms and Conditions away from the 'Forgot your Password'. It appears participants are not 'checking' this box and are therefore not 'logging in' to the Register. This heightens the issue of releases being able to be made without an audit trail.

- The requirement to register against companies within 20 business days was carried over from the ASIC registration rules in the Corporations Act, but is now superfluous given the vesting provisions in the Act and therefore should be removed.

- The Regulations should be amended to make it clear that registrations against individual partners of a partnership are not required in order to capture a security interest granted by the partnership (unless the partnership does not have an ABN).

- The Regulations should be amended to make it clear that where a trustee is a body corporate and the trust does not have an ABN, a registration against the corporate trustee (using the appropriate body corporate identifier) is sufficient to capture the trust.

- The Register allows for the linking of registrations but this functionality is not referred to in the Act or Regulations. The legal effect of this functionality is uncertain although it is valuable in allowing a search to disclose that a secured party has maintained continuing perfection relevant to priority type. Providing legal certainty supporting this function would be desirable.

9. Specialised working groups to consider other issues

9.1. Revisit the definitions of commercial and consumer property

There are instances where a business is not required to have an ABN allocated to it. If the business (or trust) does not have an ABN because it is not required to do so, but the grantor is an individual, it is understood that the Register collateral type that would apply in this case is "consumer" property. This appears to mean that provisions specifically referring to "consumer" property should then apply.

However, where there is no specific reference to "commercial" or "consumer" property but only, for example, under section 115 where there is the reference to "collateral not used predominantly for personal, household and domestic purposes" there is some uncertainty. It is unclear whether or not a secured party could treat this group of grantors similarly to those under the "commercial" property type when dealing with these provisions and security interests in collateral that is used predominantly for business purposes.

9.2. PMSIs, sale and lease back transactions and priority

As this is an area which is likely to involve contention, the ABA considers that a focus on improvement where consensus for change and the solutions are broad would be desirable.

For these reasons, the ABA believes that a specialised working group of industry participants could help to resolve some of the potential differences as a basis for possible regulatory change.

Conceptually, there could be a benefit in allowing certain sale and lease back transactions to be created as PMSIs. However, to strike the right balance between this and protections for existing security holders would be difficult and would benefit from a deeper analysis by the proposed working group.

For example, as an interest acquired under a sale and lease back transaction to a seller is excluded from the definition of a PMSI (section 14 (2)), there may be room to treat (deem) some sale and lease backs occurring within a short time of the original purchase by the customer, as PMSIs. This would acknowledge the commercial reality that customers often come to financiers after (technically) having already acquired and purchased the asset.

Possibly, a change to the Act could be made to recognise that a PMSI may be claimed for the full amount advanced by a secured party where the secured party effectively funds the grantor's acquisition by reimbursing the grantor for a deposit the grantor had already paid in addition to paying the balance to the supplier.

However, currently it is not clear whether the reimbursement of the deposit means that an effective PMSI could not be claimed for the deposit portion, so secured parties may require non-PMSI registrations and deeds of priority to ensure they have priority to the full amount funded and so defeating the policy for PMSIs.

9.3. APAP descriptions of collateral

Where there are exceptions to an APAP, there could be benefits if APAP descriptions more accurately reflected the nature of the security interest rather than the use of broad based descriptions that are virtually all encompassing. The latter registrations increase the number of times a financier must make enquiries to clarify the priority position which can be time consuming and adds cost.

One view is that this is more an issue for industry than a legislative issue.

9.4. Receivables finance

Lack of customer/seller awareness of a financier/buyer's need to register and the section 64 process to notify the customer/seller's suppliers with PMSIs can add to cost and delay for this finance option. This arises from the need to disclose by a registration and notice to suppliers disclosing arrangements that often were undisclosed prior to the Act. Overall, this aspect of the Act has made receivables finance a less attractive option for businesses looking to manage their cash flows or balance sheets, particularly where businesses would prefer to keep such arrangements undisclosed.

Further, the ABA's view is that retention of title suppliers with PMSIs should not be able to trace their interest through to receivables acquired by a receivables financier. The need to review supplier PMSIs, determine their relevance and potentially send a section 64 notice to them within 15 business days before registering adds cost and delay while disclosures can create discomfort for the seller.

However, the prospect of removing the rights of, for example, a manufacturer supplying goods (who registers its security interest on the Register) to a wholesaler who, in turn, factors its receivables to a debtor financier on a confidential basis and which, in turn has no obligation (if as suggested by a change in section 64) to give notice to the manufacturer is problematic and may result in an unintended consequence.

Arguably, the wholesaler would be unreasonably advantaged by enjoying the benefit of the confidential factoring arrangement because the manufacturer would be unaware of the factoring facility. Knowledge of its existence may be relevant to the manufacturer's supply decision. Commercially, there is a case that the wholesaler should either permit the debt financier to give notice under section 64 to the manufacturer, or the advance rate for those affected invoices should be reduced to mitigate the subrogation of, or risk to, priority.

There is some uncertainty over the terms and outcomes associated with the operation of section 64 where there are further PMSI registrations during the 15 business day period between issuing the section notices and registering over a company's accounts (i.e. an intangible property – account registration, which, itself cannot be flagged as a PMSI on the Register).

If further PMSI registrations are made during that 15 day period, the financier really needs to issue further section 64 notices and wait another 15 business days before registering over the accounts. This scenario has the potential to continue endlessly preventing the financier's registration over accounts and settlement. An option may be to allow registration over the accounts at the time the initial section 64 notices are issued.

This registration would not come into effect until 15 days had elapsed for any existing PMSIs, but would take immediate priority over any new PMSIs.

Another option may be to register an ALLPAP at the time the initial section 64 notices are issued.

Within the Register, it is possible to register 'Inventory' without being a 'PMSI'.

But it is uncertain where such registrations sit in relation to section 64 and priority. Are they deemed PMSIs and do section 64 notices need to be issued at all?

9.5. Confidentiality

Clarity is required around whether a banker's duty of confidentiality owed to its customer is sufficient to restrict disclosure, or whether some additional express confidentiality obligation is required (e.g. in the security agreement).

If a party is required to provide a copy of a "security agreement" at the request of an interested person, it should be able to redact parts of the agreement to remove any terms which may be confidential or commercially sensitive. This is particularly relevant where security interests are embedded in facility agreements. This concern has led to the removal of references to some security interests and included in separate documents, adding complexity and cost to documentation.

9.6. Syndicated loans

An important issue in the syndicated loan market is the requirement to perfect transfers of receivables to repay all or part of syndicated loans or other syndicated facilities by registration, as they may be considered transfers of accounts or chattel paper. Transfers of receivables to repay all or part of syndicated loans or other syndicated facilities should be expressly excluded as a PPS security interest.

9.7. Non transitional PMSIs and priorities

The Act is not expressly clear on whether a non-transitional interest can be a PMSI, and if so, whether it overrides a transitional registration. Section 322A deals with this issue in relation to "control" but the PMSI position has not been clarified. It would be helpful to include express provisions to clarify how this is intended to work.

9.8. Defective registrations and constructive notice

More clarity would be welcome about when a registration is defective and when a person should be taken to have constructive notice of a security interest. A key question is whether a prudent financier should be taken to have constructive notice of the contents of the Register or put another way, whether a defective registration could constitute constructive notice of a security interest.

This is also relevant as to whether secured parties require searches of certain identifiers because a registration may have been made against them incorrectly (for example, a company name) and deeds of priority where a free text description indicates that there" may be a competing interest despite use of an incorrect collateral class, for example, an "other goods' registration which has a free text field claiming a security interest in motor vehicles.

9.9. The Register

9.9.1 Multiple migrated security interests registrations

The migration from the former registers to the Register has sometimes resulted in multiple registrations for security documents. Unnecessary registrations should be removed to improve the efficiency of the Register.

9.9.2 Managing listing

The process for managing listings on the Register is not particularly efficient. Clients have little incentive, and perhaps an insufficient understanding of the Act to take an active role in managing unnecessary registrations and third parties undertaking searches seem to have no influence. The time and costs involved in investigating these unnecessary registrations is a constant source of frustration.

9.9.3 Recognition of general categories of security interests

It would be beneficial if general categories of financial interests could be recognised on the Register, for example interests arising from leasing, retention of title, general finance charges and so on.

Identifying what security interests are going to be relevant to an intending financier and what are not is a time consuming exercise.

10. A post script on awareness and understanding of the Act

10.1. Lack of awareness among small, non-financial industry law and accounting firms.

Some examples of this lack of awareness include:-

- Small, non-financial industry law firms resisting the use of the ABA/AFC standard release or payout documents preferring their own release wording as being sufficient, which can increase a lender's process timing and delay finance to a business.
- Law and accounting firms recommending business structures which may have PPS implications that they appear not to have considered, for example creating asset holding or service trust and trading entity structures which may create internal on-hire transactions.

These instances leave financiers in a position where they need to explain the implications of the Act and the Register to business customers and their accountants and lawyers, which again delays the provision of finance.

11. Concluding comment

The ABA expects that there will be a range of views provided to you concerning possible changes to the Act that will require some further consultation and decision.

The idea is attractive for a specialist group of financiers and practitioners to be established to work with you through the policy and practical operation of the Act and any modifications to the Act that are considered to be appropriate to simplify and improve the working of the Act.

The ABA looks forward to hearing further from you with respect to the consultative process going forward.

Yours sincerely,

Ian Gilbert