



THE LAW SOCIETY
OF NEW SOUTH WALES

Our ref: BLC: RHLb:1828581

16 October 2020

Personal Property Securities Reform
Attorney-General's Department

By email: PPSAReform@ag.gov.au

Dear Sir/Madam,

Review of the *Personal Property Securities Act 2009 (Cth)* (“PPS Act”)

The Law Society of NSW appreciates the opportunity to provide comments in response to the Attorney-General's Department Discussion Paper: *Industry consultation on financial products and the Personal Property Securities Act 2009 (Cth)*. The Law Society's Business Law Committee contributed to this submission.

Our responses to some of the specific questions in the Discussion Paper are set out below.

- 1. If the PPS Act is amended so that Australian Clearing House Subregister System (CHES) securities are characterised as investment instruments rather than intermediated securities, would it be useful for the definition of intermediary to be amended so that it no longer expressly includes the operator of a CS facility?**

Yes. Although, if limb (b) of s 15(2) is removed, a subsequent amendment to s 15 would likely be required to ensure operators of clearing and settlement (“CS”) facilities are excluded from this definition given the breadth of s 15(2)(a). That is, given CS facilities are also Australian financial services (“AFS”) licensees, there may be a danger that s 15(2)(a) may still apply to these CS operators. Assuming the removal of s 15(2)(b) proceeds, the operation of this definition should be clarified by either providing an explicit carve out specifying that the definition does not apply to CS operators, or through a legislative note.

- 2. Should the licence requirement for an intermediary be removed from the PPS Act? If so, how could the nature of an intermediary for the purposes of these provisions be described (i.e. in order to work out what is or is not an intermediated security under the PPS Act)?**

Yes. The removal of the licence requirement would also simplify the AFS Licence (“AFSL”) framework with the *Corporations Act 2001* (“Corporations Act”) imposing the sole legislative requirement for AFS licensees. We note in addition that s 911A(2) of the Corporations Act provides exemptions from the licence requirements, which are likely to be available to an intermediary, as part of the AFSL framework under that Act. The removal of the licence requirement in the PPS Act would resolve the situation where the intermediary may be eligible for an exemption from having to obtain an

AFSL under Chapter 7 of the Corporations Act but is nevertheless required to obtain an AFSL due to the operation of the PPS Act.

3. **Should the PPS Act be amended to clarify the meaning of the ‘rights’ of a person who holds a securities account with an intermediary? For example, would it be sufficient to refer to the rights of a person who holds a securities account with an intermediary ‘in relation to the financial products’, or ‘in relation to the financial products that are recorded in that securities account’?**

No. There does not seem to be any obvious advantage in relation to defining the ‘rights’ referred to in s 15. It is likely that the rights of a person in relation to an intermediated security may differ and are contractually specified. Leaving the legislative term ‘rights’ unspecified would provide greater flexibility in the application of this section.

4. **Are there other ways in which the concept of an intermediated security could be simplified or clarified to ensure it is easier to apply in practice?**

Not in our view.

5. **Is it appropriate that the PPS Act should continue to define investment instruments by reference to the Corporations Act?**

Yes. In the interests of regulatory alignment and reducing regulatory complexity, it is important that the Corporations Act and the PPS Act definitions align.

6. **If not, should the PPS Act define investment instruments using the general definition of financial product that is in s 763A of the Corporations Act, without the qualifications in Part 7.1, Division 3, Subdivision B of that Act?**

Yes. The PPS Act should define investment instruments using the general definition of financial product that is in s 763A of the Corporations Act. However, we note that there are some elements of the Corporations Act definition of ‘financial product’ that would not be appropriate for inclusion in the context of replacing the existing definition of financial instrument in the PPS Act. Consequently, we suggest that isolating those elements of the definition of ‘financial product’ in the Corporations Act that are appropriate in the PPS Act context would be desirable. This would likely involve including the general definition of financial product from s 763A of the Corporations Act, but not including the inclusions (contained in s 764A) or exclusions (contained in s 765A).

Although the incorporation of a Corporations Act definition would require practitioners to refer to a separate piece of legislation, given many practitioners practising in the securities law space would be familiar with Chapter 7 of the Corporations Act, we don’t consider that this would be likely to create a significant issue.

- (a) **Alternatively, should the PPS Act simply use the text in paragraph (b) of the definition of financial product in the PPS Act for all purposes of the PPS Act, including the definition of investment instrument?**

See our answer to question 6 above.

7. Should all of the paragraphs of the definition be retained? Can the definition be simplified in other ways?

The alignment to the Corporations Act definition of 'financial product' described in the response to question 6 would simplify the definition sufficiently.

8. In practice, is it more appropriate that securities held through CHES are classified as an investment instrument instead of an intermediated security?

Securities held through CHES should be classified as an investment instrument instead of an intermediate security. Reclassifying the security holding arrangement in relation to securities held through CHES as an 'investment instrument' under the PPS Act would accurately reflect the true commercial arrangement of how the CHES register functions. That is, the CHES operator acting as agent for the issuer in noting the allocation of securities in the subregister to the securityholder, rather than holding those securities on behalf of the investor.

9. Would it be useful in practice if the definitions of investment instruments and intermediated securities be amalgamated? If so, the Department welcomes comments as to how this may be achieved to reflect Australian commercial realities.

It is possible that while the two definitions could be amalgamated into a single definition, the concept of 'intermediary' in relation to dealing with securities on behalf of another person would likely need to be incorporated as a separate limb to the existing definition of investment instruments. We query whether this would simplify the operation of the PPS Act considerably.

10. Would it be useful for the term 'negotiable instrument' [to] be aligned with the meaning at general law?

As currently drafted in the PPS Act, while there is considerable overlap between the general law meaning of "negotiable instrument" and the PPS Act meaning of the term, the latter is slightly wider. We would recommend that the PPS Act definition not be aligned with the meaning at general law as alignment with the meaning of general law may, we believe, exclude some instruments that parties would seek to include in securities packages. The alignment of the PPS Act definition with the general law definition would narrow the availability of registrable security interests on the PPS register, which would result in less flexibility from a security perspective.

11. Do you support aligning the mechanisms for perfection by control in ss 26 and 27 so they are as consistent as possible? If so, the Department welcomes comments on how this alignment would be best achieved.

Yes. We support the aligning of the mechanism for perfection by control so that they are consistent. The alignment will be best achieved by capturing both of the aspects for perfection by control in sections 26 and 27. A unified approach to perfection by control would likely quash the possibility that a party may perfect their interest under the incorrect test in the PPS Act.

12. How does perfection by control of intermediated securities and investment instruments operate in practice?

It is our understanding that an agreement under which the secured party is in a position to control (or initiate control) of intermediated securities and investment

instruments by the sending of some or all electronic messages or other electronic communications by which the intermediated security could be transferred or otherwise dealt with, will be sufficient to satisfy the existing statutory test for perfection by control.

17. Is the concept of perfection by control over a letter of credit meaningful and appropriate for the PPS Act, or should ss 21(2)(c)(v) and 28 be deleted?

Yes. These provisions should be retained. They provide additional protection and their removal would create some difficulties in structured finance where, as a component of the financier's security package, a letter of credit is required and perfection of the security is desired by the financier.

18. If your answer to the previous question is that the sections can be deleted, should any of the other references in the PPS Act to letters of credit be retained, or can they all be deleted?

Our preference is for the PPS Act sections relating to letters of credit to be retained as provided in our response to question 17.

19. Should the taking free rules under ss 50-51 be retained in the PPS Act? If so, why?

Yes, these rules should be retained. The provisions are useful to market participants in several situations including in the context of takeovers in relation to the compulsory acquisition of securities.

20. If retained, should these sections operate in favour of another secured party? If so, why?

Yes. They should be made to operate in favour of any other secured party.

21. For the following types of collateral, should a security interest be able to be perfected by control? Please give reasons.

(a) Section 21(2)(c)(i) – ADI accounts

A security interest in an ADI account should be able to be perfected by control. Given that ADI accounts are often incorporated as a component of security packages by financiers, providing financiers super priority in relation to ADI accounts would provide certainty in financing transactions.

(c) Section 21(2)(c)(v) – a right evidenced by a letter of credit that states that the letter of credit must be presented on claiming payment or requiring the performance of an obligation

In the context of a letter of credit, it is appropriate that this form of collateral be perfected by control. The issuance of a letter of credit from a buyer to a seller should be sufficiently perfected by control given that letters of credit are common facilities and methods of guarantees relied upon to facilitate international trade and commerce.

Additionally, if you think a security interest over the collateral type should be able to be perfected by control, should it have a preferred priority position? Please give reasons.

Yes. A security interest should be able to be perfected by control as stated above.

22. Would it be useful for s 109(3) [to] be:

- (i) retained in its current form**
- (ii) amended so that it applies only to investment instruments and intermediated securities that are traded on a prescribed financial market**
- (iii) expanded to cover all collateral that is traded on a prescribed financial market**
- (iv) amended in some other way, or**
- (v) deleted?**

Section 109(3) should be expanded to cover all collateral that is traded on a prescribed financial market. This should include security interests over intermediated securities and investment instruments that are perfected only by registration.

Please contact Liza Booth, Principal Policy Lawyer on 02 9926 0202 or liza.booth@lawsociety.com.au if you would like to discuss this in more detail.

Yours sincerely,



Richard Harvey
President