Queensland Law Society

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Office of the President

23 October 2020

Our ref: [WD-BF]

Attorney-General's Department
Robert Garran Offices
3-5 National Circuit
BARTON ACT 2600

By email [redacted]

Dear Attorney-General

Industry Consultation on Financial Products and the *Personal Properties Securities Act 2009* (Cth) – Public consultation paper, September 2020

Thank you for the opportunity to provide feedback on the *Industry Consultation on Financial Products and the Personal Properties Securities Act 2009 (Cth) - Public consultation paper*.

The Queensland Law Society (**QLS**) appreciates being consulted on this important review.

QLS is the peak professional body for the State's legal practitioners. We represent and promote over 13,000 legal professionals, increase community understanding of the law, help protect the rights of individuals and advise the community about the many benefits solicitors can provide. QLS also assists the public by advising government on improvements to laws affecting Queenslanders and working to improve their access to the law.

This response has been compiled by the QLS Banking and Financial Services Law Committee, whose members have substantial expertise in this area.

Please find **enclosed** our submission on this consultation. We would like to also thank you for the extra time granted to QLS to provide this submission.

If you have any queries regarding the contents of this letter, please do not hesitate to contact our Legal Policy team via policy@qls.com.au or by phone on (07) 3842 5930.

Yours faithfully

[redacted]

Luke Murphy
President

Queensland Law Society

Industry consultation on financial products and the Personal Property Securities Act 2009 (Cth)

	Question	Response
1.	If the PPS Act is amended so that Australian Clearing House Subregister System (CHESS) 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, assuming the definitions of investment instrument and intermediated security are not merged. Refer to our response to question 9 below.
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 (ie - in order to work out what is or is not an intermediated security under the PPS Act)?	Yes, the licence requirement should be removed from s 15(2)(a). The focus of the definition should be on the functions performed by the intermediary not the regulatory regime to which it is subject.
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'?	Yes. We agree that the PPS Act should be amended to clarify the meaning of the 'rights' of a person who holds a securities account with an intermediary.
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?	Refer to our response to question 9. An issue that is relevant is the current inability to effect a registration on the PPSR that applies to more than one collateral class. It should be possible to register a financing statement that covers more than one collateral class; for example, investment instruments, intermediated securities, general intangibles and ADI accounts, enabling all collateral classes related to a particular secured transaction to be covered by one registration (without having to resort to using the 'all present and after acquired property, with exceptions' collateral class).

	Question	Response
5.	Is it appropriate that the PPS Act should continue to define investment instruments by reference to the Corporations Act?	No. We believe that the definition in the PPSA should be self-contained and based on appropriate policy objectives for the PPSA.
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?	No, we do not think that the general definition of 'financial product' in the Corporations Act is appropriate for PPSA purposes.
	(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?	We prefer this alternative approach. However, we note the following: • it should not be necessary to have two definitions (ie. investment instrument and financial product) if they have the exact same meaning; • we expect it will still be necessary to exclude certain things from the definition of investment instrument (refer to paragraphs (k), (l), (m) and (n) of the definition as currently drafted); • if the definitions of investment instrument and intermediated security are merged (refer to our response to question 9 below) this approach may need adjustment; • we support including an express reference to units in unit trusts in the definition of investment instruments as well.
7.	Should all of the paragraphs of the definition be retained? Can the definition be simplified in other ways?	No, the current definition of 'investment instrument' should not be retained. Refer to our responses to questions 5, 6, 6(a) and 9.
8.	In practice, is it more appropriate that securities held through CHESS are classified as an investment instrument instead of an intermediated security?	Yes, assuming the definitions of investment instrument and intermediated security are not merged. Refer to our response to question 9.

	Question	Response
9.	Would it be useful in practice if the definitions of investment instruments and intermediated securities were to be amalgamated? If so, the department welcomes comments as to how this may be achieved to reflect Australian commercial realities.	As a practical matter this may overcome some of the difficulties of characterising certain property within one or the other of these two collateral classes. We think it should be possible to combine the concepts into a single definition if the control perfection requirements are also aligned. An amalgamated definition of 'investment property' is suggested below. *'investment property' means any of the following or an interest in any of the following:* *(a) a share, participation or other interest in an issuer or in property or an enterprise of an issuer;* *(b) an obligation of an issuer (other than an obligation arising from the disposal of property to the issuer or from the granting of a right to, or the provision of services to, the issuer);* *(c) any other financial instrument;* *(d) any other financial asset;* *(e) an account in which the grantor's interest in any of the above assets may be credited or debited,* *that may be transferred or dealt with (whether or not subject to conditions):* *(f) by, in the case of an interest that is evidenced by a certificate, delivery of the certificate with any necessary endorsement, assignment, or registration in the records of the issuer or agent of the issuer, or by compliance with restrictions on transfer or withdrawal; or* *(g) by an entry in the records of a clearing house or securities depository; or* *(h) by an entry in the records maintained for that purpose by or on behalf of the issuer; or*

	Question	Response
		(i) by an entry in the records or account maintained for that purpose by or on behalf of a nominee, intermediary or other person, *but does not include cash, a document of title, a letter of credit or a negotiable instrument.*
10.	Would it be useful for the term 'negotiable instrument' [to] be aligned with the meaning at general law?	Yes. We think the definition should be confined to paragraphs (a), (b), (c) and (d)(ii) of the current definition. The exclusions in paragraphs (f), (g) and (h) of the current definition should not be necessary.
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.	We support aligning the mechanisms for perfection by control in ss 26 and 27. This will be particularly useful if the definitions of investment instrument and intermediated security are merged. The concept of control should, in our view, simply focus on ensuring that the secured party, and no-one else, is able to deal with the relevant collateral. The concept should also seek to ensure that, absent fraud, only one secured party is in a position to control dealings with the relevant collateral. To the extent a secured party must rely on a third party (such as a CHESS participant or intermediary) to ensure no-one other than the secured party can deal with the relevant collateral, any agreement between the secured party and that person should include provisions which, if complied with by that person, would prevent another secured party obtaining control. The grantor should not be able to initiate or give effect to dealings in collateral that is subject to control unless the secured party has consented. The current drafting of ss 26 and 27 contemplates that such dealings may be permitted to occur (for example, s 26(2)(b)(ii) and s 27(6)). If relevant property is uncertificated and recorded on an account maintained by an intermediary or CHESS participant, that party should be required to expressly agree or acknowledge the secured party's rights to control dealings with the collateral. Mere notification should not suffice.

	Question	Response
12.	How does perfection by control of intermediated securities and investment instruments operate in practice?	Secured parties seek to satisfy the requirements of ss 26 and/or 27, as applicable. If the grantor is a company, the secured party usually also seeks to ensure that the company's constitution does not give the directors of that company a right to block the secured party from transferring the investment instrument. A prudent secured party will also take measures to ensure no other person can obtain control of the relevant collateral and the grantor is unable to deal with the collateral without its express consent. That is to say, a secured party will often go beyond the minimum requirements of ss 26 and 27. Secured parties often also register one or more financing statements depending on the nature of the transaction and the collateral involved - refer to our response to question 13 below.
13.	Would it be appropriate in commercial practice for the requirements for perfection by control to be amended to ensure that a secured party will only be perfected by control if it is able to ensure that the intermediated security or investment instrument cannot be dealt with without the secured party's consent, or	Yes. In practice, it is not unusual for a secured party to establish control (as per ss 26 and 27) but also take steps to ensure the relevant collateral cannot be dealt with without its consent. In addition, a secured party will often register one or more financing statements. This is to ensure that the security interest is properly perfected against after acquired property and proceeds in all forms and to ensure that original collateral or proceeds that are not of a collateral class that can be perfected by control are perfected by registration.
	The department welcomes other suggestions as to how the requirements for perfection by control can best achieve a notification objective.	Refer to our responses to questions 11, 12 and 13.
14.	Should the PPS Act be amended to allow perfection by control over cash that is held through an intermediary?	It is unlikely that cash, as such, would be held by an intermediary. Money paid to the intermediary pending investment and the proceeds of investments would normally be held in a 'cash account' but technically this would be an ADI account maintained by the intermediary so the relevant asset is the investor's interest in an ADI account maintained by

	Question	Response
		the intermediary rather than cash. Such amounts should also be held on trust by the intermediary for the benefit of the investor. Another consideration is that perfection in respect of proceeds generally requires a registration (s 33, PPSA) and perfection by control in respect of an ADI account as original collateral can only be achieved when the ADI is the secured party (s 25, PPSA). Departing from this position to enable any person to perfect by control in respect of certain proceeds of original collateral that can be perfected by control will have significant implications for both the drafting of the PPSA and commercially. Proceeds of investment property should not necessarily be treated in the same way as the original collateral. The Public Consultation Paper (at page 25) refers to reforms recommended in Ontario to allow perfection by control over cash collateral accounts. However, it appears that these recommendations were not specifically directed at cash held by an intermediary and the proposal to allow perfection by control over cash collateral accounts in Ontario appears to be directed at a specific scenario, namely, where 'cash collateral' (ie. typically money deposited in a bank account) is held in respect of OTC derivatives. The Ontario proposal seems intended to ensure such security has priority over certain preferred creditors who are entitled to a deemed statutory trust that would otherwise have priority (Ontario Business Law Advisory Council, Report to Minister of Government and Consumer Services, Fall 2016). On balance, we are not in favour of enabling a security interest in cash or ADI accounts to be perfected by control, other than as currently provided for in the PPSA (s.25).
15.	Do uncertificated negotiable instruments (in the technical legal sense) exist in practice?	Not in a technical legal sense.
16.	Should ss 21(2)(c)(iv) and 29 be removed from the PPS Act?	Yes. We agree with the points made by Bruce Whittaker at 5.3.8.1 and 5.3.8.2 of the Review.

	Question	Response
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?	Although rarely seen in practice, we are aware of security being taken and perfected in the manner outlined in these sections. We support the retention of these provisions.
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?	Refer to our response to question 17.
19.*	Should the taking free rules under ss 50-51 be retained in the PPS Act? If so, why?	On balance we are of the view that ss 50 and 51 should be retained if security interests in investment instruments and intermediated securities are to continue to be capable of being perfected by control. It is common practice for a secured party wishing to obtain the best possible protection for security over investment instruments and intermediary securities to perfect by control and ensure that the collateral cannot be dealt with without the secured party's consent. This practice pre-dates the PPSA and the current PPSA position reflects long standing practices. If a secured party does not have effective control (or possession in the case of certificated investment instruments) we think the take free rule benefitting a purchaser is desirable from a policy perspective.
20.†	If retained, should these sections operate in favour of another secured party? If so, why?	No. We believe s 50 is not intended to favour another secured party. Section 50(1) refers to a "purchaser… other than a secured party" but there is some ambiguity caused by s 42(b) and the definition of purchaser in s 50(3). The drafting of both ss 50 and 51 should be amended to make it clear they do not operate in favour of another secured party.

* Incorrectly referred to as [17] on page 32 of public consultation paper
† Incorrectly referred to as [18] on page 32 of public consultation paper

	Question	Response
21.	For the following types of collateral, should a security interest be able to be perfected by control? Please give reasons.	
	• Section 21(2)(c)(i) - ADI accounts	Yes. As noted in the Review, ADIs can rely on set-off and combination of account rights so the ability of an ADI to perfect by control is consistent with these rights. We do not believe the ability to perfect by control in respect of an ADI account should be extended to secured parties other than the ADI itself.
	• Section 21(2)(c)(iv) - a negotiable instrument not evidenced by a certificate	No. As noted above, we support the deletion of s 21(2)(c)(iv).
	• 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	Yes. As noted above, we support the retention of s 21(2)(c)(v).
	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	Security interests that can be perfected by control in respect of particular collateral should have priority over security interests perfected by other means such as registration. Otherwise, there is no real point to enabling perfection by control. The issue as to which types of collateral should be capable of being the subject of a security interest perfected by control is essentially a matter of policy having regard to the commercial consequences. In the case of ADI accounts, enabling an ADI to perfect by control and have priority over an earlier registered interest is commercially practical given that an ADIs set off rights are not governed by the PPSA and they will usually prevail over a registered security interest. ADIs often include both set off rights and security provisions in the terms and conditions applicable to ADI accounts and the other agreements between an ADI and its customers. In our view it would be cumbersome and commercially impractical to require an ADI to have to register and possibly enter into a priority deed with a secured party having an earlier registration in order for the ADI to ensure it has priority over an ADI account with itself in relation to any security interest that supplements its set off rights. Any reference in this paragraph to ADI should (consistent with Bruce Whittaker's recommendation in paragraph

	Question	Response
		5.3.7.1.3 of the Review) be read as a reference to any financial institution (including any foreign banks). We understand the ability to perfect by control in respect of security interests over investment instruments, intermediated securities and letters of credit that must be presented for payment and achieve a super priority outcome reflects stakeholder input during the original consultation process leading up to the introduction of the PPSA. The continuance of these arrangements is an issue of policy rather than legal necessity.
22.	Would it be useful for s 109(3) [to] be:	
	(i) retained in its current form	No.
	(ii) amended so that it applies only to investment instruments and intermediated securities that are traded on a prescribed financial market	Yes, subject to any necessary amendments if these two collateral classes are merged.
	(iii) expanded to cover all collateral that is traded on a prescribed financial market	Yes.
	(iv) amended in some other way, or	No.
	(v) deleted?	No.