Australian Securitisation Forum

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To The Honourable Ben Wyatt,
MLA Treasurer of Western Australia
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Copy Oliver Mailes
Assistant Director Technical Advice and Specialist Services
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Department of Finance
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Dear Sir,

Impact of the *State Revenue Laws Amendment Act 2019* on securitisation of equipment finance receivables

1 Introduction

This submission is divided into the following sections:

(a) section 2 contains an executive summary of the submission;

(b) section 3 provides an introduction to the Australian Securitisation Forum ("**ASF**");

(c) section 4 describes the process of securitisation in relation to equipment finance receivables;

(d) section 5 describes the current transfer duty position in Western Australia as it effects the securitisation of asset finance receivables;

(e) section 6 describes the impact of the *State Revenue Laws Amendment Act 2019* on arrangements which involve the securitisation of equipment receivables; and

(f) section 7 sets out the ASF's recommendations to address the issues raised by the submission.

2 Executive summary

The past decade has seen significant growth in the securitisation of equipment finance receivables. In this market, receivables such as those under operating leases, finance leases, hire purchase agreements and chattel mortgages have been securitised. Queensland and New South Wales have each included asset-backed securitisation

exemptions in their duties legislation, alongside their mortgage backed securitisation exemption. Victoria has a mortgage backed securitisation exemption but given its historically narrower duty base, the *Duties Act 2000* (Vic) has not, until recently, had a significant impact on the securitisation of equipment finance receivables.

The ASF is concerned that Western Australia has recently expanded its transfer duty base in a way which will increase the costs of securitising equipment finance receivables in particular where the equipment is fixed to land. These increased costs erode the benefits of securitisation to small business and consumers, being lower financing costs for equipment financing arrangements.

To prevent the erosion of those benefits for small businesses and consumers, it would be beneficial if the *Duties Act 2008* ("**Duties Act**") were amended to introduce an exemption for the transfer of dutiable property comprising equipment finance receivables in connection with asset backed securitisations.

3 Introduction to the Australian Securitisation Forum

The ASF was established in 1989 and is the peak body representing the securitisation industry in Australia. Its role is to promote the development of securitisation in Australia by facilitating the formation of industry positions on policy and market matters, representing the industry to local and global policymakers and regulators and advancing the professional standards of the industry through education and market outreach opportunities.

The ASF is comprised of a National Committee of 12 members, 10 task specific sub-committees and a national membership of 138 organisations. ASF members include Australia's banks, domestic and foreign investment banks, building societies and credit unions, non-bank mortgage originators, investors and many other participants in the Australian financial system including organisations that provide professional services to the securitisation industry (such as trustee companies, mortgage insurers, ratings agencies and the major legal and accounting firms).

4 Securitisation of equipment finance receivables

Securitisation essentially involves the repackaging of large numbers of illiquid receivables into liquid securities which can be issued to investors. The repackaging is achieved by the sale of a portfolio of receivables into a securitisation special purpose entity, which is typically a unit trust. The trustee is the issuer of the securities to the investors, which may be either debentures units in the unit trust or both. The advantage of securitisation compared to other potential sources of funding which an equipment financing business can choose from is that the cost of the funding is typically lower than other sources of funding. This is because securitisation techniques allow finance to be provided by wholesale debt capital markets.

In the context of this submission, the kinds of receivables which are being securitised are receivables which arise under equipment financing arrangements such as operating leases, finance leases, chattel mortgages and hire purchase agreements. Relevantly to this submission, the most common types of equipment which business and personal

customers finance through these arrangements are vehicles,[1] industrial equipment, medical equipment, dental equipment and general office equipment such as computers and photocopiers, although this is by no means an exhaustive list.

The diagram in Schedule 1 illustrates how the process of securitisation fits into the typical business operating model of an equipment financier.

Typically, an equipment financier has its own customer base or obtains access to customers through a network of brokers who introduce customers to the equipment financier. Initially, the equipment financier may use its own funds to acquire equipment from a supplier and then enter into equipment financing arrangements with customers such as a finance lease, operating lease or a hire purchase agreement for a number of years. In other cases, the customer will purchase the equipment and borrow money from the equipment financier in order to pay the purchase price to the relevant equipment supplier. The customer will grant a security interest over the equipment (also known as a "chattel mortgage") in order to secure the repayment of the loan.

Even though the equipment financier may use its own funds initially, the next step in the process involves the equipment financier transferring to a securitisation special purpose entity the right to payment (or repayment) and related rights for a purchase price. This special purpose entity funds the purchase price by issuing notes (i.e. "asset-backed securities") to a financier (typically a bank) and involve debt funding in the wholesale market starting at levels of around $100 million typically. These types of arrangements are typically referred to in the securitisation industry as "warehouse trusts". This is because the relevant receivables and related rights are "warehoused" in this type of structure until a number of "warehouses" are refinanced into a special purpose entity which issues notes to investors in the wholesale capital markets. The special purpose entity in a "warehouse trust" arrangement will in some cases be in the same corporate group as the equipment financier. This is because the equipment financier will often own most, if not all, of the units in the special purpose trust.

Following an assignment to the special purpose entity under a warehouse trust, the securitisation vehicle will own the right to payment (or repayment) from the customer. One of the related rights which is often assigned to the special purpose entity is the ownership of the relevant equipment. The equipment is assigned so that if a customer defaults in payments under the lease, the equipment can be sold, and the proceeds applied to satisfy the amount owed by the customer to the trustee. In the case of a loan secured by a chattel mortgage, the chattel mortgage is also be assigned to the special purpose entity in addition to the loan for essentially the same reasons (i.e. to provide the ability to sell the equipment in a default scenario).

Securitisation arrangements typically also allow the flexibility to refinance the funding provided by a financier in a "warehouse" structure. Typically, this involves the relevant receivables and related rights being moved into a new special purpose trust.

Once a significant pool of equipment finance receivables has been created and funded through a number of "warehouse trust" arrangements, the receivables and related rights are then moved to the trustee of a further special purpose trust. Since the value of the

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[1] Although vehicle financing arrangements are a significant type of equipment which is financed using securitisation techniques, the issues raised by the recent amendments to the Duties Act have very little impact on the securitisation of vehicle financing arrangements. Vehicle financing arrangements are mentioned for completeness only.

receivables and related rights held by this special purpose entity is significantly higher than in the "warehouse trust", investing in the trust is more suitable for institutional investors in the wholesale debt capital markets. This kind of securitisation is usually referred to as a "term deal".

Over time, the receivables which are beneficially owned by a special purpose entity may reduce as customers make required payments. Once the total value of the receivables drops below a certain level, it is often desirable to unwind the securitisation transaction to save time and money on the ongoing administration of the securitisation transaction. When this happens, the equipment financier will repurchase the receivables and related rights at their then current value so that the "term deal" securitisation structure can be brought to an end.

5 History of securitisation exemptions in Australian duties legislation

The first securitisation stamp duty exemptions in Australia appeared in 1985 (in New South Wales). They were highly detailed and specific. The government's thinking in the context of mortgage-backed securitisations was expressed as follows:

> *"This government is now taking another positive step in the continuing process of financial reform with the abolition of further stamp duties. ... The purpose of these proposals is to promote the development of a fully-fledged secondary mortgage market dealing in mortgage backed securities and to facilitate the expansion and growth of the secondary mortgage market in corporate debt securities. ... I believe it is wrong to inhibit creativity in the market. ... The intent of the amendments is to promote the development of the secondary market and to provide considerable scope for innovation in the market. It is a valuable step forward if Sydney is to be a major financial centre in the South Pacific. ... It is expected that the development of a secondary mortgage market will provide a substantial boost to the supply of housing finance through the attraction of new investors into the housing finance market and by encouraging major financial institutions to be more active in providing funds for such purposes through a developed secondary market."*[2]

New South Wales and Victoria[3] developed securitisation exemptions[4] which focused on the key elements of the mortgage-backed securitisation market. Originally, the key focus of the securitisation industry was housing loans and the early securitisation exemptions were focused exclusively on those types of securitisations. Subsequently, the securitisation of trade receivables and equipment financing receivables securitisations has become quite common as well.

Those changes in the securitisation industry as well as changes to the duties legislation over the past 20 years have been the main drivers for the introduction of further specific securitisation exemptions. For example, just after the *Duties Act 2001* (Qld) was

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[2] New South Wales Legislative Assembly Hansard of 1 November 1984.

[3] Currently, sections 251A and 251B of the Duties Act contain exemption from duty in connection with mortgage-backed securitisations. A corresponding exemption was also found in section [137] *Stamps Act 1958* (Vic) prior to it being replaced by the Duties Act.

[4] The Northern Territory had an exemption for a few years (section 56B(1) of the *Taxation (Administration) Act 1978* (NT) was repealed in 1994).

introduced, the legislation was amended to add mortgage-backed and asset-backed securitisation exemptions (sections 130C to 130I *Duties Act 2001* (Qld)). New South Wales introduced its asset-backed securitisation exemption[5] in 2010 as a result of certain New South Wales mortgage duty amendments. The ASF was closely involved in making submissions on these New South Wales and Queensland changes.

At the same as this submission, a similar submission is being made to the Treasurer of Victoria in relation to some recent amendments to the *Duties Act 2000* (Vic) which also concern equipment which is "fixed to land".

6 Impact of the *State Revenue Laws Amendment Act 2019*

6.1. Transfer duty

The *Revenue Laws Amendment Act 2019* has recently amended the Duties Act to add to the definition of land in section 3A of the Duties Act "anything fixed to land" whether or not the thing is a fixture at law. Such things are now also excluded from the definition of chattel.

If an item of equipment is fixed by a customer to land, the equipment is within the definition of land in section 3A of the Duties Act. A subsequent transfer of that equipment (even without any other dutiable property[6]) is therefore a dutiable transaction.

The terms of the equipment financing arrangement do not seek to prohibit relevant equipment from becoming a fixture or fixed to land in any way. This would usually not be acceptable to a customer because it places a restriction on how the customer can use the financed equipment. Even if such a restriction existed, it would be impractical to monitor whether the customer complies with the restriction on an ongoing basis. This is due to the sheer volume of transactions which equipment financiers enter into. In a warehouse or term securitisation, depending on the value of the underlying equipment, there can be thousands of equipment finance receivables securitised.

Although there are exceptions from treating items which are fixed to land (and which are not fixtures at law) as being outside the definition of land, the exceptions will either not apply or at best would be impractical to rely on.

The exceptions in section 3A(4)(a) to (c) of the Act from "things fixed to land" will not apply in most cases involving the securitisation of equipment finance receivables.

The exception in section 18A of the Act generally requires that the thing be removed from the land within 90 days of the relevant transaction or within such longer period as is allowed by the Commissioner of State Revenue. The leases in question are typically for a period which is longer than 90 days and is usually measured in years rather than days. Due to the large number of leases and items of equipment which are involved it is not practicable to seek an extension of time from the Commissioner in relation to a large number of items of equipment which have become fixed to land.

Although a relevant reconstruction exemption may be available in some circumstances, this still involves forming a view about whether the items in question are fixed to land.

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[5] See *Duties Act 1997* (NSW), section 284.

[6] Since the thing is excluded from the definition of "chattel", section 14 does not apply to things which are fixed to land, but which have not become fixtures at law.

Due to the number of underlying items of equipment involved in a typical securitisation transaction this is not practicable because the customer, rather than the owner, is in possession of the relevant equipment. As noted above, the original transfer to the securitisation vehicle is not the only type of transaction which may occur with respect to the equipment. The equipment may become subject to different special purpose trusts and may also be repurchased by the equipment financier. Even with a relevant reconstruction exemption the costs involved in seeking advice on the availability of the exemption and the costs of preparing applications represent an increased cost which will erode the benefits of securitisation as a source of funding for equipment financiers and their customers.

Even if a relevant reconstruction exemption is granted, the exemption could be automatically revoked if there are changes in the holding of the units in a special purpose trust. This does happen occasionally (e.g. where the equipment financier sells its business).

6.2. Landholder duty

Occasionally, it becomes necessary to transfer the units in the special purpose securitisation entity. For example, this can occur where the seller is selling its wider business and needs to transfer the units to an entity outside of its corporate group. The revised definition of "land" now makes it more likely that landholder duty would be triggered just by virtue of a person having an entitlement to equipment fixed to land in Western Australia which have a value of $2 million or more. This issue should also be addressed in order to provide parity with any transfer duty exemption which may be introduced for equipment lease receivable securitisations.

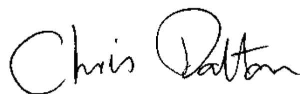
7 Recommendation

The ASF therefore urges Treasury to introduce a Bill into Parliament to amend the Duties Act to include an exemption for the transfer of dutiable property in connection with asset-backed securitisations. A similar request is being made by the ASF of the Victorian Treasurer.

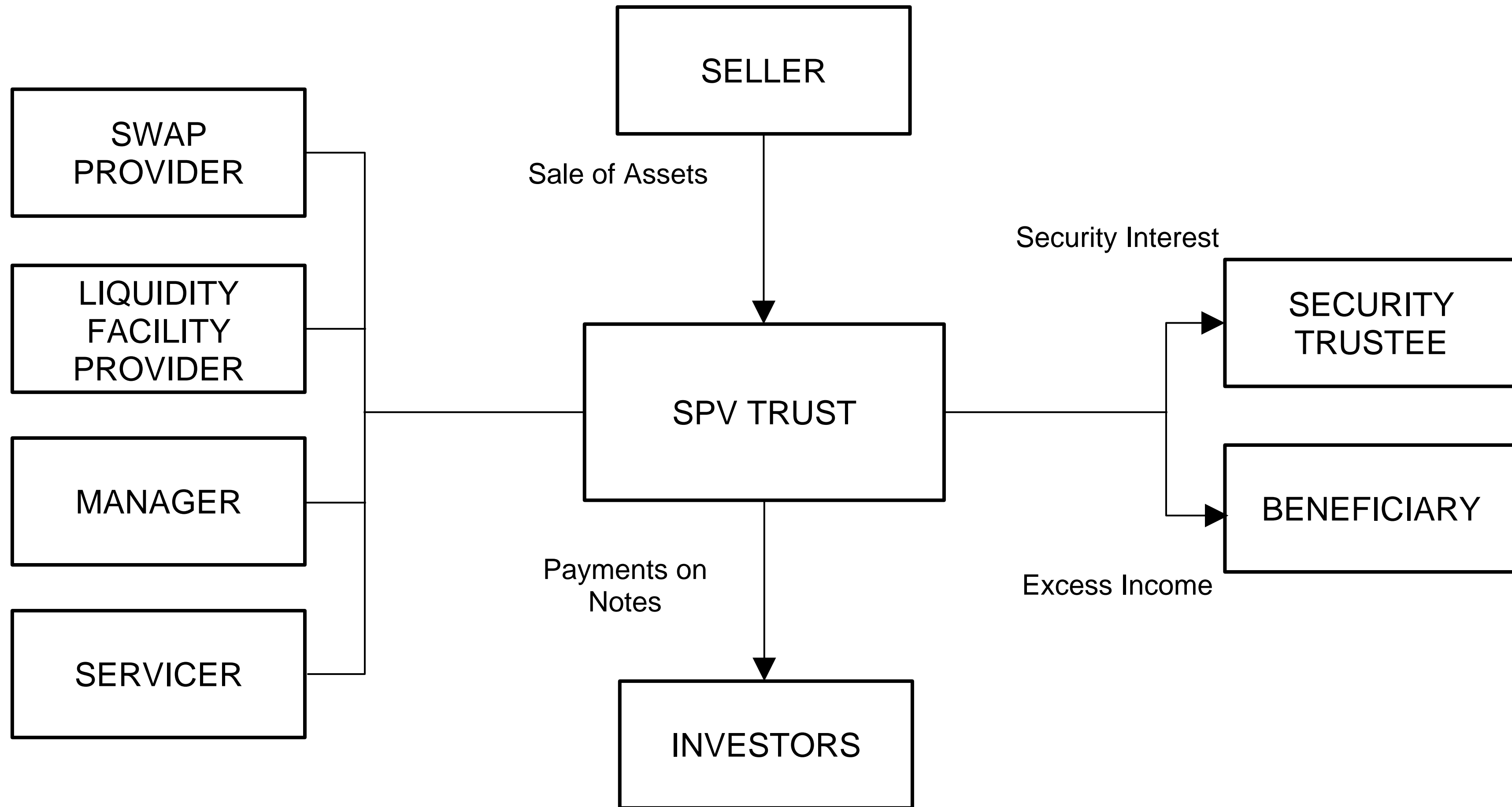
The alternative to a legislative amendment would be the making of a regulation under section 3A(4)(d) of the Act to prescribe a dutiable transaction with respect to fixtures and items fixed to land where the transaction is entered into in connection with the issue, creating or marketing of an "asset backed security". For this purpose, the definition of "asset backed security" from the attached drafting could be adopted.

If you would like to discuss any aspect of the above, please contact Chris Dalton or Robert Gallimore (Policy Executive).

Yours faithfully



Chris Dalton
Chief Executive Officer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