ASA Submission: CAMAC - Aspects of Market Integrity

Date of Submission: 11 March 2009

The ASA

The Australian Shareholders' Association (ASA) is a not-for-profit organisation formed to represent, protect and promote the interests of investors in shares, managed investments, superannuation and other financial investments.

Submission

1. Margin lending to directors

The ASA identified a need to address the issue of the implications of margin lending by directors and executives of listed corporations in early 2008. Several high profile cases involving directors of listed corporations which have subsequently failed bought this issue to the attention of retail shareholders.

In June 2008 the ASA released its policy, *Margins Loans: Directors and Executives* which is appended to this submission (Appendix A). Many of the responses raised in the CAMAC issues paper were considered at the time, including imposing a regulatory requirement for disclosure of margin loans relating to holdings over a specified proportion of the issued capital of the corporation.

Chartered Secretaries Australia suggests a threshold of a 5% holding, at which not only directors but other substantial shareholders would be required to disclose their holdings. The ASA consider such a requirement to be arbitrary and not directly linked to the materiality of the lending.

The ASA policy is best reflected by part 1.7 of the issues paper, with directors to disclose their equity interests including any financing to the company, with the company then responsible for deciding whether those interests and arrangements need to be disclosed to the market. ASA policy extends requirement not only to directors, but also to executives of the corporation.

2. Blackout trading by company directors

Retail shareholders have long been concerned insider trading by directors and executives. In the past the Association's position has bean that the laws prohibiting insider trading should be sufficient regulation of this activity. However research done by governance consultants, Regnan over a number of years, the ASA's own research carried out in the first half of 2008 and the ASX's research in 2008 (quoted in the issues paper) have left the Association increasingly concerned that the current laws do not act as a sufficient deterrent to insider trading.

In the current situation it is within the discretion of each company what, if any, period is a blackout/ trading window, whether there is a process of granting exceptions and the instances when approval will be given by the chair to trade during the black out. The ASA sees a number of problems with the current regime:

- There is uncertainty amongst investors as to what is allowed
- Corporations do not have any duty to explain why trades took place during a black out, so there is a lack of transparency
- Any knowledge by the market of a potential inside trade is retrospective as is any investigation and action which can be taken by the regulator.

The ASA have noted several high profile instances in 2008 where the suspicion that a director has traded on inside information has not been abated by explanations provided by the corporation. Retail shareholders have lost confidence in boards and are frequently looking to the regulators to play a more active role. Given that approximately 46% of Australian adults own shares[1] and successive Governments have encouraged investment by ordinary Australians both directly and indirectly in the capital markets, maintaining the confidence of these investors in the system should be a fundamental consideration of Government and regulators.

The ASA would ideally see trading by directors and executives regulated in a similar manner to that which applies in the UK through the FSA Model Code. This would include a blanket prohibition against trading during prescribed periods and a process of ASIC providing approval of any exceptions, which would be limited to financial hardship. These changes would be additional to the current laws on insider trading.

The ASA accepts that there would be costs involved in this proactive approach both for industry and regulators. However the current procedure of regulators investigating and querying trades also involves considerable resources.

There are benefits not only for investor confidence but also for directors and executives who would be able to point to clearance from the regulator as an answer to accusations of impropriety. The clearance process would provide certainty for corporations in circumstances where there is ambiguity and remove the responsibility for decision making and for potential conflict from chairs and company secretaries.

[1] ASX Australian Share Ownership Study 2006

3. Spreading false or misleading information

The view of the ASA is that the only effective mechanism in preventing the spreading of false and misleading information is in ensuring that there is a significant risk that offenders will be caught and ensuring that the penalties bear a relation to the offence. Guidelines for best practice and other well meaning, but essentially self regulatory measures cannot address a practice, at the heart of which lies an intention to breach the law.

The ASA would support measures which would allow ASIC to successfully pursue a greater number of prosecutions. There is a suggestion that the taping of phone conversations could assist. Obviously the relationship between the costs to industry and regulators and the benefits that could be gained must be considered.

Long-lasting penalties, such as banning brokers, must provide a greater deterrent than fines. Assisting the regulator to make a case by attaching civil penalty provisions to those relevant sections of the Corporations Act 2001, must also act as a greater deterrent.

Ensuring that ASIC is properly resourced to investigate and prosecute is extremely important.

4. Corporate briefings to analysts

The ASA view is that analysts' briefings are sufficiently provided for by 3.1 of the ASX Listing rules and the insider trading provisions of the Corporations Act 2001. Information should not be provided to an analyst that has not been announced to the market as a whole.

Relatively simple and inexpensive technology exists to ensure that briefings can be broadcast live, and even the most technologically constrained listed corporation can ensure that a detailed notice of any information to be given at a briefing is placed in the web prior to the meeting with additional information which may be elicited during the meeting to be published during or immediately after the meeting.

The experience of the ASA is that listed corporations in Australian have generally made reasonable efforts to disseminate information from briefings. The quality of the information varies. Frequently the disclosure is in the form of power point slides or other summary documentation which requires further explanation, which is provided to the briefing but not to the market. There are few listed corporations that could not take the extra step of broadcasting analysts briefings live, and the ASA will be encouraging a situation where this becomes a standard practice.

ASIC have recently begun to attend analyst briefings. Likewise many of the corporations monitored by the ASA invite the ASA representative to attend the briefings.

Whilst there are improvements to be made, the ASA sees this as an area where corporations have been willing to effect change and accordingly neither regulation or further guidance are currently needed.

Appendix A: ASA Policy Statement

Margin Loans: Directors and Executives

Background

Margin lending is a form of gearing whereby the shares purchased with the loan are the subject of a mortgage in favour of the lender. Because shares are more volatile than other property, margin lenders limit the level of gearing to a set percentage (known as the Loan-to-Value Ratio or LVR) of the value of the shares. Commonly, LVRs are set at a maximum of 70%. The difference which is known as the "margin" is made up by the borrower's own collateral.

Company directors and executives are not restricted from entering into margin loans with respect to the stock of that company. However ASX Listing Rule 3.1, requires an entity to disclose information with regard to margin loans that "a reasonable person would expect to have a material effect on the price or value of the entity's securities".

Disclosure of margin loans to directors and executives might cause companies to become prey to opportunistic buying and selling. However failure to disclose could mean that information about specific loans becomes insider information circulating amongst a minority in the market, allowing those insiders to obtain an advantage over other investors.

In the event of a margin call it is likely that some underlying performance issue, real or rumored, has already caused the value of the company to decrease. These losses of value however are given further momentum by the increased supply of shares caused when a director or executives significant share holding is sold to meet a margin call.

There are risks, which are largely outside of the control of the company, inherent in allowing margin borrowing by executives and directors over the company's stock. The benefits which accrue to shareholders from this practice are small. Although there may be virtue in tying directors/ executives financial fortunes to the company in some circumstances, this can and should be achieved without entering into margin loans.

The ASA Position

1. Full details of any margin loans entered into by directors and executives, including triggers for margin calls, should be disclosed to the board. The board must, if circumstances demand, meet its appropriate disclosure obligations in accordance with ASX Listing Rule 3.1.

2. Listed companies should have a policy with regard to directors and executives entering into margin loans. In formulating such a policy the board should consider the risks which may arise as a result of the duty to publicly disclose information about such loans, the short and long term business environments in which the company operates and the size of potential holdings the subject of any loan.

3. Directors and executives need to take into account both the duty to disclose and the potential negative effects which could arise from margin calls being made when deciding whether it is appropriate to enter into a margin loan over company securities.