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9 March 2009

Apply five per cent rule to disclosure of margin loans

Directors holding more than five per cent of their company's issued securities subject to a margin loan should be required to disclose the fact, Chartered Secretaries Australia (CSA) argues in its submission on market integrity to the Corporations and Markets Advisory Committee (CAMAC).

Having long held the view that if a third party owns a director's shares then shareholders need to know about it, CSA strongly recommends that the Corporations Act be clarified to oblige directors to inform the market if any shareholding in excess of five per cent is subject to a third-party interest.

"Shareholders and the market need to know about such arrangements, so they can make their own assessment of whether a third-party right can be triggered from the market moving downwards sharply and quickly," Mr Tim Sheehy says. "Otherwise the market is uninformed or, potentially, misinformed."

It has been said that, following the spate of margin calls on directors in 2008, directors no longer hold margin loans on shares in the companies which they govern. However, data published by the Reserve Bank of Australia (RBA) showed margin calls in the December 2008 quarter soared to a fresh high. The average number of margin calls per day rose to 9.77 per day per 1000 clients in the final quarter, more than doubling from the third quarter and surging 12-fold from the December 2007 quarter. It is unlikely that directors are not included in these statistics.

"Investors should have access to information that a margin loan arrangement may involve directors losing control of their stock. When the market observes a director selling shares, even when it is a forced sale, the market may perceive such a sale as representing inside knowledge of the prospects and performance of the company. There is a serious risk of misinterpretation by the market that directors are seeking to exit their investment, if investors do not know that a third-party right exists in the shares," says Mr Sheehy.

There has been support for such disclosure remaining a matter of a company's continuous disclosure obligation rather than requiring additional regulation. The advantage of regulating disclosure is that boards are not placed in the invidious position of enquiring into directors' personal financial arrangements and circumstances to determine whether a particular margin loan or other arrangement is material and should be disclosed under the continuous disclosure regime.

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In fact, more often than not, companies would be unable to determine materiality without examining the financial arrangements of directors. The reality is that it is unlikely they would have access to that sort of information and nor should they.

For example, a director's shares in one company may form part of a larger portfolio to which the security interest applies, and judging materiality would involve examination of the entire portfolio.

It's been argued that substantial shareholders of a company who are not directors could also have arrangements in place that could have a material impact on the share price. But the issue here is that substantial shareholders who are not directors do not have a fiduciary duty to act in the best interests of that company, and nor do they have access to the same inside information or capacity to influence company decisions that directors do.

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About Chartered Secretaries Australia

Chartered Secretaries Australia (CSA) is the independent leader in governance, risk and compliance. As the peak professional body delivering accredited education and the most practical and authoritative training and information in the field, we are focused on improving organisational performance and transparency.

MR/2009/1