

3 July 2008

Financial Services and Credit Reform Green Paper
Corporations and Financial Services Division
Treasury
Langton Crescent
Parkes ACT 2600

Email: financialservicesgreenpaper@treasury.gov.au

Fax: (02) 6263 2770

Dear Sir/Madam

Financial Services and Credit Reform Green Paper - Director Margin Loans

The Australian Institute of Company Directors (AICD) welcomes the opportunity to comment on Treasury's Green Paper.

Consistent with the general focus of the Paper, the discussion of margin lending primarily focuses on the regulation of the credit component and consumer protection aspects of such transactions. The Paper only briefly touches on margin lending and directors. We note that in spite of the increase in the number and value of margin loans, shares financed by margin loans still only account for 2.5% of the domestic market capitalisation (Paper page 28).

The AICD has over 23,000 individual members from a wide range of corporations: publicly-listed companies, private companies, not-for-profit organisations, and government and semi-government bodies. As the principal professional body representing directors in Australia, we consider it is important to have our views on director margin loans inform Treasury's consideration of the issue.

General Comments

In a sophisticated capital market like Australia, margin lending arrangements play an important role for the purchase of shares. Margin lending arrangements are used by directors, executives and other shareholders. There has been some recent focus by

regulators on the use of such arrangements by directors of listed companies because they have duties at law and greater access to company information. Market expectation is that directors should have their interests aligned with the companies of which they are directors by holding shares in those companies. Margin lending is consistent with such expectations because share purchases must be funded and margin loans can be used to finance such purchases.

AICD's Position

Although there have alleged recent abuses of margin lending arrangements, AICD considers that no fundamental overhaul of the regulatory oversight of such transactions is required, just incremental improvement. Regulation of margin loans must not be made so onerous that directors will, in effect, be precluded from certain share purchases. That outcome will be detrimental to the overall market capitalisation and ultimately to shareholder value. In particular, we must remember that with entrepreneurial-type companies where the founders may also be directors, their personal investment in the company (which serves a major source of capital), may inadvertently be discouraged.

A nationally consistent regime for margin loans is one of the stated objectives of the Paper and there is a nationally consistent regime for companies. As the Paper notes, the conduct of directors in purchasing shares is governed by the Corporations Act's insider trading rules and the general duties to act in good faith and in the best interests of the company. The ASX Corporate Governance Principle's Recommendation 3.2 also requires listed companies to establish a policy concerning trading in company securities by directors, senior executives and employees and to disclose that policy or a summary of that policy to the market.

In addition, the Corporations Act and the ASX Listing Rules oblige directors to disclose certain transactions to the regulator and the market so as to ensure the market is properly informed. In this regard, the clarification provided by the ASX/ASIC Companies Joint Update February 2008 (ASX/ASIC Update) in terms of a company's continuous disclosure obligation is a welcome initiative. The ASX/ASIC Update provides that where a director of a company had entered into a margin loan or similar funding arrangement for a material number of listed securities, ASX Listing Rule 3.1 (Continuous Disclosure) may operate to require disclosure of the key terms of the arrangements. It provides the necessary flexibility for boards and companies to decide when margin loan arrangements may be material and therefore require market disclosure. In volatile trading conditions, a judgment of materiality may fluctuate frequently. AICD believes that the ASX/ASIC Update should be applied to officers of the company, who also have duties at law and enhanced access to company information, not just directors.

To give effect to the ASX/ASIC Update, boards must possess all relevant information about the funding arrangements for a material shareholding. AICD has recommended to its members that their boards adopt a policy requiring the disclosure to the board, or a

committee of the board, of that information. The objective of such disclosure is that the market be fully appraised of the circumstances in a timely fashion and adjust accordingly. The determination of materiality for the purposes of disclosure might include the size of the parcel of shares proposed to be disposed and whether it might be expected to affect marketing trading patterns and the manner in which a financier might force disposal of the shares.

The margin lending positions of directors could be made more vulnerable through additional regulation of disclosure. Such information may advantage one class of shareholder over another. For example, hedge funds with greater company analysis at their disposal could target companies in which directors have borrowed to buy shares.

Conclusion

Director margin loans are appropriately regulated through the Corporations Act, Listing Rules and the ASX Corporate Governance Principles. More onerous regulation of margin loans may preclude directors from certain share purchases. This outcome would be at odds with current market sentiment which encourages directors to hold shares in the company on which they serve as directors and thereby to be incentivised to improve the company's performance. Appropriate regulation regarding disclosure already exists and is confirmed in the ASX/ASIC Update. It provides the necessary flexibility for boards and companies to decide when margin loan arrangements may be material and therefore require market disclosure.

Please contact myself or Gabrielle Upton, Legal Counsel, on (02) 8248 6635 if you have any questions regarding our submission.

Yours faithfully



John Story

Chairman