

arrangement at all".

Articles

[92] Market integrity vs systemic stability: should APRA have the power to suspend an entity's continuous disclosure obligations?

Introduction

The Global Financial Crisis (GFC) highlighted the vulnerabilities of financial institutions to adverse market developments, as seen in the collapses of Lehman Brothers and Bear Sterns and the liquidity crises that affected Northern Rock and AIG. Since the GFC, several financial crisis management initiatives have been pursued internationally. In 2009, the G20 reconstituted the Financial Stability Board (FSB), which together with the Basel Committee on Banking Supervision's Cross-border Bank Resolution Group, has worked to promote financial stability internationally. In line with these developments, the Treasury is currently reviewing the financial crisis management powers of the Australian Prudential Regulation Authority (APRA). As part of this process, in December 2012, Treasury released a consultation paper on various reform proposals titled *Strengthening APRA's Crisis Management Powers* (Consultation Paper).¹ The Consultation Paper included a proposal to enable APRA to temporarily suspend the continuous disclosure obligations of listed prudentially regulated entities that are in financial difficulty. This article critically analyses the need for APRA to have this power and whether it has been appropriately designed to achieve its purpose.

The Proposal

The Consultation Paper proposes that APRA be enabled to direct a regulated entity (including an authorised Non Operating holding company or subsidiaries) not to make market or public disclosures of information for up to 48 hours, where APRA:

- a) is of the view that the entity is in, or is likely soon to be in, financial difficulty;
- b) is working with the entity to implement a resolution to address its financial difficulty;
- c) is of the view that the disclosure of the entity's financial condition ahead of the disclosure of the intended resolution would destabilise the entity and potentially impede its ability to implement the resolution; and
- d) has consulted with ASIC and the Treasurer before giving the direction (Proposal).²

The Proposal is intended to supplement APRA's current intervention powers, which include the power to direct a regulated entity to undertake or cease specified actions or activities, to remove and replace directors and senior management, and to direct authorised deposit-taking institutions and insurers to take actions to recapitalise.

Policy rationale for the Proposal

The Consultation Paper explains that the key policy rationale for the Proposal is facilitating confidential resolutions of financial distress of a listed prudentially regulated and systematically important entity (Policy Goal). The Consultation Paper notes the destabilising effect of such institutions in financial distress being required to disclose this information to the market and the risk that an APRA-supported resolution may be rendered unworkable, to the detriment of stakeholders and, possibly, the stability of the financial system.

The Consultation Paper describes the Proposal as being consistent with current international principles on crisis resolution, including the FSB's *Key Attributes of Effective Resolution Regimes for Financial Institutions* (FSB's Key Attributes), which relevantly provides:

In order to preserve market confidence, jurisdictions should provide for flexibility to allow temporary exemptions from disclosure requirements or a postponement of disclosures required by the firm, for example, under market reporting, takeover provisions and listing rules, where the disclosure by the firm could affect the successful implementation of resolution measures.³

The continuous disclosure framework

ASX Listing Rule 3.1 requires listed entities to disclose market-sensitive information immediately upon becoming aware of it. However, this obligation does not apply where:

- o the information relates to, among other things, an incomplete proposal or negotiation;
- o the information is confidential and remains so in the view of ASX; and
- o a reasonable person would not expect the information to be disclosed.⁴

In spite of this exception, ASX may compel an entity to release a clarifying statement to the market where there is, or is likely to be, a false market in the entity's securities.⁵ Listed entities may manage their continuous disclosure obligations through requesting a halt in the trading of their ASX-quoted securities and related derivatives for a maximum of two trading days.⁶ If the entity considers that a trading halt will not provide sufficient time to formulate an appropriate market statement, it can request that ASX suspend the quotation of its securities for a specific period.⁷ A trading halt or voluntary suspension does not suspend an entity's continuous disclosure obligations, but does prevent trading in the entity's securities on an uninformed basis.

The continuous disclosure framework is intended to enhance confident and informed participation by investors in secondary securities markets and, as a corollary, the depth, liquidity and efficiency of those markets.⁸ As the Consultation Paper notes, any change to the continuous disclosure framework risks undermining confidence in the market and discouraging investment.

Will the Proposal achieve the policy goal?

The Proposal requires revision to ensure that it achieves the Policy Goal and does not unnecessarily compromise market integrity. There are several problematic aspects of the Proposal that warrant further consideration.

The Proposal ignores the information that may already be in the public domain due to the entity's compliance with its continuous disclosure obligations leading up to receiving a non-disclosure direction from APRA. Commonly, entities experience a progressive, rather than sudden, deterioration of their financial position. This deterioration may be marked by profit downgrades, revision of its debt rating, departures of key personnel, all of which is likely to be market-sensitive information that is required to be disclosed. In those circumstances, suspending the entity's continuous disclosure for 48 hours would be ineffective to conceal its financial distress.

The Proposal also does not account for information that may be available through sources other than information disclosed by the entity to ASX. As the Law Council of Australia's (LCA) submission on the Proposal notes, an entity's financial distress may be indicated by its difficulty in accessing credit markets or a spike in credit default swaps premiums for its debt.⁹ A listed entity may also have disclosure obligations in overseas financial markets, beyond the jurisdictional reach of Commonwealth legislation. In that case, any direction by APRA would be ineffective, to the extent that the entity was required to disclose the information in a foreign market. This is particularly relevant from the perspective of investor protection, given that retail investors are likely to be substantially reliant on information that is disclosed to ASX, and therefore most vulnerable to suffering financial loss as a result of a listed entity's continuous disclosure obligations being suspended.

Further, the Proposal goes beyond the Policy Goal. In its current form, the Proposal will apply to all regulated entities, including entities whose financial health is not properly described as "systematically important". Listed entities that are regulated by APRA encompass the "Big 4 Banks", building societies, credit unions, as well as general and life insurance

companies, with a broad range of importance to systemic financial stability. The justifiability of the Proposal being implemented in its current form is increasingly tenuous when viewed in this context. If it is ultimately deemed that APRA should have the proposed power, its operation should be confined to entities that are, in fact, systematically important.

Finally, the Proposal may have unintended consequences. The knowledge that an entity's continuous disclosure obligations can be suspended when it is at its most fragile may dissuade investors from acquiring the entity's securities, or retaining them, upon becoming aware of adverse information regarding the entity's financial position. In this sense, the proposal may impair the entity's access to equity markets or accelerate the entity's downward spiral. Further, if the entity is in genuine financial distress, a statement to the market that the entity is working with APRA to formulate a resolution may have a stabilising, rather than destabilising, effect.

Is implementing the proposal necessary?

Given the prejudice to market integrity that could result from the proposal being implemented, it is important to assess whether any change to the current framework is required. Central to the proposal is preventing the disclosure of an APRA-supported resolution before it has been agreed. This operates on the premise that any prejudice caused by the market disclosure of the entity's financial distress would be balanced by a credible resolution being presented contemporaneously. This concern seems ill-founded, as the current continuous disclosure framework does not require disclosure of a partly formed resolution on the basis that it is an incomplete proposal or negotiation.

Further, in the event that the entity was not in a position to release a market statement, the entity could request a trading halt or voluntary suspension to minimise the risk of a claim that it had failed to comply with its continuous disclosure obligations. In providing for an entity to postpone its disclosure obligation, the current framework goes a long way to providing the flexibility advocated by the FSB's key attributes.

In its submission to Treasury, the LCA proposes that an alternative to implementing the proposal would be for APRA and ASX to formulate guidance to listed entities on when a workout proposal for a distressed financial institution would require disclosure. This seems a sensible and valid alternative to implementing the proposal.¹⁰

Conclusion

The GFC underscored the importance to the general economy of stability in the financial system. Reforms targeted at bolstering and supplementing the powers of supervisory authorities to manage a financial crisis therefore merit careful consideration. However, any such reforms need to be both appropriately designed to achieve their purpose and in the public interest. The proposal does not satisfy these criteria. In its current form, the proposal risks compromising investor confidence and protection, overreaches its policy rationale, may well be ineffective in practice and is not necessary when viewed in the context of the current continuous disclosure framework. If providing APRA with this power is to be pursued, further consideration should be given to its precise terms.

¹ *Strengthening APRA's Crisis Management Powers*, Treasury Consultation Paper, September 2012.

² *Strengthening APRA's Crisis Management Powers*, Treasury Consultation Paper, September 2012, para 2.1.3. "Suspending Continuous Disclosure Requirements".

³ *Key Attributes of Effective Resolution Regimes for Financial Institutions*, Financial Stability Board: October 2011, para 5.6.

⁴ ASX Listing Rule 3.1A.

⁵ ASX Listing Rule 3.1B.

⁶ ASX Listing Rule 17.1.

7 ASX Listing Rules 17.2-17.6; ASX Guidance Note 16 provides guidance on trading halts and voluntary suspensions under the ASX Listing Rules.

8 See *Strengthening the financial reporting framework*, Australian Government Treasury, available at: <http://archive.treasury.gov.au/documents/403/HTML/docshell.asp?URL=Ch8.asp>.

9 Law Council of Australia submission to *Strengthening APRA's Crisis Management Powers*, Treasury Consultation Paper, 14 December 2012, para 4.1.

10 Law Council of Australia submission to *Strengthening APRA's Crisis Management Powers*, Treasury Consultation Paper, 14 December 2012, para 3.4.

Recent Cases

[93] First time consideration of certain provisions of the Aboriginal Corporations Act

Susan Cirillo

Registrar of Aboriginal and Torres Strait Islander Corp v Ponto [2012] FCA 1500; BC201210489 (24 December 2012, Reeves J)

[CA ss 9, 180-182]

Court found two directors contravened civil penalty provisions.

Facts

The Ngukarr Progress Aboriginal Corporation (the Corporation) was registered under the Corporations (Aboriginal and Torres Strait Islander) Act (2006) (Cth) (the Aboriginal Corporations Act).

The Corporation was responsible for the operation of the Ngukarr store, being a store in a remote Aboriginal community.

Any dealing with the Corporation's funds required authorisation from six of the Corporation's ten directors.

On 3 December 2009, two directors of the Corporation, Mr P and Mr H, purportedly signed a letter offering Mr D appointment as CEO of the Corporation. Mr D accepted the offer on 9 December 2009.

Also on 9 December 2009, someone at Westpac was handed a letter (the 9 December Letter), again purportedly signed by Mr P and Mr H, instructing Westpac to:

- o open a new account and transfer \$100,000 of the Corporation's money into it;
- o provide banking facilities to Mr P and Mr H for the new account and three of the Corporation's existing accounts; and
- o transfer \$3500 fortnightly as "salary" from a Corporation account to Mr D.