Law Council
OF AUSTRALIA

Professor (Emeritus) Sally Walker
Secretary-General

14 December 2012

The General Manager
Financial Systems Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir or Madam

Treasury Consultation Paper: *Strengthening APRA's Crisis Management Powers*

This is a submission by the Corporations Committee of the Business Law Section of the Law Council of Australia (the Committee), responding to Treasury's Consultation Paper entitled *Strengthening APRA's Crisis Management Powers* (September 2012). The submission is confined to one section of the paper, namely section 2.1.3, concerning the proposal that APRA be given power to suspend the continuous disclosure requirement for an APRA-regulated entity that is a listed entity or a subsidiary of a listed entity (Proposal).

1. Issues to be addressed

1.1 The issues that the Committee wishes to raise concerning the Proposal are not about the relative importance of stability of the financial system, on the one hand, and efficiency of the securities market on the other hand. The Committee accepts that protection of the financial system is of fundamental importance. Therefore a further, precisely limited, exception to the continuous disclosure requirement could be introduced if it were shown to be necessary and effective.

1.2 The issues that the Committee wishes to address are whether:

(a) it is necessary, in order to achieve the objectives of protecting the financial system and avoiding systemic risk, to limit the market disclosure obligation to the extent envisaged by the Proposal;

(b) the Proposal would be effective in practice; and

(c) the Proposal is cast in terms much wider than needed to address systemic risk and financial system stability.

1.3 In the Committee's view, for the reasons set out in this submission, there is sufficient doubt about these issues that Treasury should review the Proposal. The Committee submits that the Proposal needs to be more fully developed and justified. The Committee would be happy to assist in that process.

2. Is the Proposal a necessary and appropriate response to the perceived problems?

2.1 First, as presented in the Treasury Paper, the Proposal is designed to address problems about a regulated entity's relationship with various categories of creditors relating to:

(a) reducing the risk of a run on deposits; and

(b) preserving short-term money market flows to an institution in crisis

during the period in which a resolution is negotiated, struck and implemented (the perceived problems).

2.2 To the extent feasible, it would be better to address the perceived problems more directly, rather than adopting a solution that impairs the efficiency of the Australian securities market and prejudices a class of investors that are not a cause of the problems.

2.3 Second, the Committee considers in the next section of this submission whether the perceived problems might be capable of being handled within the framework of the existing Listing Rules.

3. Can the perceived problems be satisfactorily handled within the existing Listing Rules?

3.1 The Committee submits that the potential for dealing with the perceived problems within the framework of the current continuous disclosure requirements should be given further consideration.

3.2 The central question here is whether the continuous disclosure Listing Rules would require disclosure of information about a proposed, but confidential, APRA-supported workout when it remains part of an incomplete negotiation, in circumstances where there is a proper basis for apprehension that

disclosure of the negotiations with APRA would force the company into external administration and/or create systemic risk.

3.3 ASX's principal concerns, in such circumstances, will be to ensure compliance with the disclosure obligation in Listing Rule 3.1, to avoid the establishment of a false market, and to query any anomalous price movements. The extent of ASX's ability and willingness to reach a sensible accommodation in analogous circumstances is explained in Draft Guidance Notice 8 (October 2012), para 4.10. ASX's approach to correcting or preventing a false market under Listing Rule 3.1B is addressed in the Draft Guidance Note, Chapter 5.

3.4 It may be possible for APRA to establish a memorandum of understanding with ASX concerning the application of the current Listing Rules 3.1, 3.1A and 3.1B to hypothetical circumstances along the lines envisaged at 3.2 above. In particular, APRA and ASX might seek to establish an understanding, which ASX would embody as guidance to listed entities, in the case where a workout proposal for a distressed financial institution remains incomplete and confidential, regarding:

(a) the circumstances in which a reasonable person would not require disclosure of the workout negotiations to the market (so that the listed entity could rely on the exception from disclosure in Listing Rule 3.1A); and

(b) the circumstances in which ASX would perceive that there are grounds for intervention relating to false market concerns.

In the Committee's opinion, it would not be open to an aggrieved party to argue that the listed entity had engaged in misleading or deceptive conduct by silence in a case where a reasonable person would not expect disclosure.

4. Is the Proposal a practical and effective way of addressing the perceived problems?

4.1 In the Committee's opinion, if an Australian regulated entity is running into financial difficulty, there are likely to be some indications, available to those who know where to look (such as a spike in CDS premiums, a rating downgrade, difficulty in accessing debt markets). Experience suggests there is likely to be a lead-up to the collapse of a financial institution accompanied by external indicators that it is undergoing financial stress.

4.2 A mandated silence for 48 hours will only exacerbate such a situation. It is likely that by the time APRA acts to suppress disclosure, especially after

having to consult with ASIC and the Treasurer, the market will be expecting a statement and the entity's silence will be seen as confirmation that APRA is attempting a rescue, and so the purpose of the Proposal will be defeated.

4.3 Further, if APRA is able to (and does) act soon enough to introduce the 48 hours 'blackout' before these other signals of difficulty become apparent, the situation is not improved, because the imposition of the 'blackout' will:

(a) not stop the creation of these external indicators; and

(b) impose an arbitrary timeframe on discussions which may require the resolution of quite complex matters.

4.4 The investors most likely to suffer from APRA's intervention in such circumstances are those least switched into information flows, that is, the retail investors.

4.5 In addition, to achieve the objective of relieving a listed entity from any disclosure obligation, it would be necessary not only to qualify the continuous disclosure law, but also to qualify the laws about misleading and deceptive conduct and false and misleading statements to the market and regulators. A principal, but not the sole, concern is the proposition that misleading conduct can occur through silence.

4.6 Finally, overseas periodic reporting and continuous disclosure requirements raise a problem where an Australian regulated entity's debt or other securities are quoted on an overseas market. To the extent that there is a disclosure obligation in an overseas market, empowering APRA to suspend disclosure locally will be ineffective. There would be a real risk of damage to the interests of Australian investors if the Proposal were to be implemented while applicable foreign disclosure requirements are still operative.

5. Is the Proposal expressed too widely to address the perceived problems?

5.1 Assuming (notwithstanding the questions raised by our comments above) that the case has been made out for the Proposal, in terms of avoiding or dealing with systemic risk and protecting the stability of the financial system, the Committee submits that, in its present form, the Proposal is too wide in two respects.

5.2 First, the Proposal is not limited to circumstances where the financial distress of a particular regulated entity itself creates systemic risk: as formulated, the Proposal applies whenever any regulated entity, authorised

NOHC or subsidiary 'is in, or is likely soon to be in, financial difficulty'. In other words, as formulated, the Proposal is available to be used whenever any APRA-regulated entity is in some financial difficulty without any regard to whether those circumstances also give rise to systemic risk.

5.3 Second, the Proposal is not expressed to be limited to those activities of financial institutions which might give rise to issues of stability of the financial system through creating a run on funds.

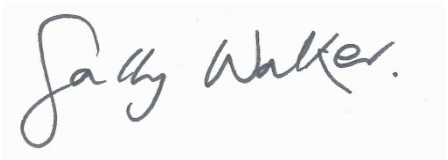
5.4 As drafted in the Proposal, the power could be invoked for relatively small regulated entities and those entities whose activities do not affect the financial system in general. There is no justification for applying the Proposal to all listed regulated financial entities. Instead, the Committee considers that it should be confined to entities that APRA has previously designated as systematically important financial institutions.

5.5 Assuming there is a case for creating a new regulatory power, appropriate safeguards should be embodied in the Proposal. The risk of inappropriate use of the power should be circumscribed by defining the grounds of intervention with precision.

5.6 If you have any questions regarding this submission, please contact either the Committee Chair, Marie McDonald, on 03-9679 3264, Dr Robert Austin on 02-9921 4788 or Jeremy Kriewaldt on 02-9777 7000.

5.7 This submission has been lodged by the authority delegated by the Directors to the Secretary-General, but does not necessarily reflect the personal views of each Director of the Law Council of Australia.

Yours faithfully



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