Opes Prime: who understood?

Now is a time for investors to be careful and for regulators to be vigilant, writes Ian Ramsay.

LAST week was bad for the sharemarket. The S&P/ASX 200 benchmark share index again closed lower on Friday and is down almost 16% this year. The index is down 25% from its peak early last November.

At an extraordinary meeting in Melbourne on Friday, MFS shareholders vented their frustration at the management of a company whose share price has plunged from $4.40 to 99¢.

MFS runs several funds that have many small investors. One of these funds is the $770 million MFS Premium Income Fund, which has 11,000 investors. Investments in the fund are frozen and investors may face significant losses.

Also on Friday, the Australian Securities and Investments Commission said it had begun investigating Opes Prime Stockbroking. This followed the appointment of insolvency specialists to Opes Prime on Thursday night and its suspension as a trading, settlement and clearing participant of the ASX. ASIC said it was investigating any potential breaches of the Corporations Act.

Unlike MFS, Opes Prime has mainly wealthy clients. But their investments are also frozen and the company’s stockbroking and related businesses are suspended. In a worrying development for investors, one of the insolvency specialists appointed to take charge of Opes Prime said the company had no future as an ongoing business. He said solvency was under pressure because several clients had not met margin calls. Opes Prime had operated equity financing and share lending businesses where clients borrow money from the company to buy shares. But in a falling market, clients can face a margin call to invest more to cover losses.

Opes Prime allowed clients to invest in more speculative shares than many other providers of loans for share purchases, thereby adding to the risk of the business.

Complex business strategies operated by brokers are driven by the need for more revenue given the pressure on traditional stockbroking businesses because of competition from internet broking services. But with this complexity comes more risk and the challenge of adequately disclosing these complex arrangements to clients.

A key aspect of Opes Prime’s business is that clients handed over the title of their shares to the company, which used them as security for loans to fund its business. This means the clients are unsecured creditors of Opes Prime. This might not be a problem if they are the only investors. But Opes Prime has some very large secured creditors — ANZ is owed $650 million and Merrill Lynch is owed $350 million. They have already started selling the clients’ shares — which is their security — and the clients will only get what is left after the shares are sold and secured creditors and others with priority over unsecured creditors are paid out. Losses for the clients could be big.

How many of the clients of Opes Prime understood they could be left as unsecured creditors in a collapse and face potentially large losses? How many really understood the business of Opes Prime? There is already talk of legal action to recoup any losses. No doubt the Opes Prime disclosures to its clients will be scrutinised carefully by lawyers. But any legal action might take years.

It is a volatile market. In addition, there are concerns that the prices of some shares are being manipulated. ASIC recently stated it had been approached by market participants concerned that some people were deliberately spreading false or misleading information about listed securities in order to provoke artificially sales of securities and to reduce their market price. This is a time for investors to be careful and for regulators to be vigilant.

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