

Tricom breakdown exposes fragility of Australian share market

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Australian share market indexes have fallen sharply since the beginning of the year, with share prices down more than 11 percent for the year and over 15 percent since their November peak. This is a worse performance than on Wall Street. Market volatility was compounded at the end of January when a prominent stockbroking firm, Tricom, was unable to make its scheduled midday payments for its share purchases for two days in a row.

Tricom became the first stockbroker to fail to settle its accounts since 1975. On both days, the Australian Stock Exchange (ASX) was forced to suspend settlements between all brokers until late in the day. Although Tricom was ultimately able to meet its obligations, the breakdown eroded confidence in the stock exchange's operations.

Tricom's difficulties are one expression of the end of the five-year upward "bull run" on the share market since 2003. They throw light on some of the murky operations of the Australian share market, which is increasingly dominated by financial parasitism.

Two increasingly widespread practices in particular lie beneath the crisis triggered by Tricom. One is margin lending and the other is short-selling. Margin lending is the practice of brokers and finance houses lending money for share purchases, encouraging clients to borrow up to 70 percent of the price of shares. In Tricom's case, the company apparently lent some of its best customers up to 90 percent of the share price.

Between 2003 and 2007, the value of margin loans on the Australian market nearly quadrupled from \$10 billion to \$36 billion. Eager to profit from a rising market, purchasers large and small rushed into debt. For some buyers there were tax advantages—the borrowing costs could be written off against income in a scheme known as negative gearing.

Many of the major banks and financial companies also dived into what has become a highly lucrative business. Among the biggest margin lenders are ANZ Bank, the Commonwealth Bank's Commsec and Adelaide Bank.

While prices were rising, this mountain of debt presented no immediate problems. As soon as prices began to fall last year following the US subprime collapse, however, lenders started to hit purchasers with "margin calls". That is, they demanded that the borrowers either provide extra capital as collateral for the loans, or sell some of their stock at a loss. These forced sales had the effect of further pushing down prices. Margin calls reached record levels on "Black Tuesday" January 22, when the market crashed by 11 percent.

Tricom gave margin lending a new twist because its clients financed their purchases through a different type of loan, which required them to hand Tricom the effective ownership of the shares. When prices fell, this arrangement gave the company the power to sell the shares from underneath those borrowers who could not come up with extra money as collateral.

Tricom also sought to boost its profits by "loaning" its clients' shares, either directly or indirectly, to hedge funds and other financial speculators in return for payment. These hedge funds and other operators then engaged in "short-selling", a practice through which operators sought to profit from falling share prices. Finance houses can do so by selling shares they do not actually own, with the intention of later buying them back at a lower price. This practice gives those involved an incentive to help lower the price, perhaps "talking down" the stock by making negative commentary about a company, or by triggering margin calls.

One form of short-selling is regulated by the ASX. It permits traders to offer only “approved short sale products”, which include shares in 400 large companies. Over recent years, however, the bulk of short selling has moved “off-market”, that is, outside the ASX rules. It seems that Tricom’s transactions were “off-market” because of the type of loans that the company used.

Writing in the business pages of the *Australian*, Adele Ferguson commented: “The end result of all this hocus pocus is Tricom lending your shares, either directly, or indirectly, to a hedge fund to drive down the price and force you to sell to them more cheaply.”

By aggressively pushing this model—offering relatively low interest rates of around 8.5 percent on its loans—Tricom grew rapidly. In just one year, from mid-2006 to mid-2007, its margin loan book expanded from \$776 million to \$2.7 billion. Tricom’s founder Lance Rosenberg had the financial backing of one of Australia’s four largest banks, ANZ, and two major finance houses, Merrill Lynch and Credit Suisse. He also enjoyed close ties with leading establishment families, the Pratts, Packers and Lowys.

Moreover, Tricom’s practices had the tacit approval of the ASX, which did nothing to regulate or halt them. “We all know what’s going on,” one unnamed fund manager told the *Sydney Morning Herald*. “We all know the rules. We all know the risks.”

The fund manager explained that hedge funds target stocks that are believed to have high levels of margin lending over their shares, with the goal of pushing the price down so that stockholders are forced to sell as a result of margin calls. “There’s plenty of hedge funds out there whose main aim in life is to find these vulnerabilities, putting [investors] in a position to find where they are forced to sell. Once you get over that area where your margin kicks in, it just goes into free fall. These guys come in and they are like sharks. It’s a feeding frenzy.”

Some big names, including Barclays, Merrill Lynch, Goldman Sachs and UBS, are known to be involved in the related practice of prime broking, where large fund managers have relationships with brokers who act as custodians of their shares. The prime brokers are permitted to lend the stock, and that stock-on-loan can be used to short-sell investments held by the fund managers.

After the Tricom breakdown, the ASX sent in officials to monitor the company’s operations and demands were raised in the business media for tighter regulatory controls. Tricom’s financial backers required it to wind back its loan book to \$995 million.

Whatever the immediate outcome of these interventions, it is certain that similar predatory schemes will emerge, in one form or another. The Tricom debacle underscores the anarchy and irrationality of the profit system and demonstrates how the share market increasingly rests upon the most speculative and parasitic activities, entirely divorced from the real productive process.



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