Financial Services

Edited by: spatten@afr.com.au

Breaking news at www.afr.com

Options trader rang St George alarm bells

Brendan Swift

The bank is believed to have met Tony Famularo because of concerns he might have breached its loan limit. Photo: JESSICA HROMAS

St George Bank's margin lending business raised serious concerns about the activity of options trader Tony Famularo up to two years ago, after discovering he controlled several companies to which it had lent funds.

It is understood the bank held meetings with the options trader because of concerns his aggregate loans might have breached St George's loan limit, although there is no suggestion Mr Famularo tried to mask his trading position.

A spokeswoman for St George did not respond to questions.

It was revealed this week that failed margin lender Lift Capital lent $331 million – almost half its total loan book – to companies associated with Mr Famularo, which administrator McGrathNicol said was a major factor in its collapse on April 10.

Three days before the collapse, Lift called in Mr Famularo's loans, which were then transferred to Lift's financier, Merrill Lynch. Its decision to sell the stock caused a $32 million loss and McGrathNicol is now pursuing Mr Famularo because he gave personal guarantees on the bulk of his borrowings.

It is believed Mr Famularo first came into contact with Lift director Bassem Jammal while Mr Jammal was employed as a broker at Citi Smith Barney. Citi discontinued the relationship with Mr Famularo.

Lift, which was founded in October 2004, later wooed Mr Famularo as a client.

One source said Mr Famularo only invested in blue-chip stocks and had not breached any positions with Lift Capital.

Messages left for Mr Famularo drew no response yesterday.

It is understood Mr Famularo also had loans with several other lenders, including Merrill Lynch, as a direct client. A spokeswoman for Merrill Lynch declined to comment.

One company associated with Mr Famularo, Brosis, had an agreement to take out a St George margin loan of up to $3 million in mid-2006, according to documents lodged with the Australian Securities and Investments Commission.

Another company, Hypertrade, had an agreement for a maximum loan of up to $50 million with Lift Capital in April 2007. The agreement was signed by Mr Jammal, acting as attorney for Hypertrade.

KEY POINTS

- Lift Capital lent $331m to companies associated with options trader Tony Famularo.
- McGrathNicol says this was a major factor in the April 10 collapse of the margin lender.

Other documents lodged with ASIC suggest companies associated with Mr Famularo may have had past margin loans with BT Financial Group and Adelaide Bank.

Creditors voted unanimously this week to adjourn a meeting until September 15, when they will decide on a course of action. McGrathNicol has recommended creditors accept a deed of company arrangement after finalising key terms, including funding contributions, with Merrill Lynch and Lift's directors on July 10.

If creditors ultimately accept the deed of company arrangement, they may receive 62.8¢ in the dollar, compared with 59.7¢ if the company is liquidated.

Two Lift clients have already taken action against Merrill Lynch and Lift in Perth's Federal Court, claiming Merrill Lynch was not entitled to sell their securities and retain the proceeds.

with Emily Parkinson

The naked truth: ASX has most short sellers covered

Eric Johnston

Financial firms such as Babcock & Brown, Macquarie Group, Allco Finance Group and each of the major Australian banks feature among a list of 320 shares permitting hedge funds to engage in "naked" short selling.

While the United States this week moved to stamp out short selling against financial stocks, local market players believe there are adequate rules to prevent the practice decimating the market here.

New rules in the US will stop naked short selling, or short selling of shares when the seller has not first borrowed the stock, in certain financial firms, including the struggling mortgage funders Fannie Mae and Freddie Mac, major Wall Street investment banks and big retail banks. The rules are part of efforts by US regulators to protect institutions that are core to the financial system.

"What the US has done is targeted specifically to their circumstances – that is, they had no rules on naked short selling at all. We already have restrictions on naked short selling," said a spokesman for the Australian Securities Exchange.

The spokesman said no changes were planned for the current list of approved shares that could be short sold under the ASX's existing rules.

Each month the ASX updates a list of stocks approved for short selling activity. As well as banks, the list includes top 100 firms and key blue-chips such as BHP Billiton, Woolworths and Telstra.

Nick Sherry is eyeing tougher rules

Shares on the approval list are subject to liquidity and capitalisation tests.

Companies that are subject to a takeover, such as St George Bank, are removed.

The spokesman said there had already been full transparency on naked short selling locally for some time.

Other measures include a cap so only up to 10 per cent of a company's shares on issue could be subject to naked short selling.

Meanwhile, "uptick" rules prevent shares being sold at a lower price than a previous transaction.

The volume of naked short selling is relatively minor in Australia, with less than 1 per cent of market turnover thought to be sold under such deals.

The Alternative Investment Management Association, which represents 65 hedge funds in Australia, has called for naked short selling to be stamped out entirely.

"The hedge fund community doesn't undertake naked short selling," AIMA Australian chairman Kim Ivey said. "The protocol for the hedge fund industry is you have covered short selling. That's the way its done around the world."

A second body, the Australasian Investor Relations Association, which represents interests of listed companies, has also called for a ban on naked short sales.

In Australia, the debate over short selling has swung behind the issue of disclosure.

Corporate Law Minister Nick Sherry is considering whether to introduce tougher rules on disclosure surrounding "covered" short sales.

While backing the measures surrounding disclosure, Securities & Derivatives Industry Association chief executive David Horsfield cautioned that such moves would place additional cost pressures on brokers.

"For some firms it's going to be quite expensive to change the technology to have that recorded," Mr Horsfield said.

Traders warned against trying to stop short selling completely. They said the activity was part of normal functioning market.

"It's always the knee-jerk reaction of every crash to blame the short sellers," one institutional trader said. "Short sellers are active in bull markets, but there they often lose money."

Editorial, page 74

Kelly shakes up divisions

Brendan Swift

Westpac Banking Corp boss Gail Kelly has made her first organisational change since taking the top job less than 6 months ago in an effort to boost customer service and sales.

Business banking boss Peter Hanlon will take the reins of a new combined retail and business banking division, which will include customer facing services previously in the consumer financial services and business banking divisions.

Meanwhile, former St George executive Peter Clare, who was poached in March to run Westpac's consumer banking business, will now run a products and operations division overseeing product development, management and operations.

Ms Kelly said the bank's new structure would bring it closer to meeting its goal of winning all of its customers' business.

"We have identified the need to enhance our customer segmentation capabilities, and to significantly strengthen our consumer and business banking distribution by building strong, locally empowered businesses," she said.

Mr Hanlon said the bank would particularly improve its branch service for small to medium-sized businesses.

The changes come as the bank awaits a decision on whether the competition regulator will block or amend its proposed $18.6 billion acquisition of St George Bank on competition concerns.

Street Talk, page 30
Westpac's new track, page 70
Chanticleer, back page