

# Collateral damage

*Executives caught in margin calls are forced to sell off their companies' stock. So long, aligned interests.*

By Beth Braverman

THE HEAVY USE OF LEVERAGE, which has boomeranged on companies blindsided by sinking stock prices and a darkening economic picture, is also taking an increasing toll on the personal finances of executives.

The stock market's gyrations have forced dozens of corporate officers and directors to dump stock they had pledged as collateral for margin loans, further depressing the share prices of the companies that employ them. The sales came as a shock to investors, many of whom were aware of executives' large stakes but didn't realize they had pledged their shares as collateral.

"The reason this is troubling from the investor side is that there is a sense that if executives hold a lot of stock, their interests are aligned with shareholders," said Alexander Cwirko-Godycki, a research manager for Equilar. "But if those shares are pledged, then their interests aren't aligned, because they don't have control over those shares when there is a margin call. That stake could just evaporate."

From Oct. 1 through Oct. 22, executives at more than three dozen companies were forced to sell more than \$1.2 billion in stock as a result of margin calls, according to researcher InsiderScore. That represents just a third of the companies that have acknowledged that insiders have put up shares as security and still face margin exposure going forward, according to InsiderScore.

In a typical month, there may be one or two insider sales triggered by margin calls, or none at all, said InsiderScore research director Ben Silverman, and the sales usually result from a com-

pany-specific event that caused its stock price to dive. "Even last year, when we saw the first subprime issues hit in late July and early August, we only saw a handful of margin call-related sales."

Mr. Silverman said he expects the sales to continue until the stock market stabilizes, which will likely not occur until earnings season ends. "Just like anyone else, insiders are consumers, and their credit and liq-

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# Insiders slammed with margin calls in downdraft

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uidity [are] restrained right now.”

He cited Chesapeake Energy as an example of the dangers posed by pledging shares as collateral. The volatility in commodity prices battered the company's stock during the first three weeks of October, pushing the price down about 35%. In the midst of the slide, chief executive Aubrey McClendon was forced to sell 32 million shares—more than 5% of Chesapeake's outstanding stock—to satisfy margin calls.

Like many of the executives who have faced margin calls, Mr. McClendon had borrowed money to buy company stock and then used the shares as collateral for that loan. When Chesapeake announced the margin sales in a press release Oct. 10, Mr. McClendon, the company's largest shareholder, emphasized that the sales did not reflect his views on the business.

“These involuntary and unex-

pected sales were precipitated by the extraordinary circumstances of the worldwide financial crisis,” he said in the statement.

Asked about Chesapeake's policy on insiders' holding and selling shares on margin, a spokesman directed *Financial Week* to review the company's insider trading guidelines, which make no mention of buying or selling stock on margin.

Some companies do forbid insiders from using their shares as collateral, and others limit the percentage of shares an insider can pledge. But there are no regulations that require such restrictions. Mr. Silverman estimates that about half of publicly traded companies have such restrictions.

At Boston Scientific, co-founders Peter Nicholas and John Abele were forced to sell on margin a combined 36.5 million shares of the company.

“While these involuntary sales

are certainly disappointing, it is important to keep in mind that the company has approximately 1.5 billion shares outstanding, and that even after the events of last week John Abele and I continue to collectively hold more than 90 million shares of Boston Scientific stock,” Mr. Nicholas said in an Oct. 13 statement. “Our confidence in the company and its future is unwavering.”

The sales were related to shares the two had pledged to collateralize loans, and both executives had other assets they could not access because of the bankruptcy of their broker, Lehman Brothers, according to InsiderScore. A representative from Boston Scientific did not return calls for comment.

When a large shareholder gets a margin call, he or she must dump shares on the open market, inevitably adding to the downward pressure when share prices have already fallen low enough to trig-

ger the margin calls. “That creates a cascading effect of pushing prices down even further,” Mr. Cwirko-Godycki said.

Of course, occasionally the opposite happens.

XL Capital chairman Brian O'Hara had to sell about 80% of his stake in the insurer on Oct. 9 to meet margin calls. He had pledged the shares as collateral to secure a personal loan he used to buy XL shares ahead of option expirations. Since then, XL's share price has doubled. A representative from XL did not return calls for comment.

Companies whose insiders are facing margin calls represent a range of industries, from finance to entertainment, but about a quarter are energy-related.

Current laws require that insiders disclose shares that have been pledged as collateral on an annual basis, so any shares pledged since January likely would not have been disclosed. The recent spate of mar-

gin sales may spark regulatory changes and lead to a requirement of quarterly disclosures of stock pledged as collateral by insiders, Mr. Silverman said.

Although most of the corporate insiders who have faced margin calls remain in their jobs, such events may lead shareholders to doubt an executive's prudence. On Oct. 3, real estate investment trust General Growth Properties said its chief financial officer, Bernie Friebaum, had stepped down following revelations that he had sold about 3 million shares in the company to pay outstanding margin debts. A representative from the company did not return calls for comment.

“When you see someone hit hard by the margin calls, you're going to question their judgment and their risk-reward approach for both themselves personally as well as in how they manage the company,” Mr. Silverman said. **FW**