

# Are share buybacks distorting the market?

As share buybacks on the open market could potentially have a significant impact on the price and volume of a security and could last a considerable period, 'honest mistakes', 'inadvertent errors' or other excuses should not be accepted. **BY CHEW YI HONG AND MAK YUEN TEEN**

**I**N THE November 2018 Regulator's Column, the CEO of Singapore Exchange Regulation (SGX Regco) sets out very clearly what the regulator expects of companies conducting share buybacks. However, it appears that issuers are not paying heed to his message.

## RULES ON SHARE BUYBACKS

Subject to prior shareholders' approval obtained via a share buyback mandate at a company's annual general meeting, a company may buy back its shares through on-market transactions or off-market acquisitions on an equal access scheme. Based on an earlier study of annual general meetings (AGMs) in 2016 by the authors, approximately 46 per cent of companies with a primary listing in SGX obtained a share buyback mandate from shareholders.

Share buybacks serve as a useful capital management tool. However, like any market trading activities, they are subject to relevant market conduct provisions of the Securities and Futures Act (SFA).

SGX Regco has rightly warned that share buybacks should not be used to carry out any form of market misconduct such as insider trading or creating a false market. A company should not undertake share buybacks during periods when it is in possession of inside information.

Share buybacks on the open market could potentially have a significant impact on the price and volume of a security and could extend over a considerable period.

If the price and volume of a security have been artificially interfered with through share buyback activities, the investing public would be misled as to the genuine market value of the security. This will undermine the operation of a fair, orderly and transparent market.

SGX Regco states that issuers should be paying no more than 105 per cent of the average of the closing market prices of the shares over the last five consecutive active trading days – referred to as the Maximum Purchase Price Limit. Share buybacks exceeding 30 per cent of the daily on-market traded volume are also considered excessive.

## SOFT LIMITS?

Some companies have conducted share buybacks above the Maximum Purchase Price Limit.

In April 2019, the Commercial Affairs Department (CAD) launched an investigation into the share buyback at No Signboard and its CEO was subsequently arrested on "reasonable suspicion" that provisions in the SFA on false trading, market-rigging transactions and insider trading may have been breached. In this case, the shares were bought back at more than the regulatory limit of 105 per cent of the average market price and during the "blackout period" before the board and audit committee had approved the quarterly results. The company said it was an "honest mistake".

In April 2020, an "inadvertent error" led another company to conduct a buyback at above the Maximum Purchase Price. A breach was avoided by rebooking the buy order in the name of the holding company.

## SHARE BUYBACK 'CHAMPIONS'

Many issuers have undertaken share buybacks that exceeded the 30 per cent limit of



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average daily trading volume on days when they carried out the buybacks.

Curiously and perhaps coincidentally, these four issuers have sizeable exposure to investments in quoted securities, fixed income securities and/or quoted funds. Several other issuers might have affected the volume and/or price of their shares with their buybacks as they significantly exceeded the 30 per cent limit on more than one occasion during the period we looked at – with their buybacks accounting for up to 100 per cent of the daily volume.

## TRADING BY DIRECTORS

In the case of Company S, there is also concern with trading by its directors while the company was conducting share buybacks. On Feb 10, its independent director sold 3.1 million of the company's warrants at \$0.001 per warrant for \$3,120. This does not appear to be linked to the share buybacks and also not undertaken for the purpose of benefiting the director since \$0.001 is the lowest traded price on SGX.

However, its executive director bought warrants on Feb 18 at \$0.002 per warrant, even as the company was active in buying back shares during the month. Given that the company's share buybacks appear to have supported and pushed up the share price, the price of the warrants could be affected by the buybacks. To be clear, there has been no sale of warrants by the executive director but we believe that the timing and transactions by the company and its directors could have been better.

## ARE DIRECTORS OVERSEEING SHARE BUYBACK PROGRAMMES?

In all the cases where share buybacks were conducted at above the 105 per cent price limit or the 30 per cent volume limit, did the directors provide any oversight of the share buyback programme?

Before embarking on a share buy-back programme, boards of directors should do more to understand the liquidity of their company's shares and determine the pace and scale of their share buyback programme. They must recognise that share buybacks may not be a viable option for companies whose shares are illiquid.

"Honest mistakes", "inadvertent errors" or other excuses should not be accepted for practices that affect the integrity of the market.

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the daily on-market traded volume.

Using data obtained from *sginvestors.io*, we looked at share buybacks conducted for the year up to the end of the third week of March 2021. In these 54 trading days, there were 248 share buyback transactions carried out by 36 issuers. Of these, 155 were above the 30 per cent daily threshold set by SGX Regco.

While this may be due to an illiquid market for the shares of these companies, it nevertheless shows that they may not have properly sized their share buyback programme, resulting in a real risk of inflating the price and trading volume. There appears to be a significant gap in SGX Regco's expectations and market practices.

The four issuers that were most active in conducting buybacks during this period carried out 33, 24, 19 and 18 buyback transactions respectively.

In the case of **Company G**, the most active in conducting buybacks, if we were to exclude the one-month blackout period prior to the full year results announcement, it was active on each of the remaining 33 trading days in 2021. When it carried out its buybacks, the average daily trading volume was over 800,000 shares. When it stopped its buybacks, the average volume was just around 190,000 shares. It would appear that the company's buybacks have pushed up the trading volume to an average of over four times.

For the 33 days outside of the blackout period when Company G undertook share buybacks, they accounted for 79 per cent of the daily volume on a simple average basis – well above the 30 per cent daily threshold. It did not cross the 30 per cent threshold on only one occasion, when it was 27 per cent. On two other days, the company bought back 34 per cent and 44 per cent of the volume traded. On all other days, it was at least 51 per cent including on the 12 days when they accounted for more than 90 per cent of the daily volume. On three of these

days, the company was the only buyer of its own shares.

Company G appears to be acting like its own market maker. The buybacks may have had an impact on the company's share price and trading volume, which may subsequently affect the calculations used in its reasonably complex incentive fee structure.

In addition, as the company invests in fairly liquid equity and debt securities, there is information asymmetry. Management is well apprised of its updated net asset value (NAV) whereas shareholders and potential investors only have an outdated figure based on the company's half-yearly results announcements and ad-hoc announcements on its NAV for the first and third quarters. Even for these announcements, there is a lag of about a month to as long as nearly two months (for the full-year results).

**Company S** has been almost as active in buying back shares, albeit in a slightly different manner. Its 24 share buyback transactions averaged 83 per cent (based on simple average) of the total volume. On 12 of the days, the company buybacks accounted for 100 per cent of the volume traded on SGX, including five consecutive trading days from Jan 14 to 20 when it accounted for 100 per cent of all shares traded except for 100 shares. Company S stopped its buybacks on Feb 24, presumably in preparation for its results announcement on or around March 30. To be fair, although the company's internal code identified a two-week blackout before the announcement of the half yearly results, it appears that it had stopped its buybacks a month before the announcement of its half yearly results.

Nevertheless, for the month of February up to Feb 23, it accounted for 83 per cent of all shares traded by volume. Prior to that, it had conducted share buybacks on 24 out of 36 days.

In Company S's case, there is concern about the impact of the buybacks on its share price. Over the period from Jan 5 to

Jan 21, when the company was active on 12 of the 13 trading days, it bought back shares at 24 cents on Jan 5, accounting for 178,400 of the 183,400 shares. During this period, only 123,000 shares were transacted that were not under the share buyback programme while the company bought back 1,098,500 shares, helping to push the share price up to 25 cents. The constant and steady buying by the company led to an upward creep of the maximum price limit. In effect, the company's own action enabled it to buy shares at 25 cents.

The constant buying "pressure" continued through to Feb 23. Its buybacks accounted for 65 per cent of the total volume in 2021, more than double of what SGX Regco

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deems as reasonable. The share price continued its climb and hit a high of 26.5 cents by the time the company halted its share buyback activities.

In the case of **Company T**, its 19 buybacks boosted its trading volume to an average of nearly 2.8 times, while it was nearly 2.9 times for **Company M** which had bought back its shares on 18 trading days in 2021. Company T and Company M accounted for 43 per cent and 85 per cent of the av-