Dear Sir or Madam,
Thank you for the opportunity to make a submission on LIC Stamping Fees.
Short Introduction About Myself, As Requested

I am a private citizen writing in the national interest. I worked in equity markets in Australia and overseas from 1980, and in fund raising and acquisitions from 1986 as a partner at J B Were, and as a consultant at its successor firm Goldman Sachs J B Were. I am now semi-retired and work on a number of charitable investment committees and others, some of which invest in listed investment companies. I believe my market knowledge is reasonably current. My former work included helping listed investment companies raise equity funds, raising money from equity markets for new investments by listed companies, mergers and acquisitions, as well as helping various governments with privatisations, including advising the Commonwealth on the Telstra1 IPO, as a member of the steering committee for that share sale. My work now includes making equity and other investment decisions and recommendations for charities and other entities.

Key Points

I strongly recommend against any changes to the stamping fee or selling fee regime.

This attack on stamping fees for LICs and LITs strikes at the heart of our market based capitalist system, in my view.

Stopping or constraining stamping fees would;

1. Inhibit the raising of permanent risk capital for existing and new Australian businesses thereby reducing long term capital formation and growth for Australia, and contradicting the fundamental purpose of the Stock Exchange,
2. Deny investors in LICs and LITs access to a proven attractive source of investment returns, (a fundamental objective of the Retirement Incomes Policy and of the Stock Exchange), and
3. Impose more regulation on an already heavily regulated sector, and thereby constrain pubic access to these services and inhibit productivity.

What is the Point of Stock Markets?

The highly regarded doyen of Scots investment managers, James Anderson, says it superbly:

"What's the point of capital markets? There are surely two fundamental components behind any satisfactory answer. The core objective, even the genius, of equity capital is to utilise the savings of society to provide the necessary risk capital in order to both drive economic progress and deliver returns to savers. This is in one sense the canonical description of stock exchanges as the enablers of industrial achievement best remembered in railway and railroad epics of the 19th century in Britain and the Americas."[1]

LICs and LITs do exactly this, (when they are successful). They harness savings, make long term investments, and have provided attractive returns to investors.

Who Pays Stamping or Selling Fees?

Every company which raises larger amounts of long term risk capital pays stamping fees or selling fees to raise the money, whether the company is Tesla, CSL, BHP, a small technology

start-up, IPO, an LIC, LIT or a Listed Property Trust (LPT). An exception is when established companies issue new shares by dividend reinvestment plans (DRPs). While valuable, these DRPs provide a relatively small contribution to capital formation.

Why are Stamping or Selling Fees Needed for Capital Formation?

Issuing new shares involves work and quite simply comes at a cost. Someone has to be paid to arrange the fund raising and find investors willing to buy the shares. These costs include Stamping Fees or selling fees.

Stamping or selling fees have been and are paid by issuing companies and by third parties, world-wide.

The Government paid such stamping or selling fees to raise money from its public share offer privatisations like Telstra.

How would LICs, LITs and LPTs raise any new funds without Stamping Fees?

It surprises me to think that some serious and well intentioned folk believe that LICs and LITs, and perhaps LPTs, should be constrained or not allowed to pay brokers and advisers to raise funds. How else will LICs, LITs and LPTs raise such money? So the real question here seems to be should the Government act to close down or inhibit future fund raising by the LIC, LIT and LPT industry? I suggest not. This review of stamping has wide implications.

Conflicted Fees?

And yes, this fund raising process, whether it be for the Government selling Telstra shares or for a fund raising by an LIC, LIT or LPT to raise new permanent risk capital, does involve a potential conflict of interest. The potential conflict arises because the broker or adviser who is paid by the LIC, LIT or LPT to raise the money also will be asked to advise his or her clients to invest in the new shares. In response to this potential conflict, and over hundreds of years, markets and Governments have developed sophisticated laws and practices to cope with this conflict. For example, the LIC, LIT and LPT sectors are subject to the disclosure rules covering all public fund raising and all Stock Exchange listed entities. They are transparent, with clear disclosure on stamping and selling fees.

Quite apart from these rules, is a hard business fact that if a broker or adviser sells a ‘dud’ investment to his, her or their clients, then that adviser may not be in business for long!

In some cases an investment management company may sponsor the establishment of an LIC, LIT or LPT, and in exchange for a management contract from the LIC, LIT or LPT, the investment management company may be prepared to pay the stamping fees and other costs of raising funds. This is another potential conflict of interest. When this happens it is fully disclosed to potential investors and it can only happen after negotiation and with the approval of the LIC, LIT or LPT Directors. In these cases the Directors of the LIC, or in the case of an LIT or LPT, the Directors of the Responsible Entity, represent the interests of shareholders and unitholders.

Fundamental Differences, and Investor Choice – Part 1

LICs, LITs, and LPTs offer an attractive alternative to ETFs and unlisted investment vehicles. They are fundamentally different from all other collective investment vehicles (CIVs) because they raise permanent risk capital. An LIC, LIT or LPT never has to pay back the contributed capital. It never has to sell its underlying investments to repay its investors. (If it wishes it can conduct a return of capital, but that is its choice.) Investors who wish to sell LICs, LITs or LPTs

can do so by selling their shares or trust units on the Stock Exchange. (This also means that these shares or units can trade on the Stock Exchange at prices which are both above and below their underlying asset backing from time to time, depending on demand.)

Other popular CIVs such as ETFs and unlisted investment trusts operate differently: on the basis that if an investor wants their money back then the ETF or unlisted trust will sell down its underlying investments and use these funds to pay back investors.

Accordingly the risk capital formation provided by ETFs and unlisted trusts is not permanent. Also such vehicles are subject to the risk of 'a run on the bank'; if the underlying investments of the ETF or unlisted vehicle cannot be sold quickly enough to pay back investors, then an investor's funds may be unavailable and locked up for a long time. This has happened.

Many LICs and LITs Have Provided Attractive Investment Returns to Investors

Many LICs and LITs have exceptional long term track records of serving the interests of investors, and in the case of the larger and more established listed investment vehicles, much lower cost structures than almost any other type of collective investment vehicle. The low total costs of the larger listed investment vehicles are testament to the cost effectiveness of the structure, including stamping fees, for investors.

The larger LICs have provided attractive investment returns for many thousands of investors. For example, the largest listed LIC, Australian Foundation Investment Company Ltd (AFI) provided total investment returns over the ten years to June 30, 2019 of 11.5% per annum, had $7.8billion in assets, and over 138,000 shareholders. Its management expense ratio was 0.13%, which makes it one of the most efficient fund management entities in Australia. It was established by J B Were in 1928.[2]

Fundamental Differences, and Investor Choice – Part 2

I believe that listed closed end investment vehicles offer much better long term governance for investors.

LIC, LIT and LPT governance tends to eliminate and better handle any conflicts of interest which arise.

In very few other types of investment vehicle are the Directors of the entity obliged first and only to the shareholders or investors, and not to any other interest.

The Directors of the LIC, or in the case of an LIT or LPT the Directors of the Responsible Entity, are accountable primarily to and appointed by the investors of the entity. They can either employ their own investment management staff or contract with an investment management company to do this work. They do not seek to gain separate profits from the business of investment management. All profits are for the shareholders or unitholders. The benefits of this approach are evident in the low management costs of AFI cited above; 0.16% per annum. Quite simply this means that a lot more money is available to shareholders, especially when this advantage is compounded over time.

This is a very different model from the unlisted investment sector where the investment manager does seek to profit from the management of investors' funds. This latter model by definition creates potential for greater conflict of interest.

As you know the Reserve Bank has identified conflict of interest as perhaps the biggest challenge facing Australia's retirement investment management system, where Directors of

Responsible Entities of unlisted funds may not be directly accountable to and/or responsible to investors, and/or are not elected by them, and are not subject to the continuous disclosure rules which apply to listed investment vehicles.

Fundamental Differences, and Investor Choice – Part 3

LICs, LITs and LPTs also have fundamentally higher disclosure obligations, when compared with unlisted investment vehicles. They are subject to the continuous disclosure rules of the Stock Exchange. Accordingly they are much more transparent than unlisted investment vehicles. Investors are better informed.

Overseas Experience

Stamping or selling fees are paid in major overseas markets.

The success and size of the LIC, LIT and LPT (or 'closed end' investment vehicle) markets overseas indicate that these fees have helped rather than hindered long term capital formation and provided long term attractive returns for shareholders.

For example;

"London Stock Exchange has over 450 listed investment funds accounting for a market capitalisation of around 220 billion. Closed-end investment funds [LICs, LITs LPTs etc] listed on London Stock Exchange raised £2.9 billion through IPO proceeds in 2018 – more than any other exchange in the world. In addition, our further issue market has enabled fund managers to upscale their funds efficiently, with more than £22 billion raised through further issues over the last five years.
Key highlights:
Over £6 billion was raised by investment funds on London Stock Exchange in 2018
Over 40% of investment fund IPOs from 2017 came back to raise further capital during 2018.
New asset classes such as music royalties, energy efficiency and energy storage were welcomed to London's funds market in 2018
We continue to see increasing diversity in funds and new innovative asset classes listing in London, whilst also celebrating our long history in this sector. In 2018 we celebrated 150 years of funds with the anniversary of F&C Investment Trust, the world's oldest collective investment vehicle."[3]

Potential Improvement Opportunities, as Requested

The sector would benefit from levelling up, or the establishment of a level playing field with unlisted investment vehicles and ETFs.

The listed investment vehicle structure offers potentially significant long term benefits to the Australian economy and to investors.

These benefits are described above. They arise because of much better governance and disclosure standards. They have a proven successful long term record.

The UK and USA markets provide a much more level playing field for listed collective investment vehicles. The economic and investor advantages of doing so are outlined above. This level playing field mainly involves laws which give generally equivalent tax status to eligible LICs, LITs and LPTs, so they can compete more fairly with unlisted collective investment vehicles.

The UK Treasury, the London Stock Exchange and The Association of Investment Companies in the UK could provide full details.[4]

For example:
“Provided that it is approved by HM Revenue & Customs, an investment trust's investment income and capital gains are generally not taxed within the investment trust. This avoids the double taxation which would otherwise arise when shareholders receive income, or sell their shares in the investment trust and are taxed on their gains.
An approved investment trust must
* be resident in the United Kingdom
* derive most of its income from investments
* distribute at least 85% of its investment income as dividends (unless prohibited by company law)

The company must not hold more than 15% of its investments in any single company (except another investment trust) and must not be a close company.[12] Investment trusts were in 2012 given the ability to distribute capital profits to shareholders. Investment trusts that wished to take advantage of this had to change their Articles of Association, with shareholders' approval, to allow such distributions. However, only a small minority of investment trusts distribute their capital profits.”

In the USA, the Department of the Treasury, The New York Stock Exchange and the Closed End Fund Association, could provide more information.

Conclusion

Please do not impose new rules on this sector.

Instead I recommend levelling up the rules so that this sector can compete on a level playing field with unlisted investment vehicles.

Yours Sincerely,

[1] James Anderson, The Imperatives of Growth Investing, Baillie Gifford, Edinburgh, Autumn 2019. https://www.bailliegifford.com/en/uk/intermediaries/insights/?article=2019-q3-trust-39-autumn-2019-the-imperatives-of-growth-investing-ind-we-1461

[2] See https://www.afi.com.au , and AFIC 2019 annual report pages 1, 5, 10 and 82.

[3] https://www.lseg.com/markets-products-and-services/our-markets/london-stock-exchange/investment-funds

[4] See for example: https://www.theaic.co.uk/guide-to-investment-companies, and https://en.wikipedia.org/wiki/Investment_trust and https://www.cefa.com