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Stamping Fees Team
The Treasury
Langton Crescent
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AUSTRALIA

SUBMISSION – STAMPING FEES EXEMPTION

Introduction

I am responsible for managing around $600 million for mainly retail clients through a business that I built from scratch and which now employs around 40 people. We have clients spread through the east coast of Australia. My qualifications include a B Ec., and a Diploma in Corporate Management. I have studied investment related coursed with INSEAD and with FINSIA, and I am a Graduate of the Australian Institute of Company Directors. I was for some time a rated equities analyst, and I have worked in regulation (Prices Surveillance Authority, since subsumed into the ACCC). In short, I am an expert in the provision of customer focused financial services and I have provided those services in a fee for service, competent and ethical manner for almost 20 years. My staff and I work very hard for our clients. Less than 5 per cent of our overall revenues derive from stamping fees, so I would take strong exception to any assertion that the primary driver for this missive comprises "vested interests".

Not a day goes by without ASIC and other regulators making some half-baked announcement, designed to drive a wedge between consumers and service providers. Such an observation is reflected in the content of Treasury's introduction to the request for submissions, vis.:

> *"Stamping fees are an upfront one-off commission paid to financial services licensees for their role in capital raisings associated with the initial public offerings of shares."*

Let's be clear from the start – Stamping fees are a fee. They are paid by product issuers, and they compensate for significant effort on the part of the AFSL holder. Assuming a desirable investment opportunity, these fees are earned in a very competitive environment, where a number of AFSL holders are vying for a limited amount of stock on offer. This is important:

- The economics of an aging population means that the demand for income producing assets is close to insatiable
- Bonds, which rank higher in the order of capital structure of business (and are therefore, all things being equal, a "safer" investment than equities), are in very high demand, as evidenced by the level of interest rates in almost all Western economies
- Good quality bonds for example (and other investments) are often only available on a wholesale basis. Indeed the minimum parcel traded through Austraclear is normally $0.5 million. For similar reasons, other assets and investment strategies may not be able to be executed other than through a pooled investment apparatus
- Listed Investment Companies (LIC) / Listed Investment Trusts (LIT) provide a liquid and divisible mechanism through which retail investors can access such opportunities. They must also meet the requirements of ASX listing rules

- Assuming good quality, competition for new issues is fierce. The AFSL holder has to assess the investment itself, its suitability for clients, advise those clients, and collect funds ready for payment. This often has to be done in a very short space of time – most often 10 days, but sometimes as short as overnight.

Such an endeavor requires effort and resources. It is right (and fair) that it be paid for.

Stamping/Placement fees

Stamping/Placement fees are typically paid by the issuer of a new listed security. ASIC has formed a view that these payments represent conflicted remuneration, and as I understand it, wants them banned. However, FASEA's recently implemented Code of Ethics has already made it clear that an advisor's remuneration (which is not the same as the AFSL holder's revenue) is not to be tied to such payments. This puts the onus on the advisor not to accept such payments, and also to act in the best interests of each client. Such an approach is consistent with how we run our business and we have no argument with any of that.

There is however no rule preventing a Financial Services Licensee from receiving stamping fees, and neither should there be. Stamping fees are intended to offset the administrative burden of taking on a new issue. Note the following:

- A new issue is announced. Interested parties have to research, model and value it – a task much more demanding than for securities that currently trade, because of the lack of trading history
- Advisors have to be educated regarding the new issue
- If the issue is thought to be useful in the context of client portfolios, then someone has to identify those portfolios for which the issue is suitable
- The task, more often than not, has to be completed within days – timeframes are tight and there is often significant demand for the stock
- Clients have to be contacted, investment monies rounded up, and payment made
- Once committed to a certain "bid" value, the uncertainties of the bookbuild process mean the Licensee often (explicitly or on account of the likelihood of being excluded from future offers, implicitly) takes on the risk of not being able to place all of the stock bid for (thereby having to purchase it as principal), or not getting enough stock (in which case clients have to be contacted again and alternative investments found).

These tasks may not be too onerous if you are talking about a large placement taken in one line, but I can assure you they are very significant, in the context of hundreds of portfolios for retail clients, where the proposed investment will be suitable for some and not for others. Significant resources have to be devoted to the task, as noted above, often at short notice.

Once again ASIC's pronouncements are biased, ill-informed, and likely disingenuous. I say this because:

- In an environment where official interest rates are ¾ of one percent, finding good quality investments at the right price is very difficult. New issues are therefore important in satisfying demand for quality assets. As I understand it, approximately $2 billion in upcoming new issues have been withdrawn since this review was announced, because issuers do not wish to be associated with yet more damaging Royal Commission style hysterics. Investors are consequently denied access to lower risk, liquid investment opportunities. The result will be a move to higher risk investments (an example being the resurrection and popularity of widely

advertised, "award winning", pseudo-deposit financial instruments reminiscent of the late 1980's).

- Not receiving a stamping fee would result in AFSL holders taking on the administrative costs of dealing with new issues. I explained above why these costs are higher than for existing securities
- Taking these two points together, clients need access to new issues, and the licensee needs to be compensated for the work involved with assessing and administering those opportunities. Imposing specific additional fees on the client recipient of a new issue would be one alternative, but aside from the additional costs and complexity, why is that sensible when currently it is the issuer and not the client that is paying?

Further, removing placement fees will favour existing investments as opposed to new issues:

- Existing issues attract brokerage whereas new issues do not. Eliminating placement fees would mean that there are brokerage fees to be earned from dealing in existing investments, but none on new issues. Combined with the costs attendant on new issues, this creates a disincentive to advise on new issues. Or are you proposing to ban brokerage on existing securities as well?
- A disincentive as regards new issues will impact LIC's ability to raise capital, and to meet ASX requirements for shareholder spread.

In short implementation of the proposal will benefit incumbents and eliminate investor choice.

Banning of stamping/placement fees for LICs/LITs will also reduce competition and lead to poorer client outcomes. Self-Managed Superannuation funds for example rely on access to a range of good quality investment opportunities. ASIC has been targeting SMSFs through extensive negative press, but it's analysis of this biggest sector of the superannuation market is flawed:

- With the position of retail superannuation funds virtually untenable, SMSF's are the only competitive alterative to industry funds. ASIC has been vocal in criticising the sector but its analysis relied on ATO data, which has not been adjusted for consumer preferences (for example low risk, high cash balances, control), and which includes all sorts of expenses including property related expenses like depreciation and insurance, and also advice fees. Further ATO data does not consistently record unrealised gains. The Productivity Commission acknowledged the issues with the ATO sourced data. ASIC's reliance on it is a nonsense.
- SMSF's provide legitimate competition to Industry funds, which are closely aligned with Trade Unions, themselves regularly in the news for numerous wrongdoings, and indeed for deliberately and publicly flouting legal responsibilities. Some industry funds are also known to not invest according to stated risk profiles (funds marketed as conservative often contain higher than indicated exposure to growth assets for example), and many do not disclose their true operating costs. They commonly rely on investment in very large illiquid projects (raising questions as to conflicted links to Trade Unions) for their returns which will in time result in liquidity challenges, as the retirement of the baby-boomer cohort gathers momentum.

The health of the SMSF sector is critical to fostering competition amongst superannuation providers. It is therefore important that SMSF trustees have access to a wide range of investments with varying characteristics. The banning of stamping fees will compromise that.

Finally, ASIC makes reference to an observation that a significant number of newly listed LICs/LITs are trading below NTA. There are many reasons why that might occur, including simple demand and supply for that particular investment, the prevailing market attitude to LICs/LITs (which is often negative when markets are otherwise bullish), and perception as to the valuation of the underlying investments. On

its own a negative discrepancy between price and NTA is not sufficient reason to suggest an investment is not appropriate. For example:

- Dividends (including franking credits) may be more than enough to compensate for any discount to NTA
- The underlying investments in the LIC/LIT portfolio may have characteristics that complement an overall investment portfolio (a specific asset class or low beta for example)
- Even large well-known LICs/LITs trade below their NTA from time to time. Over time market forces generally work to close the gap; and
- As opposed to an unlisted investment that might be redeemed at NTA, the fact that the share price is lower than the NTA may just be a factor of the investment being traded. Put another way – the price of market-based liquidity is volatility.

Summary and suggestions

- LICS/LITS are an important part of the investment landscape. They have a place as regards diversification, income management, liquidity and competition
- The proposal to ban Stamping Fees will move the costs of distribution from the product issuer to the AFSL holder. AFSL holders will therefore avoid new issues, or look to recover related costs from clients (probably by way of a transaction based change). Some may look to scale transaction based changes according to demand. Either way it is consumers that lose out
- We have already established through FASEA and the Code of Ethics (which is now law), that asset related fees are not to be linked to advisor remuneration. We also have a law requiring that recommendations need to be made in the best interests of clients. ASIC would be well advised to oversee existing laws, rather than trying to make additional laws, the effect of which will result in higher fees, increased risk, less competition and choice, and lower returns for clients.

By way of suggestion:

- Assuming ASIC is really serious about encouraging positive outcomes for investors in the LIC/LIT sector, it should become very active in eliminating cross-shareholdings and other market impediments to takeovers and other corporate actions. A primary function of the sharemarket is that not only is it a market for trading assets, it is a market for corporate control. This keeps management focussed, and the threat of a takeover (in the case of an LIC/LIT, loss of management rights) is the best way for value to be realised for investors. Managers of LIC's/LIT's often try to defeat this threat through cross-shareholdings or clauses in the relevant management agreement. Without competition for management rights, prices languish.
- Apart from the professional concerns I have toward Government setting prices (which is detrimental to the welfare of society - just look at which prices have risen most in the CPI – Government regulated and owned utilities, rates, car registration), we would have no objection to imposing a percentage cap on stamping fees – 1 per cent perhaps.

Yours sincerely

David French
Managing Director