7th July 2022

**Assistant Director**

**Advice Unit**

**Retirement Advice and Investment Division**

**Treasury**

**By email: FinancialAdvice@treasury.gov.au**

Dear Sir/Madam,

## Submission re Removal of the Stamping Fee Exemption June 2022

The Listed Investment Companies & Trusts Association Ltd [LICAT] represents over 75% of the listed investment companies and trusts in Australia by market capitalisation, and indirectly the 850,000 investors in those entities.

LICAT made submissions to Treasury in 2020 outlining our concerns with the proposed policy change. In particular we were concerned that:

(a) there was a failure to differentiate between open-end investment entities that raise capital continuously (managed funds and ETFs) and closed-end entities that raise capital in isolated centralised blocks, and the necessarily different distribution structures that those entities adopt;

(b) there was a failure to recognise that stamping fees primarily funded centralised distribution and administration services, not advice; and

(c) by prohibiting all stamping fees, that stockbrokers would be commercially unable to provide the centralised services needed to conduct block share issues

Our concerns appear to have been well-founded, with the policy change having created a competitive bias against listed issuers to the detriment of retail investors.

## Consultation Question 1: What impact has the policy change had upon retail investors?

**The policy change has had the impact of almost fully blocking the issuance of new LIC and LIT securities to retail investors.**

This outcome is **entirely contrary to one of the stated intentions of the policy** which was to achieve competitive neutrality between open end managed funds and ETFs and closed end-LICs and LITs.

LIC/LIT IPOs averaged 11 per year over the period 2014-2019, and have averaged 1 per year since 2020. In addition to this primary issuance, there has been a small amount of secondary issuance.

Excluding share purchase plans to existing investors, the LIC and LIT issuance of new securities that has occurred since 2020 has almost exclusively been to wholesale investors.

This trend has occurred despite LICs and LITs being designed to be useful and suited to retail customers as well as wholesale ones.

## Consultation Question 2: How has the policy affected stockbrokers and financial advisers?

**A. Corporate departments of stockbrokers are being prevented from receiving remuneration for the centralised services they provide in conducting an issue of securities to retail investors, and accordingly they do not believe they can commercially provide any such service.**

As a consequence LIC/LIT issues are either not being made at all or not being made to retail investors.

**B. It is difficult to assess any further impacts on stockbrokers and advisers – for the very reason that there have been almost no LIC/LIT issues.**

At the least, the unwillingness of corporate departments to undertake issue work if they can't be remunerated creates a breakdown in the effective operation of the capital markets linkage between customers looking to invest, the stockbroking and advisory businesses that act for them and the ultimate operating businesses/assets in which LICs/LITs would otherwise invest had an issue taken place.

It is also logical to expect that the policy change would create (a) a bias in favour of issues of direct shares to retail clients (for which corporate departments of stockbrokers may be remunerated for the services they provide) and (b) a bias against issues of professionally managed LICs/LITs holding diversified investment portfolios (for which corporate departments of stockbrokers may not be remunerated for services they provide).

The implication of this is that ultimate investors may inadvertently find themselves exposed to riskier, non-diversified, non-managed investments.

**The breakdown in issuance noted at A and B above is contrary to several of the stated intentions of the policy** which were to promote competition amongst investment products and create competitive neutrality amongst investment products and advisory models.

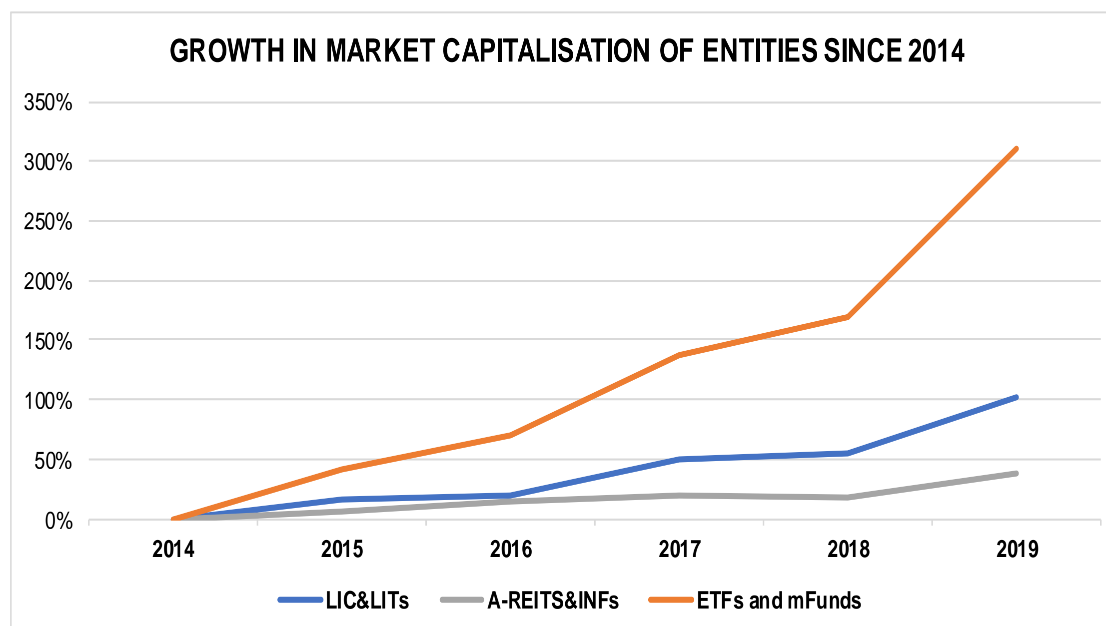
## Consultation Question 3: How have consumers’ investment choices been affected?

**As shown in the chart below, prior to the introduction of the policy change in 2020:**

**(a) The LIC/LIT market exhibited a moderate level of growth that was not inconsistent with other investment vehicles.**

**(b) Issuance data indicated that a relatively unbiased market existed**, in which consumers could freely choose between investment structures.

**(c) There was no evidence of a bias in favour of LICs/LITs over ETFs and mFunds.**




**Since the policy change in 2020 the issuance of LICs and LITs has fallen dramatically (from an average of 11 IPOs per year to 1) and the issuance of LICs and LITs to retail investors has fallen to almost zero.**

**This rapid and significant drop in issuance is highly suggestive that the policy changes have resulted in a structurally biased market against LICs/LITs.**

**It follows that the policy change has had the following detrimental impacts on consumers:**

(a) A lowering of competition in funds management generally

(b) The specific blocking of access to ASX listed managed investment products for retail investors

**The policy change which acts to prevent the proper functioning of LIC/LIT issuance, has the further effect of preventing consumers from accessing the important structural benefits of closed-end funds.** The benefits of closed-end LIC/LIT structures include:

(i) The development of stronger, larger and more cost-efficient investment structures over time.

The LIC/LIT industry contains some of Australia’s longest lasting, largest and most cost efficient investment vehicles accessible by retail investors. This is a direct result of the long term commitment made by investors in closed-end LICs/LITs which in turn encourages and fosters the development of responsible, high quality long term management.

(ii) Access to asset types/classes (particularly long time horizon investment assets and strategies) that may not be otherwise available to retail investors, either at all or in a form that still provides an investor with daily liquidity

(iii) Access to the structurally higher returns that may be paid as compensation for making a longer term investment commitment

(iv) The ability for the entity to benefit by investing in a contrarian manner (buying assets when they are cheapest - typically when other investors are fearful and open-end funds are forced to sell assets to fund withdrawals)

(v) Potential transaction and administration cost and tax deferral savings by avoiding the repeated buying and selling of assets faced by open-end funds which experience daily investor inflows and withdrawals

(vi) The ability for investors to buy and sell their investment on ASX at open-market prices (ie the basic functioning of share markets which provides investors with the opportunities, risks and potential for excess returns that accrue from fluctuating share prices)

## Consultation Question 4: Has the policy beneficially changed competition settings in the managed funds sector?

**No. We refer to our response to Question 3. It is clear that competition has materially decreased as a result of the policy change.**

**We contend that this is because the change has created policy bias, not policy neutrality. The specific areas of policy bias are explained below:**

### 1. Managed funds and ETFs are allowed to pay their centralised costs of distribution and marketing

Managed funds and ETFs issue capital continuously. Accordingly the manager of a managed fund or ETF will directly employ a permanent distribution team to undertake the centralised services of marketing and distributing the product to advisers. The fund charges customers an ongoing management fee which is high enough to fund these costs of marketing and distribution.

### 2. LICs and LITs are prevented from paying their centralised costs of distribution and marketing

LICs and LITs only issue capital in isolated blocks. Accordingly they do not maintain the same permanent in-house distribution teams as open-end funds and ETFs. Instead they engage the corporate departments of stockbroking firms to perform centralised distribution and administration services at the time of a share issue.

The policy change creates a structural bias that prevents LICs/LITs remunerating the corporate departments of stockbroking firms for these centralised services.

These centralised services are primarily provided to the issuer (not the customer), and it is both logical and established practice that these services should be paid for by the issuer. Such centralised services do not have the nature of services provided to customers, and it would be illogical and inefficient to expect such centralised services to be paid for by customers.

## Consultation Question 5: Have there been unintended consequences resulting from the policy change?

**Yes.**

**As we have explained in our responses above, the policy change has not achieved its intent of increasing competition and achieving competitive neutrality between open end funds (managed funds and ETFs) and closed-end LICs/LITs.**

The policy prevents LICs/LITs from paying the normal costs of the centralised services provided by corporate departments of stockbrokers that are required to conduct a block share issue, while allowing managed funds and ETFs to pay for their centralised costs of marketing and distribution.

Accordingly with brokers unable to provide the basic services associated with LIC/LIT share issues, a significant competitive bias against LICs/LITs has been established, competition in the funds management arena has been materially lessened, and retail investors have been almost completely prevented from participation in LIC/LIT issues..

## Explanation of the competitive bias that has been created by the policy change

### The primary reasons for the blockage of LIC/LIT issuance are:

**(a) The process for issuing new shares of any ASX listed entity (whether BHP, CSL or a LIC or LIT) typically involves a significant block of upfront work at the point of issuance.**

This work involves:

(i) **corporate departments of stockbroking firms** reviewing and assessing the merit of a proposed issue and determining its suitability for investor types;

(ii) **corporate departments of stockbroking firms** distributing security information, their general assessment on merit and their suitability assessment to their advisers;

(iii) **advisers and corporate departments** handling paperwork and applications in a single coordinated block for multiple clients at a single point of time;

(iv) Advisers providing specific advice and recommendations to clients;

(v) Advisers distributing general security information and general suitability recommendations to clients for their clients' consideration.

**(b) Corporate departments of stockbroking firms cannot commercially be expected to undertake the significant block of centralised work we note at (a) (i), (ii) and (iii) above without being remunerated.**

Accordingly, the removal of the stamping fee exemption for the issuance of LIC and LIT securities has resulted in stockbroking firms being commercially unable and unwilling to provide their services to retail clients, as they cannot be remunerated for these centralised services.

## The influence of the Design & Distribution regime which has been implemented subsequent to the policy change

The Design & Distribution Obligations regime was introduced in 2021 subsequent to the policy change.

This regime:

- Provides a significant level of added protection to ensure products are suitable for (and are not mis-sold to) customers;
- Requires a material amount of additional work to be undertaken by advisers for retail clients at the point of a share issue for which they need to receive fair remuneration if the process is to be commercially viable;

**For LIC/LIT share issues, which take place in a single block for thousands of customers at one time, this regime magnifies the need for advisers to be appropriately remunerated for work undertaken at the point of an issue being made, while in itself providing protections around suitability.**

## How policy could better satisfy its objectives of preventing conflicted advice while encouraging competition and achieving competitive neutrality between product types

**A. There should be a clear recognition of the difference between the centralised work provided by stockbroker corporate departments for issuers, and the advisory work provided by advisers directly to customers.**

We contend that the necessary central services provided by corporate departments for issuers are logically and properly a service to issuers, and those service providers should be allowed to be fairly remunerated by the issuer for those services.

(This would be consistent with the fact that open-end managed fund and ETF issuers pay the costs of running their in-house distribution and marketing teams and would also provide consistency of practice between the issuance of direct shares, AREITS, Infrastructure funds and the issuance of LICs/LITs.).

**B. There should be appropriate transparency of disclosure regarding a fee paid to stockbroker corporate departments**

Should fees be paid by an issuer to cover the centralised costs of stockbroker corporate departments as noted at A, such fees would be required to be clearly disclosed to investors under existing PDS disclosure requirements.

Depending on the nature of the work provided by the stockbroker it may be appropriate for materials produced by stockbrokers to include a similar disclosure.

C. **There should be recognition that where advisory services are provided on a centralised, aggregated basis to multiple clients at the same time relating to a block share issue, that it is both logical and efficient for an advisory fee to be determined and paid on an aggregated basis, subject to requirements relating to client consent.**

   Acceptable methods of client consent could include the advisor and client having a current agreement that allows such transactional fee for service remuneration, combined with the disclosure of the advisory fee to the client.

   This would be consistent with existing procedures for acceptable methods of transactional stockbroker or adviser remuneration, consistent with the objectives of the policy, while accommodating the inherent structural difference between a single issue for multiple clients at one time (the closed end fund block share issue) and the entirely different process of advising differing clients at completely differing points of time on an individual client basis (the process adopted by investors in open-end funds).

As we indicated to Treasury at their initial point of consideration, we would welcome the opportunity to discuss and workshop policy solutions to ensure that policy objectives can be achieved in a manner that is both efficient and effective for all parties.

Yours faithfully,

**Listed Investment Companies and Trusts Association Ltd**

**Ian Irvine, Chief Executive Officer** | **Angus Gluskie, Director**

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