

7 August 2013

Mr Gerald Yip  
Senior Lawyer  
Australian Securities and Investments Commission  
Level 24, 120 Collins Street  
Melbourne VIC 3000

Dear Mr Yip,

### ***Consultation Paper 208 ASX Managed Funds Service: Relief from the application form requirement***

The Stockbrokers Association of Australia would like to make the following comments on the proposals contained in ASIC Consultation Paper 208 ASX Managed Funds Service: Relief from the application form requirement (**CP208**).

In CP208, ASIC proposes –

- to grant relief from s1016A for responsible entities of schemes in relation to applications made through the ASX Managed Fund Service (**AMFS**), and
- to modify the Corporations Act to impose obligations on AMFS brokers (settlement participants) who choose to give instructions or make applications through AMFS to ensure that investors are provided with a PDS.

The **Australian stock market** is a pioneer in innovation and automation. In 1990, the ASX closed its trading floors and became one of the first stock markets to conduct its markets exclusively through an automated trading system. In 1994, the ASX's CHES system was launched, heralding a new era of automated settlement of securities transactions. The CHES system was the culmination of work to address the problems caused by manual processing of securities

transfers. These had become evident particularly during the boom years leading to the 1987 stock market crash<sup>1</sup>. Purpose-built by ASX, it was one of the world's first paperless 'name on register' settlement, registration and transfer systems.

In contrast to the stock market, the **Australian funds management industry** is still characterised by a high level of inefficient and costly manual processing.

From the experience of the stock market, it is obvious that there would be benefits to be gained by the automation of processing in the funds management industry. Therefore, generally speaking there is a high level of support for any initiative that would lead to greater automation in the processing of applications and redemptions of units in managed funds. However, there are issues in terms of who should bear the liability and cost in doing so.

### ***Features of Proposal***

The proposal has a number of **salient features**:

- it would apply to offers of units in managed funds eligible for a Simple PDS only;
- there would be no pricing or trading of units, only applications and redemptions;
- it would not be covered by the National Guarantee Fund; and
- liability for ensuring that the application form and PDS has been received by the client will be borne by an ASX Settlement participant.

Our Members have commented that the new obligation to give the PDS and Application and ensure that the forms are acknowledged is a logistically challenging one. It is submitted that the new provisions should mirror as far as possible those for listed **Australian Government Bonds**, where it is sufficient to give clients a 'term sheet' and keep a record of having sent it, without acknowledgement.

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<sup>1</sup> ASX Settlement Procedure Guidelines Section 2. CHESS Overview May 2013

## **Benefits**

The proposal claims a number of **Benefits** (Table 1 p.9) including:

- For Fund Managers,
  - greater distribution opportunities through being able to leverage off stockbrokers' relationships with their clients; and
  - lower operating costs through automation of processing and payments; and
- For Clients,
  - enhanced asset management through consolidation of AMFS holdings and ASX equities holdings in a single CHESS holding;
  - greater transparency and certainty in the stages of processing; and
  - *potentially* lower management fees through the passing-on of operational savings by fund managers.

Our Members acknowledge that there are benefits in the **consolidation of clients' managed funds** with their other listed equities in the one CHESS holding. In the past, some stockbrokers have tended to spurn managed funds in favour of listed equities. The proposal may reduce this tendency, and lead to greater options in asset allocation and a larger suite of products to recommend to clients. For simple convenience, it would better for clients to have access to all their investments set out in the one CHESS statement, under the one HIN without the need for a platform or wrap service to do so.

Our Members also note that it may be overly optimistic to assume that a fund manager will pass all operational savings on to the investor.

## **Risk Management**

It is proposed that, in order to control the risk that investors will not be provided with the proper documentation (PDS & Application Form) electronically, new *ASX Settlement Rules* and *Corporations Act* requirements will be implemented to ensure that the broker provides the documents and receives the necessary

acknowledgements. The main controls therefore are the imposition of new rules on the broker, overseen and enforced by ASX and ASIC.

### **Brokers' Concerns**

The implementation of the AFMS will present issues for Brokers, including logistical and system changes, technology enhancements and rebuild, and the internal 'knowledge gap' in these products. Presumably, clients will need to become CHESs-sponsored in order to have their applications and redemptions processed. It is also unclear whether brokers would be principally liable for settlement of AFMS 'transactions' in the event of client default, in the same way that they are for equity market transactions. There will also be new and greater legal liability on the broker to ensure the giving and acknowledgement of the proper documentation which will require updates to compliance plans, policies and procedures. All of this will lead to extra costs for the broker, and the major component of the extra costs is likely to be technology.

### **Cost Savings**

The expert report by the actuaries engaged by ASX, **Rice Warner**, forecasts 'industry-wide savings' of up to \$215m. These savings are spread across responsible entities, platform operators, brokers and advisers.

There are a number of comments we would like to make about this report:

- *Systems Costs ignored*: in calculating cost savings, Rice Warner has concentrated on its assumed 'per transaction' processing cost, for responsible entities, brokers and other entities. It acknowledges (at 1.3) that it has not taken into account AML/know your client costs or systems development costs, both of which will fall to the broker. As these costs are significant, it is an important omission for Rice Warner to draw conclusions, especially without taking systems costs into account.
- *Per transaction cost questionable*: the Report is based on a transaction processing cost of between \$11 and \$45 (at 1.5). Presumably, this is based on interviews with fund managers and other participants, since they acknowledge (at 1.5) that -

*'...None of the Brokers we contacted were prepared to provide an indication as to how much it may cost...'*

When any manual system is automated, it is usually reasonable to expect cost savings to result. However, in this case we do question the purported savings estimated by Rice Warner, particularly for stock brokers, as it does not take into account systems updates, compliance, professional indemnity insurance and other costs, nor is it based on input from brokers. In addition, it does not take into account any likely rebates from the ASX.

### **Concluding Comments**

There is broad support for more automated processing in the archaic managed funds industry. While fund managers will be the ones most likely to benefit directly from the AMFS, it is unfortunate and inequitable that the stockbroking industry will have to pay for its establishment. This will come during the period Post-GFC, which is a very difficult market, when already stockbrokers have had to bear additional cost and compliance burdens through no fault of their own, such as market supervision fees, FOFA and cash margining.

*New Fee arrangement for Clients of Brokers?* While they don't involve a secondary trade, operationally, applications and redemptions through CHESSE would be like Off-Market Transfers (**OMTs**) processed for clients by brokers through CHESSE. Currently, clients are not always charged for OMTs. It depends on the arrangement with the client. In order to cover costs, brokers will probably charge clients for applications and redemptions through CHESSE. This would be in addition to the entry fee (if any) charged by the fund manager. (FOFA would usually prevent the fund manager paying a fee to the broker, removing that avenue for remuneration.)

On balance, brokers who plan to offer the AMFS will bear the costs of the new service, despite its doubtful profitability, in order to provide the full suite of services to clients, and possibly open up a new asset class. Otherwise they may miss a commercial opportunity. In the longer term, after the initial establishment costs, hopefully cost savings will then flow to the broker and not just to the fund manager.

Thank-you for the opportunity to comment on the proposed relief to the application form requirements for the ASX Managed Fund Service. We would be happy to discuss these matters further at your convenience. Should you require any further information, please contact me or Doug Clark, Policy Executive on [dclark@stockbrokers.org.au](mailto:dclark@stockbrokers.org.au) .

Yours sincerely,



**David W Horsfield**  
**Managing Director/CEO**