Stockbrokers
and Financial Advisers
Association Limited

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Stamping Fee Team
The Treasury
Langton Crescent
PARKES ACT 2600

By email: stampingfeeteam@treasury.gov.au

To Stamping Fee Team

REVIEW OF STAMPING FEE EXEMPTION FOR LISTED INVESTMENT ENTITIES ("LIEs") – SUBMISSION BY STOCKBROKERS AND FINANCIAL ADVISERS ASSOCIATION

We refer to the Consultation by Treasury on the merits of the stamping fee exemption for Listed Investment Entities (including Listed Investment Companies ("LICs"), Listed Investment Trusts ("LITs") and Real Estate Investment Trusts ("REITs"). The Stockbrokers and Financial Advisers Association ("SAFAA") appreciates the opportunity to make this submission in relation to the review.

As a preliminary comment, SAFAA notes that there has not been a Consultation Paper issued on this subject. SAFAA has adopted its own approach to structuring this Submission.

Analysis of Listed Investment Entities performance

Much of the current media debate about the appropriateness of the stamping fee exemption appears to have been conditioned by internal research conducted by ASIC on the question. In addition, other research from what appear to be conflicted sources has also been cited. For example, we note that research by ETF providers, which are in competition with listed investment entities, has been referenced.

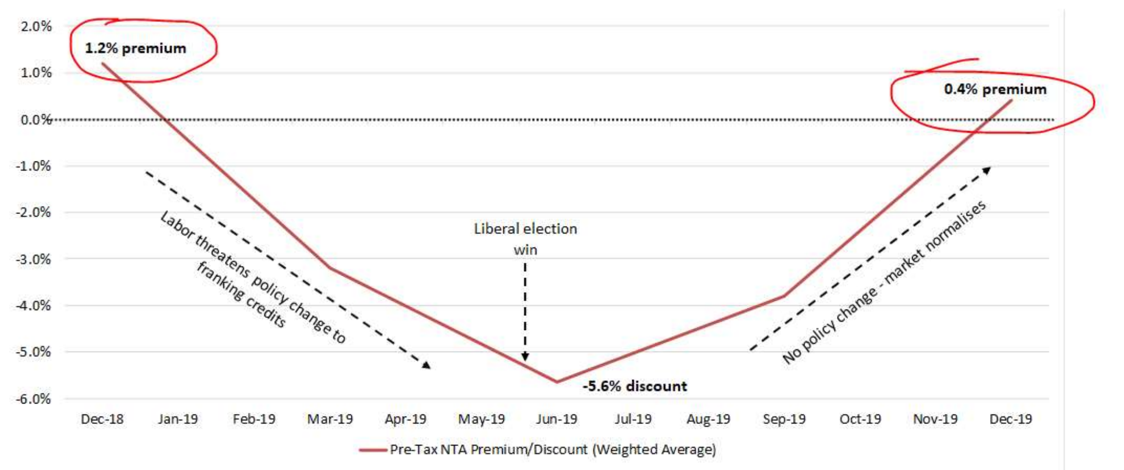
SAFAA strongly submits that the ASIC research is flawed. We note that other analysis has since been published which calls into questions the parameters within which the ASIC research was carried out, and the conclusions reached.

We refer Treasury to alternative analysis that has been carried out, such as that by Dominic McCormack: https://www.livewiremarkets.com/wires/the-lic-lit-mis-selling-crisis-is-grossly-exaggerated.

ASIC's research was carried out during a particular period when the announcement by the Labor Opposition of its proposed policy for the removal of cash rebates for excess franking credits was having a distinct impact on the market for Listed Investment Entities. In addition, there was negative sentiment playing on the market in general during this period as well.

We set out at Figure 1 below a chart produced by Seed Partnership indicating the significant rebound in the market for Listed Investment Entities in the period immediately after the Federal Election. It is evident from this that the generalised conclusions that ASIC appears to have drawn regarding the performance of Listed Investment Entities as a class and the appropriateness of these products for investors do not present an accurate picture of the matter.

Figure 1: Weighted average trading premiums 2019 – ASX LIC/LIT sector



SAFAA submits that careful examination needs to be given to the research and assertions that form the basis of much of the criticism of Listed Investment Entities that is inherent in the current debate.

Merits of Listed Investment Entities

Further to the preceding section, SAFAA's submission is that the criticisms made of Listed Investment Entities as a class of products are open to challenge. Apart from the issues with the ASIC research that we have already noted, it is SAFAA's observation, as noted above, that the public debate appears to have largely been fuelled by ETF providers, who are competitors and can in no way be considered to be unbiassed commentators. Other analysis that has been reported in the media, such as that reported to have been conducted by Stockspot, a participant active in the ETF market, also does not appear to us to be impartial.

SAFAA draws to Treasury's attention the following features that investors, including both retail and high net worth (wholesale), find attractive about Listed Investment Entities:

- Payment of franked dividends (particularly attractive to retirees)
- Listed Investment Entities allow for exposure to baskets of stocks, including to a more diverse spread of stocks than could be acquired for a small investment $amount; the exposure to overseas stocks that are not easily acquired directly by investors, or which are expensive to trade and hold as individual investors; access to Fixed Income products that are OTC and not available to individual investors; and other specialised sectors, such as tech stocks.
- the listed company structure, which is well understood and complies with ASX Listing Rules, Continuous Disclosure requirements and Corporate Governance Principles
- Listed Investment Entities are traded on market, so can be easily exited if desired
- preference for active management as opposed to passive management, or simple index tracking (as is mostly the case with ETFs and other funds which seek to replicate an index)
- investors may be attracted to a particular LIC/LIT manager based on their track record
- Listed Investment Entities are closed end vehicles, so that exiting holders do not diminish the funds invested by the Listed Investment Entity. The Listed Investment Entity is not required to sell assets, potentially at depressed prices, to fund exiting holders. There is not the potential threat that that holders will be locked into their investment, potentially for a period of years, during times of market stress, as is the case with unlisted funds

The significant increase in Listed Investment Entities in recent times has directly been as a consequence of demand from investors for greater diversification of portfolios away from an over-exposure to Australian listed shares. This is not just a matter of demand from investors, but has also been an objective identified as a desired outcome by the Australian Government.

Set out below at Figure 2 is a table which illustrates this trend:

Figure 2 – LIC/LIT Amount Raised by Strategy 2015-2019

Income - Aust	$1,532,584,670	10.8%	24.2%	Income
Income - Global	$1,888,977,782	13.3%		
Equity - Aust	$2,464,149,066	17.4%	17.4%	Aust - Equities
Equity - Global	$7,312,468,469	51.6%	58.5%	Global - Equities
Equity - Asia	$969,420,195	6.8%		
	$14,167,600,182	100.0%	100.0%	

The growth in Fixed Income and overseas equities is evident from the Table.

The growth in Fixed Income Listed Investment Entities has been particularly significant in the last few years, as a direct consequence of investors' search for yield in response to the significant reduction in income resulting from the fall in term deposit interest rates.

There appear to be inferences, even assertions, in the current debate that Listed Investment Entities are toxic products for retail investors and/or are being pushed on them by intermediaries motivated solely by the stamping fees that are being paid. This is quite incorrect, and potentially quite mischievous to an understanding of the role that these products play in satisfying the demand for diversification in the current market. Listed Investment Entities are a legitimate investment vehicle that may be suitable for many investors at different times.

Discount to NTA

We note that Listed Investment Entities will not uncommonly trade at a discount to the NTA for the entity. The ASIC research previously referred to places a great deal of emphasis on this.

Whilst clearly this is not an irrelevant matter, there are a number of other points that can be made about this:

- As mentioned, there were a number of specific factors at play during the period covered by the ASIC research. The assumption being made is that the performance of Listed Investment Entities is invariably as bad as that shown during the period selected. However, as previously noted, this is not the case, and the price of these products improved materially after the Federal election result was known in May 2019.
- We note the research conducted by Investment Trends that the average holding period of retail investors is 11 years. In general, retail investors tend to hold for the long term, including in these products. A discount to NTA during particular periods of time is unlikely to be of primary concern to investors looking to hold for the long term.
- Any tendency for this class of product to trade at a discount to NTA could benefit from greater attention from markets and regulators to encouraging more active market-making activity, which could reduce the bid/ask spread of the products. In the absence of active market making, products with lower levels of liquidity will often demonstrate this issue with respect to the market price.

Listed Investment Entities v ETFs

The current debate on the stamping fee exemption has somewhat simplistically involved two propositions, namely:

1. Why should any investor invest in Listed Investment Entities when they could invest in ETFs?

2. Why would any adviser recommend subscribing to an offer for a Listed Investment Entity, as opposed to simply waiting for the Listed Investment Entity to trade and buy the product at a discount to NTA?

As to the first question, SAFAA believes that this is dealt with adequately by the previous section of this submission.

In relation to Fixed Income products, the closed-end Listed Investment Entity model presents distinct advantages to the ETF model, given the lack of "lit markets" for the trading in the underlying assets of the entity. ETFs require the ability to readily trade the underlying asset in order to satisfy investors redeeming their holdings or the demand for creation of new units.

As regards the second question, if there is insufficient demand for Listed Investment Entities, then they may not get to market at all, so it cannot be assumed that the entity will make it to market in order to trade if there is insufficient demand to for the Offering in the first place. The analysis of the offer will decide if it has value as an investment. The assumption that the stamping fee will see all offers make it to market is incorrect.

In essence, there are some cases where an ETF will be an appropriate investment for a client, and there will be other cases where a Listed Investment Entity will be appropriate. It is simplistic to argue that there is no need for Listed Investment Entities because ETFs are available.

Rationale for Stamping Fees

Stamping fees have been the traditional way that stockbrokers have charged for the work that is done in analysing a potential offering and determining the appropriateness or otherwise of a recommendation to clients.

In addition, if personal advice is given to a particular client, then the products must be determined to be suitable for the needs of that particular client. Not all clients have the same circumstances, needs and objectives.

That is, the analysis involves two stages: analysing the offer to assess its value as an investment, and then analysing the offer to assess if it is suitable for clients.

Stockbrokers are remunerated on a transactional basis. The traditional method of remuneration of a stockbroker is to charge brokerage on a trade. In the case of an initial public offering (IPO), there is no trade on which brokerage can be charged, so the stamping fee is the analogous remuneration charged for the service.

The stockbroking model is a different model to that of other advisers, such as financial planners, who will generally charge a recurring fee based on a % of the $ value of the client's investment funds charged annually. The traditional model for stockbrokers is that they charge for a transaction.

SAFAA's members advise that:

- Stamping fees are in the range of 1-1.5%. The level of fees has been gradually reducing over time.
- Stamping fees are at the same approximate level as brokerage charged by full service brokers i.e. stockbrokers who give advice to clients, as opposed to purely online execution broking. The usual rate of brokerage is also in the range of 1-1.5%, with a minimum amount (in the range of $100-$150).

- Stamping fees at this level are not large, and do not warrant the type of criticism being levelled. On an investment of $10,000, a 1.5% stamping fee of $150 would equate to the brokerage that would usually be payable on a share trade for that equivalent amount.

- Stockbrokers regard stamping fees in relation to other fees in agnostic terms. One dollar earned from stamping fees is the same as $1 earned from brokerage, for all considerations. One source of remuneration is not seen as more attractive compared to the other.

- Because Listed Investment Entities tend to be held for long periods and not actively traded, if anything, those products ought not be regarded as lucrative for stockbrokers, as has been suggested. An investment in Listed Investment Entities would reduce the likelihood of any further brokerage earned on that investment for some years. Notwithstanding this, recommendations are made based on the appropriateness of the investment for that client, not for any considerations of the fees earned.

It is simplistic to compare stockbrokers with financial planners, who while they may as a matter of course rebate stamping fees to the client, will charge a recurring percentage-based fee each year. The fee model for that sector is quite different to stockbrokers.

There is some evolution to the fee model being adopted by some stockbrokers. There are some firms that now charge a combination of a percentage of the dollar value of the client funds, but with no brokerage charged. Some other firms have moved to a hybrid model of partly a percentage of the dollar value of the client funds under management and a modified percentage brokerage fee for transactions. Accordingly, there is a variety of approaches being adopted towards assessing fee structures and dealing with stamping fees, and any rebating of them.

Much of the current debate has referred to stamping fees that are very high, with references to 3% to 5% commonly mentioned. This is a significant distortion of the true levels of stamping fees that are commonly paid in the market.

If there are some Listed Investment Entities that have been paying stamping fees at these levels, then SAFAA would expect that ASIC should be looking at these particular funds, using its regulatory powers to determine whether the “best interests” duty has been complied with by advisers.

History behind the Stamping Fee exemption

At the time that the FOFA reforms were being introduced by the then Labor Government, it is important not to lose sight of the fact that the Global Financial Crisis (GFC) has just taken place.

In 2009 alone, the Australian capital markets had raised $109 billion to recapitalise listed Australian companies in response to the GFC. This performance by Australia, and its stockbroking sector, was viewed with the utmost regard by the rest of the world, where capital adequacy was a significant concern.

There was bipartisan support by both Government and Opposition at the time for the stamping fee exemption from the conflicted remuneration prohibition in respect of IPOs, in recognition of the importance of Australia’s capital markets and the desire not to interfere with the way in which it successfully operated.

The anomaly was later identified that the wording used for the exemption did not capture Listed Investment Entities, and this was subsequently rectified by the new Government (at that time a Coalition Government), again with bipartisan support. There was no rationale to permit the exemption for one class of Exchange traded products but not for the other. It was not, as has been characterised in the media, a “loophole” that was created. Rather, it was an anomaly that was corrected.

In this regard, we note the following passage in the relevant Explanatory Statement setting out the reasons for the legislative amendment:

> *This amendment also addresses concerns that the current regulation creates an inappropriate, market-distorting distinction between the types of entities that are otherwise legitimately permitted to raise capital from retail investors. The current regulation prevents investment entities (that is, entities whose primary purpose is to provide a financial investment) from accessing the stamping fee provision.*

If the exemption for Listed Investment Entities were to be removed, this would simply reintroduce the market distortion that existed before the anomaly was corrected.

Work undertaken for which the Stamping Fee is remuneration

There is a considerable amount of work that is involved in assessing the merits of a Listed Investment Entity.

This includes:

- Reviewing and analysing the offer documents;
- Carrying out an assessment of the various risks of the investment;
- Assessing the track record, experience and credentials of the Manager of the entity;
- Assessing the fees, expenses and other costs and comparing with similar classes of investment, and identifying any anomalies;
- Assessing the return on investment and comparing to return on investment for the asset class;
- Identifying any conflicts of interest;
- In relation to individual clients, assessing whether the investment is appropriate for that investors individual circumstances, situation and needs.

Extent of any problem with Listed Investment Entities Stamping Fees

The concerns that have been expressed by ASIC and other commentators about stamping fees for Listed Investment Entities are noted.

If those views were shared by investors, then one would expect there to be a body of complaints and enforcement action arising from this area.

The reality is that there is neither.

SAFAA is not aware of any action taken by ASIC in respect of any AFS Licensee or any adviser in relation to the appropriateness of personal advice given in respect of a Listed Investment Entity. The existing "best interests" duty is quite strict, and ASIC has been given significant enforcement powers to deal with breaches of the law and licence obligations. ASIC also has new product intervention powers to deal with any product if there is significant consumer detriment likely to occur.

If the situation is as bad as ASIC is reputed to believe, then the absence of any enforcement action is strange.

In relation to clients of stockbrokers, there is no evidence in the complaints statistics at Financial Ombudsman Service (FOS) or Australian Financial Complaints Authority (AFCA) that SAFAA is aware of that would suggest there is a problem in this (or any other) area of stockbroking advice. The number of cases lodged with FOS in respect of stockbrokers is very low. Attached at Annexure A is a table of the most recent figures available with respect to stockbroking disputes.

As can be seen from the table, the total number of complaints for inappropriate advice was only 16 for the entire industry for the year of 2017-18. The number of awards in favour of clients for all complaints for the year was five.

If investors are being badly advised by the stockbroking industry in relation to Listed Investment Entities, then the statistics do not show it.

Consequences if Stamping Fees are Prohibited

If the Government concludes that it needs to remove the existing stamping fee exemption for Listed Investment Entities, then a number of potential consequence would follow:

Consequences for investors

1. One possible outcome would be that stockbrokers would commence charging clients a fee for the advice that they currently receive for free. Stockbrokers would need to identify an alternative way of being remunerated for the work done. It is not reasonable to expect professionals to provide a service for free. If stockbrokers were not able to be remunerated for advice, then they will no doubt decline to provide it.

2. Some clients may be prepared to pay a fee for advice, but there may be significant numbers who may not be happy to do so. There is increased risk that clients may seek to invest in offerings by Listed Investment Entities direct, and without the benefit of advice from their stockbroker. There is a risk also that some clients may look for advice from the media, the internet, chat sites and so on, which may be unreliable or provide false information. If there are Listed Investment Entities that should be avoided, then the prospects of them attracting funds from investors who do not receive the benefit of advice will increase.

3. Those clients who pay a recurring fee based on a percentage of funds under management would not be affected, as they are already effectively paying for advice under the different fee model. Therefore, that class of clients would continue to receive advice. It is the class of clients who do not want to pay under this model, and instead only want to pay their broker when they transact, who will be affected.

Consequences for Listed Investment Entities

1. The role of stockbrokers to match investors with those seeking capital has been acknowledged in the past. If brokers are not able to fulfil this role because they are not able to be remunerated, then this will impact on the ability of Listed Investment Entities to raise capital and come to market.

2. Listed Investment Entities may find it more difficult to raise the amount needed to achieve listing, or sufficient numbers of investors to meet shareholder spread requirements and/or ensure a sufficient secondary market in the product. Listed Investment Entities may decide that other jurisdictions offer a better alternative market in which to list.

3. A lessening in the Listed Investment Entities offered to Australian investors will reduce investment and diversification options, at the very time when, as pointed out earlier, demand for those options is increasing

Different treatment of ETFs

There may be a suggestion that there is not a level playing field, given that the stamping fee exemption exists for Listed Investment Entities but not for ETFs.

The significant difference between the products is that ETF units are created and then bought or sold on-market. Being open-ended, they can be created by additional purchases of the underlying, or redeemed and the underlying sold.

There is no IPO or offering to which investors can subscribe, as there is with listed equity or Listed Investment Entities. Investors buy or sell ETFs by way of a transaction on the Exchanges. Stockbrokers will charge normal brokerage for the transaction (as with any trade), which is their remuneration for their service to the client.

With ETFs, there is a framework whereby Market Makers and Authorised Participants create additional units in order to satisfy demand on-market, by depositing stocks, cash or other relevant assets in exchange for the units which are then offered on market.

Because investors do not subscribe for ETFs, but rather buy (or sell) them on the Exchanges, the question of payment of stamping fees is not relevant for ETFs.

Conclusion

In summary, if it is accepted that Listed Investment Entities are a legitimate and appropriate investment vehicle for investors, and are not inherently “bad” investments, as has been argued, then there is no logical rationale for treating them differently in regulatory terms from other classes of investment at initial offering that are regarded as appropriate.

There is therefore no rationale to separate Listed Investment Entities and remove the stamping fee exemption for this class of product. Doing so would reintroduce the market distorting effect that the stamping fee exemption remedied when Parliament corrected the situation in 2014.

We would be happy to discuss any issues arising from these comments, or to provide any further material that may assist. Should you require any further information, please contact Peter Stepek, Policy Executive, on (02) 8080 3200 or email pstepek@stockbrokers.org.au.

Yours sincerely

Judith Fox
Chief Executive Officer

ANNEXURE A

Stockbroking disputes 2017-18

FINANCIAL OMBUDSMAN SERVICE AUSTRALIA

Stockbroking disputes 2017-18	Issue Count*	Dispute Count	%	Stockbroking disputes 2016-17	Issue Count*	Dispute Count	%	Variance
Number of disputes received		160				131		+22%
Number of disputes accepted		108				94		+15%
Number of disputes closed (Incl. Registration disputes)		155				132		+17%
Top 3 products for the disputes accepted				***Top 3 products for the disputes accepted***				
Shares	77		63%	*Shares*	67		64%	
Self-Managed Fund/s	12		10%	*Mixed Asset Fund/s*	8		8%	
Mixed Asset Fund/s	8		7%	*Self-Managed Funds*	5		5%	
Top 3 issue types for the disputes accepted				***Top 3 issue types for the disputes accepted***				
Instructions	35		28%	*Advice*	23		22%	
Advice	28		23%	*Instructions*	20		19%	
Transactions	18		15%	*Service*	18		17%	

Stockbroking disputes 2017-18	Issue Count*	Dispute Count	%	Stockbroking disputes 2016-17	Issue Count*	Dispute Count	%	Variance
Top 3 issues for the disputes accepted				***Top 3 issues for the disputes accepted***				
Failure to follow instructions/agreement	24		20%	*Inappropriate advice*	15		14%	
Inappropriate advice	16		13%	*Failure to act in client's best interests*	11		10%	
Unauthorised transactions	15		12%	*Failure to follow instructions/agreement*	9		9%	
Outcomes for closed disputes (Incl. Registration disputes)				***Outcomes for closed disputes (Incl. Registration disputes)***				
Resolved by FSP		62	40%	*Resolved by FSP*		44	33%	
Discontinued		20	13%	*Outside Terms of Reference*		30	23%	
Outside Terms of Reference		19	12%	*Discontinued*		14	11%	
Decision in Favour of FSP		13	8%	*Negotiation*		11	8%	
Preliminary View in Favour of FSP		9	6%	*Decision in Favour of FSP*		9	7%	
Negotiation		9	6%	*Preliminary View in Favour of FSP*		8	6%	
Preliminary View in Favour of Applicant		8	5%	*Decision in Favour of Applicant*		7	5%	
Conciliation		7	5%	*Assessment*		4	3%	
Decision in Favour of Applicant		5	3%	*Conciliation*		4	3%	
Assessment		3	2%	*Preliminary View in Favour of Applicant*		1	1%	
Grand Total		**155**		***Grand Total***		**132**		

*Note: A dispute can have multiple products/issues (issue count).