Regulation Impact Statement: Removal of the stamping fee exemption

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Background

On 27 January 2020, the Commonwealth Government announced that Treasury would conduct a targeted public consultation on the merits of the stamping fee exemption in relation to listed investment entities. This consultation was to allow the Government to make an informed decision on whether to retain, remove or modify the stamping fee exemption in order to ensure the interests of investors are protected and capital markets remain efficient and globally competitive.[1]

Stamping fees are one-off volume-based payments made to Australian Financial Service (AFS) licensees or their representatives for their role in securing investors for capital raising, such as the initial public offerings of shares. Stamping fees are typically paid to stockbrokers, but can also be paid to financial advisers where they perform a similar role.

Conflicted remuneration is any benefit given to an Australian Financial Service (AFS) licensee or its representative who provides financial product advice to retail clients that, because of the nature of the benefits or the circumstances in which it is given, could reasonably be expected to influence the financial product advice given or choice of financial product recommended.[2]

While stamping fees represent a form of conflicted remuneration, their legislative treatment has changed over the last decade. The original 2012 Future of Financial Advice (FoFA) reforms included an exemption for stamping fees, but only relating to interests in non-investment entities or infrastructure funds. The rationale for this exemption was to ensure direct capital raising activities which support the economic activity of companies in the real economy were not impacted by the reforms.

The FoFA reforms were developed in response to the 2009 Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Financial Products and Services in Australia which identified conflicted remuneration as the leading cause of poor financial advice provided to clients.

In 2014, the stamping fee exemption was expanded to include listed investment entities including listed investment companies (LICs), listed investment trusts (LITs), and real estate investment trusts (REITs), with bipartisan support. A listed investment entity is a closed-ended fund that is listed on an exchange. Investors hold interests in the entity and the entity holds the investment portfolio. Listed investment entities issue interests via capital raisings (like initial public offerings of shares in a trading company) that are then traded on the Australian Stock Exchange (ASX).

Listed investment entities were included in the exemption on the basis that the original exemption created an inappropriate, market distorting distinction between the types of entities that are otherwise legitimately permitted to raise capital from retail investors. The exemption allows listed investment entities to pay AFS licensees or their representatives a stamping fee for access to their retail investor distribution network.

1 https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/consultation-stamping-fee-exemption.

2 *Corporations Act 2001*, s963A.

Statement of the problem

Consumers engage financial advisers to help them make informed decisions where they consider the financial system, together with their own circumstances, too complex to make unaided choices. Financial advisers, through the advice they provide, can play an important role in how their clients decide to manage their money. In undertaking this role, they must be competent, trustworthy, honest and act in their clients' best interests.

Conflicts of interest undermine these requirements as the adviser is incentivised to put their interests ahead of their client. FoFA's ban on conflicted remuneration prohibited a benefit that could influence an adviser's provision of advice instead of acting in their client's best interests. These reforms removed a large proportion of the conflicted remuneration practices from the industry and set financial advisers on the path to a higher level of professionalism and improved business practices.

Stamping fees can influence the provision of financial advice as they incentivise an adviser to recommend a product without appropriate regard to its features and characteristics, and without appropriately considering their best interests duty and other legal obligations. They also create a distortion in the funds management market that puts financial advice firms that use fees for service models at a competitive disadvantage, as they must compete with firms that can offer discounted pricing by supplementing revenue through stamping fee earnings. Investment products such as exchange traded funds, exchange traded products and managed funds are unable to pay stamping fees.

There is evidence that many listed investment entities pay stamping fees. For example, ASIC analysis found that, in relation to LICs and LITs, 45 of the 51 newly listed issuances in the five years to 2019 (and which are still listed) were issued with stamping fees with approximately half paying a 1.5 per cent stamping fee, around 22 per cent paying less and 30 per cent paying more.[3] The Listed Investment Companies & Trusts Association (LICAT) submitted that the weighted average Advisory Services stamping fee on Australian LICs and LITs was 1.32 per cent from 2015 to 2019, and fell from a weighted average of 1.66 per cent in 2015 to 1.03 per cent in 2019.

ASIC analysis suggests that, while LICs and LITs are issued at full net tangible asset (NTA)[4] value, a significant proportion trade at a discount to NTA soon after issuance which declines over time. The discount to NTA represents a real, and calculable, loss to investors who seek to exit their LIC or LIT investment.

Continued issuing activity of LICs and LITs in the face of an ongoing discount to NTA indicates mis-selling potential, while the upfront fee outlays during the capital raising process paid to advisers and associates (approximately 2-3 per cent of funds based on recent transactions) suggests there is an incentive to develop and sell these investments without having due regard to their features and characteristics, and without advisers appropriately considering their best interests duty and other legal obligations.

The specific consumer harm that arises when a listed investment entity public offer is mis-sold includes the retail investor taking on additional risk in the investment relative to their risk profile, and opportunity costs arising from the availability of a more suitable equivalent investment.

3 Five that did not pay stamping fees were the result of corporate restructures and/or did not raise capital.

4 NTA indicates the book value based on the amount of its total assets less all liabilities and intangible assets.

Stamping fees can disadvantage financial advice firms that use fee for service models where they compete with firms that can offer discounted pricing by supplementing revenue through stamping fee earnings. They can also incentivise AFS licensees to construct distribution processes that avoid personal advice obligations and retail client protections. These incentives can put investment products unable to pay these commissions, including exchange traded funds and managed funds, at a competitive disadvantage. Therefore, removing these distortions is expected to improve competitive neutrality within the funds management industry and lead to more compliant advice processes and practices.

Contextually, the broader issue of conflicted remuneration was considered by the recent Financial Services Royal Commission (FSRC) with its Final Report stating that *'the definition of 'conflicted remuneration' in the Corporations Act shows why the practice should be prohibited'*.[5] The FSRC identified conflicts of interest arising from the remuneration structures of financial advisers and argued that the remaining exemptions to the ban on conflicted remuneration were resulting in poor consumer outcomes. It recommended that Government undertake a review in 2022 to specifically consider whether each remaining exemption to the ban on conflicted remuneration remains justified.[6]

Government action needed

Historically, the Government has acted to remove conflicted remuneration practices from the financial services industry. The most recent example was the legislative reforms in 2019 to remove grandfathering arrangements for conflicted remuneration. At the time FOFA was introduced, it was considered that grandfathered commissions concerning arrangements in place prior to 1 July 2013 would have a short natural life and that grandfathering would give firms and the industry the opportunity to adjust their business models. However grandfathered payments persisted for much longer than expected with parts of the industry showing a reluctance to end these arrangements.

Without Government action to remove the stamping fee exemption, firms are expected to continue paying stamping fees. Voluntarily moving towards a more transparent fees for service model or a client directed payment approach is unlikely given that issuers and distributors of these products generally oppose the removal of the exemption and AFS licensees or their representatives have little incentive to change their fee structure while the exemption is in place.

Those who support maintaining the exemption submit that stamping fees exist to cover costs and are essential for capital raising, and that without the exemption retail investors would be prevented from accessing investment opportunities. This view needs to be weighed against the notion that if an investment represents good value to retail investors then investors should be able to cover the costs their advisers incur in making the investment. Moreover, Treasury did not find evidence to indicate that these costs are significantly greater than the costs of other financial product advice for which conflicted remuneration is banned.

There are no viable alternatives to Government intervention as the stamping fee exemption is provided under law. Unless the law itself is amended there is no way of ensuring the removal of this form of conflicted remuneration.

5 Final Report of the FSRC, Volume 1, p14.
6 Final Report of the FSRC, recommendations 2.3 and 2.6.

Policy options

The RIS considered four options to address the concerns that stamping fees are incentivising stockbrokers and financial advisers to inappropriately recommend their clients buy into listed investment entities.

The first option is to retain the existing stamping fee exemption, the second is to remove the stamping fee exemption for all listed investment entities, the third is to remove the stamping fee exemption for certain listed investment entities, and the fourth is to modify the existing stamping fee exemption through introducing a cap on fees.

The four options were tested through the four-week public consultation announced on 27 January 2020, where the Government indicated that the consultation would inform its decision on whether to retain, remove or modify the stamping fee exemption. During the consultation, stakeholders were invited to consider and frame their submission around these options, including providing views on their impact.

1. Retain the existing stamping fee exemption

Under this option, the current stamping fee exemption remains unchanged and listed investment entities can continue to pay AFS licensees or their representatives stamping fees for their role in securing investors for a capital raising.

While the consultation revealed that some entities have chosen not to include stamping fees in their fee structure, and successive inquiries, reports, reviews and the FSRC have identified the need to remove benefits that can influence the provision of advice and incentivise advisers to not act in the best interests of their clients, many listed investment entities continue to pay these fees.

This option is favoured by stakeholders who currently utilise the stamping fee exemption as they submit that stamping fees have been the traditional way that advisers and stockbrokers have charged for the work that is done in analysing a potential offering and determining the appropriateness of a recommendation to their clients. Stamping fees are seen as an administratively efficient means of being able to aggregate and remunerate AFS licensees and stockbrokers for the work being done.

2. Remove the stamping fee exemption for all listed investment entities

This option would require an amendment to the law to remove the stamping fee exemption from the general prohibition on conflicted remuneration.

Between 1 July 2013 and 11 December 2014, the stamping fee exemption did not apply to LICs, LITs and REITs. Based on a review of transactions from publicly available ASX reports and an examination of product disclosure statements and prospectuses during that time, industry moved to adopting a more transparent client directed payment approach. During this 18-month period, Treasury identified 22 investment entity listings (of which, three were LICs, nine were REITs) suggesting that capital raising by these entities hadn't been difficult without the exemption. However, REITs were impacted by the reduced participation of retail investors as the sector was heavily reliant on broker channels and the payment of stamping fees to distribute the product.

Stakeholders who support this option argue that if stamping fees are to be removed then they should be removed across all types of investment entities given that stamping fees represent a conflict of interest and cause consumer detriment.

3. Remove the stamping fee exemption for certain listed investment entities

This option would remove the stamping fee exemption only for listed investment entities where there is evidence of mis-selling potential and the related risk of consumer harm, balanced against the policy rationale for introducing the exemption in 2014.

Many of the concerns regarding the stamping fee exemption and the potential for consumer harm have related to LICs and LITs. This focus has been driven by evidence of underperformance of these investment entities and their growth in attracting retail investors. Other concerns include retail investors not understanding the risk of their investments, and that LICs and LITs show a pattern of discounts to NTA soon after issuance.

In contrast to LICs and LITs, other listed investment entities generally have an underlying portfolio of assets limiting the total amount of capital that can be raised which moderates the potential amount that can be mis-sold. The level of institutional investor participation in these entities is also higher than for LICs and LITs, which raises the level of due diligence. Data provided by the Property Council of Australia regarding REIT initial public offers on the ASX since 2016 indicated the median level of institutional participation was around 50 per cent for these investments.

Stakeholder feedback to the consultation largely focused on LICs and LITs with most who favoured the removal of the stamping fee exemption advocating that it be removed only in respect to LICs and LITs. Consultation highlighted the following:

- Investors of LICs and LITs are largely retail investors;
- A significant proportion of LICs and LITs had negative returns over the five years to 2019;
  - LICs and LITs have had an average -10.7 per cent discount to NTA;
  - LICs and LITs that paid higher stamping fees tended to persistently underperform on the secondary market compared to those that paid lower or no stamping fees;
- Management fees charged by LICs and LITs are higher than for ETFs and exchange traded managed funds;
- A lack of evidence indicating possible consumer harm from the sale of REITs and infrastructure entities.

Although there has been much debate about the performance of LICs and LITs, the policy problem to be addressed is the risk of consumer harm associated with the potential mis-selling of these products to retail investors. This option is not premised on any performance analysis nor is it a reflection on the relative merits of certain investment vehicles or investment strategies. Both closed-end (LICs and LITs) and open-end vehicles (ETFs and exchange traded managed funds) are valid investment structures and investment strategy performance will perform to varying degrees over market cycles.

The consultation feedback indicated that there is evidence of mis-selling potential of LICs and LITs with related risks of consumer harm, evidence that was not presented with regard to REITs and infrastructure entities. REITs and infrastructure entities also have capital raising activities that have a more direct impact on supporting economic activity in the real economy, a key rationale for introducing the stamping fee exemption in 2014.

Treasury notes the Government will again consider the stamping fee exemption as part of its response to recommendations 2.3 and 2.6 of the FSRC, which requires a review of all remaining

exemptions to the ban on conflicted remuneration as part of a 2022 review into the effectiveness of measures to improve the quality of financial advice.

4. Modifying the existing stamping fee exemption

This option would involve the introduction of a cap on stamping fees payable by listed investment entities.

The modification option put forward by some stakeholders would be to maintain but modify the stamping fee exemption by imposing a maximum ceiling on any stamping fee payable by listed investment entities, in order to prohibit the charging of stamping fees in excess of what is considered to be an acceptable range.

An 'acceptable range' was not put forward by stakeholders and further consultation would be required to determine the parameters. However, it is noted that from 2014 to 2019, close to half of new LIC and LIT issuances (excluding conversions) paid 1.5 per cent in stamping fees, with around 22 per cent paying less and 30 per cent paying more. This provides an indication of what is usual industry practice and would inform the development of what is an acceptable range.

Comparing the net benefits of the policy options

There are different benefits and costs associated with retaining, modifying or removing the stamping fee exemption. These are set out below under each option that was canvassed.

1. Retain the existing stamping fee exemption

Impact on retail investors

Stamping fees create a risk of consumer harm as AFS licensees and their representatives are incentivised to recommend investments that attract a stamping fee without having due regard to the appropriateness of their features and characteristics, and without appropriately considering their best interests duty and other legal obligations. This can result in retail investors being placed into investments that are not optimal for their risk profile or deliver poorer outcomes than other comparable investment opportunities.

For LICs and LITs, ASIC analysis suggests that there is a pattern of trading at a discount to NTA soon after issuance and that this has increased significantly since 2015, with the current average discount for all currently listed LICs and LITs being close to 10 per cent. This is significantly greater than the average in the US calculated by the Closed-End Fund Association of close to 3 per cent, and in the UK where the Association of Investment Companies has published an average 1.4 per cent discount to NTA as at end 2019.

The discount to NTA is an important measure as it represents a real, and calculable, loss to consumers who seek to exit their LIC or LIT investment (if they held the underlying basket of assets themselves, they could sell them at the NTA values).

The payment of a stamping fee from an issuer to an AFS licensee or their representative does reduce the upfront cost for a retail client when investing in a listed investment entity. If a client does not have to pay an upfront cost they may be more attracted to this investment option as compared to those which require an upfront fee. Stakeholders who support the retention of the stamping fee exemption submit that this benefits retail investors as they can more readily access these types of investments, providing for a more diverse range of investment options.

Impact on entities involved in issuances

This option is favoured by stakeholders who currently utilise the stamping fee exemption who submit that stamping fees have been the traditional way that advisers and stockbrokers have charged for the work that is done in analysing a potential offering and determining the appropriateness of a recommendation to their clients.

ASIC estimates that for LICs and LITs, over the five years to end 2019, stockbrokers and other financial advisers and their AFS licensees have earned over $186 million in 'stamping fees', or what public offer documents refer to as broker or adviser fees, from more than $14 billion of initial capital that has been raised.

Retaining the status quo means that listed investment entities can continue to offer stamping fees.

Impact on entities that do not access the stamping fee exemption

There are number of entities in the funds management and financial adviser industry that either choose not to receive conflicted remuneration or are unable to take advantage of the stamping fee exemption. This leads to distortions in the market and puts those entities at a competitive disadvantage as firms that use fees for service models must compete with firms that can offer discounted pricing by supplementing revenue through stamping fee earnings.

In many cases these stakeholders would favour the removal of the stamping fee exemption for listed investment entities, submitting that the removal of the exemption would bring into line the regulatory treatment for conflicted remuneration for the broader advice, managed fund and exchange-traded funds sector who are not able to pay stamping fees.

Retaining the status quo will continue this distortion.

2. Remove the stamping fee exemption for all listed investment entities

Impact on retail investors

Removal of the stamping fee exemption is expected to benefit consumers through better quality advice on investment options, as AFSL licensees and their representatives are not incentivised to recommend listed investment products without having appropriate regard to their features and characteristics. It is also expected to lead to more transparent pricing as issuers would need to move to a fee for service model or client directed payment approach.

The UK's experience shows that more transparent pricing has led to greater consumer awareness and better outcomes via improved service or better pricing of advice services. In the UK, listed investment trusts (equivalent to Australia's LICs and LITs) have been prohibited from paying commissions due to a UK/EU ban on using shareholder money to pay a person to acquire shares. Open-ended vehicles were not subject to the ban. Then in 2013, the UK banned commissions for retail investment advice. This advantaged the UK listed investment trusts, as until then, the open-ended funds were the only products in this group allowed to pay upfront and trail commissions.

The UK's Association of Investment Companies indicated that, in their view, fee transparency is a large factor driving changes in retail client participation in the advice market in the UK and rejected the notion that removal of up-front selling fees drove material change in the UK listed investment trust market. More transparency has led to better outcomes via improved services or better pricing of advice services for high net worth clients in the UK, as these consumers began to question changes and have significantly more bargaining power.

Retail investors wanting to invest in these entities would be expected to pay upfront fees for the advice they receive and any transaction costs. Having to pay upfront fees may deter some investors from seeking out these types of investments. Removal of the stamping fee may lead to certain issuers and AFS licensees or their representatives move to restrict retail investors from participating in listed investment entities given there are no restrictions on conflicted remuneration for wholesale investors.

Impact on entities involved in issuances

Removing the stamping fee exemption is expected to impact a number of industry participants operating in this market – stockbroking firms and related parties who specialise in the corporate finance and related advisory services and bring these offers to market. A removal of the exemption for all listed investment entities would prevent any entity from using stamping fees, regardless of whether their capital raising activities support economic activity in the real economy, whether they have an underlying portfolio of assets that limit the amount of capital they can raise, and the extent to which investors in the entity are retail or institutional.

Removal of the stamping fee is opposed by entities involved in marketing these investments as they see a legitimate role for stamping fees in ensuring retail investors have access to these investment products.

Those who receive the stamping fee exemption will likely experience a decline in revenue in the short term and increase their administration costs over the medium term. Removal of the stamping fee does not prevent entities from adjusting their fee structure to recoup their costs through a more transparent process. Previous experience suggests industry will likely adopt a client directed payment approach, should they maintain a selling fee. This approach was adopted between July 2013 and December 2014 when the stamping fee exemption did not apply to LICs or REITs. More transparency may, however, impact margins and lead to increased customer interest in these fees.

Other responses to the removal of the stamping fee exemption could include repricing strategies, such as increasing ongoing service fees to maintain cost recovery and margin, or adjusting the pricing of corporate finance services.

There is likely to be some transition costs, largely around implementation of new practices. Transition costs could include a period of closure for capital raisings, and lack of international fund manager interest for a period of time following the removal of the stamping fee. However, new capital raisings have largely ceased since the inception of COVID-19 and removing the stamping fee exemption ahead of any resumption in capital raising activity would minimise the impact on the market. Based on Australia's experience at the introduction of FoFA reforms and the UK's experience, transition costs are expected to be temporary and the market will predominantly revert to normal operations once the policy change is implemented.

Over the medium term, AFS licensees or their representatives may move to promote other products like ETPs or managed funds now that these investments are able to compete with listed investment entities on a more equal footing.

Impact on entities that do not access the stamping fee exemption

Removal of the stamping fee exemption is expected to benefit ETFs and ETPs and other managed investment products that are in direct competition and do not benefit from the stamping fee exemption. This would improve competitive neutrality in the funds management industry and bring the regulatory treatment of investment products into alignment with the broader advice, managed fund and ETF sector.

3. Remove the stamping fee exemption for certain listed investment entities i.e. LICs and LITs

Impact on retail investors

Similar to option 2, option 3 is expected to benefit consumers through more price transparency and better quality advice on investment options. However, retail investors wanting to access LICs and LITs may have to pay upfront fees and there is a possibility that retail investors will be restricted from participating in LIC and LIT initial public offers if the stamping fee exemption were to be removed. The Australian Financial Markets Association submitted that a key outcome of removing the stamping fee exemption for LICs and LITs would be reduced and less convenient access to investment options for retail investors.

Impact on entities involved in issuances

Removing the stamping fee exemption is expected to impact a smaller set of industry participants operating in this market than for Option 2, with the vast majority of stamping fees received by approximately 14 entities and their advisers. Participants involved in the preparation and distribution of LIC and LIT offers would similarly be expected to experience a decline in revenue in the short term and would likely enter into alternative arrangements such as increase their administration costs or transparently charge investors for advice.

The removal of the stamping fee exemption for LICs and LITs is likely to increase the competitiveness of other investment products that do not benefit from the exemption. Therefore, removing the exemption may result in fewer new LICs and LITs being issued. Similar to option 2, there may also be a period of closure for capital raisings and a lack of fund manager interest for a period of time until the policy change is implemented.

Similar to option 2, new capital raisings have largely ceased since the inception of COVID-19 and removing the stamping fee exemption ahead of any resumption in capital raising activity would minimise the impact on the market.

Impact on entities that do not access the stamping fee exemption

Similar to option 2, removing the stamping fee exemption for LICs and LITs would benefit entities who do not currently access the stamping fee exemption. Given the exemption would be retained for other listed investment entities some distortions will remain in the market and AFS licensees or their representatives may be incentivised to promote those entities that pay stamping fees.

4. Modifying the existing stamping fee exemption

Impact on retail investors

Capping the amount of the stamping fee may modify but does not remove the incentive for an AFL licensee or their representative to recommend listed investment products without having appropriate regard to their features and characteristics, and therefore there remains the potential risk of mis-selling these investments to retail investors and the related consumer harm. The presence of a stamping fee exemption, even capped, will not lead to more transparent pricing and will continue to create a potential conflict of interest between the adviser and their client.

This option would be expected to see retail clients pay less or zero upfront fees if AFS licensees or their representatives received a capped amount in stamping fees. However, a stamping fee cap would not fully address the identified problem. Stakeholders who advocate for a broad-based ban on stamping fees reject the premise that the conflict can be managed, even with a cap.

Therefore, there is likely to be only marginal differences in the benefit for retail investors between option 1 and option 4.

Impact on entities involved in issuances

A cap on stamping fees would represent a compromise between retaining and removing the stamping fee exemption, however, given the length of time required to implement a cap, its potential for introducing complexity into the law and the likelihood that many entities will still be required to adjust their fee structure, there is a risk it will create regulatory costs and a prolonged period of uncertainty for industry that may outweigh any benefits of introducing a cap.

For example, to establish an appropriate quantum for the cap, a ratio setting the maximum amount payable would need to be determined which would require new definitions and a methodology for distinguishing stamping fees from other fees in the capital raising process.

Given the cap would apply to all listed investment entities, including those where the consultation did not identify evidence of consumer harm, the potential cost of this option could be increased by the possibility the cap may only be temporary if the Government's 2022 review of the remaining exceptions to the ban on conflicted remuneration reaches a different conclusion.

Impact on entities that do not access the stamping fee exemption

Stakeholders who do not support a cap submit that the continued existence of the stamping fee exemption, even if capped, does not remove the distortion it creates in the managed funds market and the competitive disadvantage at which it puts firms that do not currently benefit from this exemption.

Net benefit of preferred option

Option 3 is the preferred option as the regulatory intervention is only extended to listed investment entities where there is evidence of the potential for mis-selling with the associated risk of consumer harm, as is the case with LICs and LITs. The capital raising activities of LICs and LITs also have less of a direct impact for supporting economic activity in the real economy than other listed investment entities, a key rationale for introducing the stamping fee exemption in 2014.

Absent the stamping fee exemption for LICs and LITs, retail investors are more likely to attain better outcomes through better risk adjusted portfolio returns with appropriate diversification as a result of investment recommendations based on their specific circumstances and risk appetite. Option 3 will also address a distortion in the funds management industry and create a more level playing field for competitor investment products that do not currently access the exemption.

The entities that are involved in marketing LICs and LITs are expected to be impacted negatively in the short term but previous experience when the stamping fee exemption did not apply indicates that these entities will be able to adjust their fee structure to comply with the policy change, for example, by adopting a fees for service model or client directed payment.

Consultations undertaken and feedback received on the stamping fee exemption

On 27 January 2020, the Government announced that Treasury would undertake a four-week targeted public consultation process on the merits of the current stamping fee exemption in relation to listed investment entities. The objective of the consultation was to allow the Government to make an informed decision on whether to retain, remove or modify the stamping fee exemption in order to ensure that the interests of investors are protected and capital markets remain efficient and globally competitive.

The public consultation was open from 29 January to 24 February 2020. Treasury sought information on current industry practices and trends, and evidence on how the current listed investment entities exemption operates within the context of:

- the quality of advice received by retail investors from stockbrokers and financial advisers, and, any subsequent impacts on investor outcomes;
- capital markets and industry participants, including their efficiency and competitive dynamics both locally and overseas; and
- the broader economy.

Treasury also sought information on the consequences of modifying or removing the stamping fee exemption if the Government chose to do so. Stakeholders were invited to submit their views on these options and in stakeholders meetings held during the consultation period.

Treasury received 54 submissions and held twelve in-person meetings with industry associations and participants, including: financial advisers and advice groups, managed funds, product issuers, stockbrokers, corporate finance groups and services providers, and stakeholders operating in the REIT and listed infrastructure space.

Stakeholder views varied (see table below).

Stakeholders involved in the issuance or distribution of products that receive a stamping fee exemption were generally opposed to the removal of the exemption. They argued that stamping fees have a legitimate role to play in ensuring retail investors have access to listed investment entities and are paid to reimburse legitimate work undertaken in capital raising. Further, it was submitted that stamping fees provide for an appropriate and administratively efficient fee to be aggregated by the issuer and paid to licensees and advisers.

Other industry stakeholders, for example, financial advice representatives and the managed funds sector, were in support of the removal of the exemption. They argued that stamping fees act as a distortive incentive that leads to conflicting advice and poor consumer outcomes, that there should be harmonised regulatory treatment of across all investment products (including managed investment funds and exchange traded funds which do not pay stamping fees), and that a continuation of the stamping fee exemption undermines confidence in the advice industry.

ASIC's submission to the public consultation largely focused on LICs and LITs. ASIC provided background on these entities and the conflicted remuneration regime, and made a number of observations informed by their regulatory oversight of the market. ASIC had updated their analysis taking into account public criticisms regarding its performance assessment of LICs and LITs, and its submission specifically responded to the criticisms of its preliminary analysis.

Principal views of stakeholders

Stakeholder group	Principal views
Financial advisers and advice groups, Managed funds, ETF/ETP providers, industry figures	Favour removal of the stamping fee exemption for LICs and LITs. Argue that the regulatory treatment of investment products should be harmonised. Note that continuation of stamping fees could undermine confidence in the advice industry. Question the value proposition of LICs/LITs for retail investors.
LIC/LIT issuers	Oppose any change to the exemption. See a legitimate role for stamping fees in ensuring retail investors have access to LIC/LIT products. Claim if the exemption removed then moving to a model of client directed payments would be the natural response, though an inefficient one.
Stockbrokers/wealth management firms	Generally unsupportive of removing the exemption. If change required, suggest placing a cap on stamping fees allowed. Oppose changes that impact JLM fees. Argue that stamping fees are paid to reimburse legitimate work on behalf of brokers, and note issue costs are covered with JLM fees. Claim if the exemption removed then moving to a model of client directed payments would be the natural response, though an inefficient one.
Corporate finance groups and service providers	Oppose any change in fee structure that impacts JLM fees. Note the work involved in capital raisings and the use of internal protocols to prevent conflicts of interest. As with stockbrokers and issuers, note the one-off distribution costs required within a short time period, compared to managed funds and ETPs which have continuous distribution, sales and marketing efforts as the products are available for issue and redemption on an ongoing basis.
Consumer advocates	Favour removal of all conflicted remuneration. Argue that it is causing clear consumer detriment.
REITs and listed infrastructure	Mainly oppose removing the exemption. Argue that REITs and listed infrastructure entities exhibit different characteristics as a product class and should not be subject to any change.

Stakeholder feedback provided valuable insights regarding the operation of the stamping fee exemption, including the capital raising process, the fee structure relating to capital raisings, how stamping fees can influence the advice provided to clients, the impact of stamping fees on the efficiency and competitive dynamics of capital raisings, the performance of LIC/LIT products, and the potential risk of consumer harm where LIC and LIT public offers are mis-sold to retail clients. Feedback also revealed the different characteristics of listed investment entities (LICs, LITs, REITs and listed infrastructure investments), and potential options for addressing the policy problem.

The preferred option is to remove the stamping fee exemption for certain investment entities

The public consultation revealed that stamping fees can potentially create conflicts of interest for an AFS licensee or their representative to mis-sell a particular investment to a consumer, with continued issuing activity of LICs and LITs in the face of an ongoing discount to NTA indicating mis-selling potential. The specific consumer harm that arises when a LIC or LIT is mis-sold includes additional risk in individual investments relative to the client's risk profile and opportunity costs if a more suitable equivalent investment was available. Stamping fees also create a distortion in the funds management industry that disadvantages firms that use fees for service models, and may incentivise an adviser to recommend a product with appropriate regard to its features and characteristics and without appropriately considering their best interests duty and other legal obligations.

Treasury considered four options for addressing the policy problem and concluded that the best option is to remove the stamping fee exemption for LICs and LITs, but retain for other listed investment entities (trading companies (including hybrids), REITs and listed infrastructure entities) (Option 3).

Removing the stamping fee exemption for LICs and LITs will address the conflicts of interest that stamping fees potentially create for an AFS licensee or their representative to mis-sell these products to a consumer, will improve competitive neutrality in the funds management industry by removing a distortion that disadvantage firms that use fees for service models, and encourage more compliant advice processes and practices.

Maintaining the existing treatment for other listed investment entities will ensure that the direct capital raising activities which support the economic activity of companies in the real economy are not impacted by this regulatory change. These other listed investment entities also generally have a fixed supply of underlying portfolio of assets limiting the total amount of capital that can be raised which moderates the potential amount that can be mis-sold.

The public consultation highlighted that there are different stakeholder views regarding the use of stamping fees and whether the current stamping fee exemption should be retained, removed or modified. The decision-making process assessed the evidence collected during the consultation and weighed the various arguments presented by stakeholders, concluding the best option is to limit the regulatory response to address areas where there are clear risks of consumer harm while maintaining existing treatment for direct capital raising activities which support the economic activity of companies in the real economy.

Implementing the preferred option

Removing the stamping fee exemption for LICs and LITs will be implemented via Regulation. Treasury will undertake public consultation on the draft Regulation to ensure that the boundary between investment entities that can and cannot access the exemption is clearly defined and workable for industry.

The Regulation will take effect from 1 July 2020. This will enable the extension of the ban on conflicted remuneration to take affect ahead of any resumption of capital raising activity which has largely ceased during the current COVID-19 period. Clarifying these arrangements will address any related risk of consumer harm and ensure that stockbrokers, financial advisers and investment managers are clear about the regulatory settings that will apply in this area and investors can invest with confidence in these products.

There are no transitional arrangements in place for this policy.

In the lead-up to and following the introduction of the Regulation, ASIC will actively monitor these arrangements to ensure that industry is appropriately complying with the policy change.

The Government has committed to implementing recommendations 2.3 and 2.6 of the FSRC. This requires that the remaining exemptions from the ban on conflicted remuneration be reviewed as part of a broader review into the effectiveness of measures that have been implemented by the Government, regulators and financial services entities to improve the quality of financial advice, to be completed in 2022.

Status of this Regulatory Impact Statement (RIS)

This RIS has been prepared and published for transparency purposes following a four week public consultation on the options outlined in this RIS. It was prepared following the Government's decision to remove the stamping fee exemption for LICs and LITs on 21 May 2020 and was not assessed by the Office of Best Practice Regulation prior to the announcement. However, this RIS demonstrates that a number of options were considered and tested with stakeholders prior to the Government's decision to announce the removal of the stamping fee exemption for LICs and LITs. The public consultation process enabled a range of stakeholders to provide their views on the options being considered which allowed the Government to make an informed decision.