FINANCIAL SERVICES COUNCIL

Treasury Laws Amendment (2023 Measures No 1) Bill

FSC Submission to Senate Economics Committee

April 2023

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1 About the Financial Services Council

The FSC is a peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advice licensees. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing more than $3 trillion on behalf of over 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is one of the largest pool of managed funds in the world.

The FSC's mission is to assist our members achieve the following outcomes for Australians:

- to increase their financial security and wellbeing;
- to protect their livelihoods;
- to provide them with a comfortable retirement;
- to champion integrity, ethics and social responsibility in financial services; and
- to advocate for financial literacy and inclusion.

2 Introduction

The FSC welcomes the opportunity to provide a submission to the Senate Economics Committee on the Treasury Laws Amendment Bill (2023 Measures No 1) (**The Legislation**).

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This submission focusses on Schedules 1, 2 and 5 to the Legislation.

3 Schedule 1 – Registration of providers and assisted decision making

The Corporations Amendment (Registration of Relevant Providers) Regulations 2022 has implemented an extension to 1 July 2023 for financial advisers to self-register. Schedule 1 to the Legislation provides the mechanism for giving effect to the registration process in enabling dual registration of financial advisers and allows ASIC to administer this registration through automated tools to support that process. The Legislation has not yet passed Parliament and is currently before the Senate Economics Committee.

The current timeframe for the passage of this legislation and the already legislated 1 July 2023 deadline for individual registration, will potentially give numerous advisers only a few weeks to comply with the obligations – that is to self-register and be authorised as a representative of the Australian Financial Services License holder (AFSL-holder). This also does not account for the additional time it will take for ASIC to conduct the appropriate system build. ASIC argues they cannot act outside the powers of existing legislation meaning it cannot undertake pre-emptive measures to prepare the industry to comply with the obligations under the Legislation. For example ASIC states they are unable to provide information sheets or other guidance in advance, which would enable the industry to be fully aware of their obligations and can ensure they comply.

The tight turnaround between the Bill passing and the 1 July 2023 deadline requiring registration means significant levels of non-compliance is a risk which the Regulator has indicated it is aware of. ASIC is ultimately limited in what it can do to prepare industry for meeting its obligations until both the law passes and the commence date of Schedule 1 is aligned to the date of individual registration. This will resolve the unintended consequence of technically thousands of advisers are potentially in breach of the individual registration requirements.

The FSC **recommends** the Bill is amended to allow for a six month delay to the commencement of this provision to enable advisers to comply with its requirements to align with the extension of individual adviser registration made under the Corporations Amendment (Registration of Relevant Providers) Regulations 2022, and to provide ASIC adequate time to adapt the appropriate system builds required.

Assisted decision making

We note the proposed wording in section 921ZF regarding assisted decision making would read as follows:

(1) ASIC may arrange for the use, under ASIC's control, of processes to assist decision making (such as computer applications and systems) for any purposes for which ASIC may make decisions in the performance or exercise of ASIC's functions or powers under this Division

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This is the same as the current wording in section 270E, set our below, save for the emphasized text:

Assisted decision making

(1) The Registrar may arrange for the use, under the Registrar's control, of processes to assist decision making (such as computer applications and systems) for any purposes for which the Registrar may make decisions in the performance or exercise of the Registrar's functions or powers under this Act, ***other than decisions reviewing other decisions*****.**

The FSC **recommends** that the proposed wording in section 921ZF is aligned with the existing wording in section 270E. If there is a rationale for the divergence, this should be explained.

4 Schedule 2 – Sustainability Standards

The FSC welcomes that the Government is moving forward with its election commitment to introduce climate related sustainability disclosure standards in Australia.

The FSC has previously provided support in a submission for the *Treasury Laws Amendment (Measures for Consultation) Bill 2022: Sustainability Standards*. Similarly, this Bill would empower:

- the Australian Accounting Standards Board (AASB) to formulate sustainability standards,
- the Auditing and Assurance Standards Board (AUASB) to formulate auditing and assurance standards for sustainability purposes, and
- the Financial Reporting Council (FRC) to have oversight of the process of developing sustainability standards in addition to accounting standards and auditing standards.

Investors consider climate change as a real financial risk to their investment portfolios and the savings of millions of Australians. In order to facilitate the efficient allocation of capital, fund managers need comparable and consistent disclosure of the climate-related financial risks and opportunities that climate change poses to investee companies. A disclosure regime that requires the reporting of climate-related financial risk across Australian companies is vital in ensuring that investment decisions can be made in the best long term financial interest of Australians. It will provide investors with confidence that Australian companies are properly considering the risk that climate change poses to their business and operations. Greater investor confidence will mean Australia is better placed to attract climate risk aware capital, take advantage of the technological and energy transition, and meet its emissions reduction commitments.

We welcome that this Bill makes provision for the ASSB to draw on an international sustainability standard, modifying it to the extent necessary to take account of the Australian legal or institutional environment. Given the global nature of capital movement, it is vital that Australian standards align with the International Sustainability Standards Board (ISSB) standard and are interoperable with sustainability standards in the jurisdictions of Australia's

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major trading partners. This will open more opportunities for capital seeking long term sustainable returns and opportunities to flow to Australian companies.

We consider this Bill an important first step. The FSC looks forward to continuing to support the Government's work in delivering on its commitment to introduce a mandatory climate-related financial risk reporting regime for corporate Australia.

5 Schedule 5 – Franking of certain distributions funded by capital raisings

The FSC welcomes changes in this Schedule 5 from the previous draft of this proposal, contained in a consultation draft released in September 2022.[1] In particular, the FSC welcomes the limitation of the retrospectivity of this measure.

However, the FSC is concerned that the measure still creates a risk that some capital distributions could be affected by the measure, and some the franking of some capital distributions could be assessed as incorrect after the distribution occurs.

5.1 Impact on investors

It is currently unclear how the measure will operate for investors, including individual shareholders as well as managed funds and superannuation funds. Investors that receive a franked dividend (or a dividend that purports to be franked) are usually able to rely on the franking credits as presented in the distribution statement. This means that if a company makes an error in reporting franking, then the investor (generally) is unaffected.

However, there is a limitation to this approach in the law before the parliament. Where a franking credit stated in a distribution statement exceeds the maximum franking credit for the distribution, then the franking credits allowed to the investor are limited to this 'maximum franking credit'. The measure in Schedule 5 makes certain distributions 'unfrankable', this could reduce the maximum franking credit below the amount that is reported in a distribution statement.

Any solution to this issue should have no impact on the investor – the investor should not need to make a change to their tax return.

The FSC **recommends** that the legislation be amended to ensure that where an entity has a distribution that is made unfrankable due to this measure, then the impact of cancellation of franking is imposed on the distributing entity, and investors do not feel a (direct) impact of this change.

If this is change does not occur, the FSC submits Schedule 5 will impose substantial and unnecessary costs on investors, as detailed in Section 5.3 below.

[1] See: TBA

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5.2 Certainty

Separately from the issues from the investor-specific issue raised above, the FSC notes that the measure will create uncertainty for companies and other entities that make frankable distributions. The FSC submits the best way to reduce this uncertainty would be for the ATO to provide guidance with substantial safeharbours for companies, combined with a speedy and efficient tax ruling system.

- Some safeharbours could be, for example, that the measure will not apply where a relevant capital raising has been requested or recommended by a regulator; and it will not apply if dividends and capital raisings are within a (wide) percentage band of historical figures (including consideration of profit retention ratios). Special guidance will be needed for abnormal situations such as capital raisings for a planned acquisition that does not proceed, and major economy-wide shocks such as COVID−19.

The FSC **recommends** that the Government and the ATO commit to providing guidance with safeharbours, and a simpler and speedy rulings system for companies that are unable to use the safeharbours.

The normal ruling process would be costly and not timely for many companies. Companies, the ATO and (ultimately) taxpayers will incur high costs and resources from the large number of standard ruling requests – this will be avoided if significant safeharbours are provided.

If companies do not seek rulings, then there are significant risks to companies (and possibly investors):

- Companies would face a risk of having distributions reviewed and amended by the ATO. This would create substantial and arguably unnecessary uncertainty in the market.
- A capital raising encouraged or requested by a regulator could be caught by the measures. Any franked distribution subsequent to these capital raisings might be at risk of being targeted by the measure, even when the original capital raising was supported by regulators.[2]

5.3 Risks if impact falls on investors

If the impact of this measure is felt by investors, then this will create uncertainty for many investors, including fund managers, superannuation funds and Investor Directed Portfolio Services (**IDPS**) platform administrators (collectively **investment managers**). Some risks include:

[2] On 7 April 2020, APRA stated in a letter to banks that “Dividend payments should be offset to the extent possible through the use of dividend reinvestment plans and other capital management initiatives.” – this statement, on the face of it, supports dividend payments funded by capital raisings. A similar sentiment was expressed in an APRA letter to banks of 29 July 2020.

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- An investment manager that receives a franked dividend may face the risk that the franking will be cancelled, potentially after the benefits of franking have been passed on to investors.
- An investor affected by the measure may have to amend their tax return. There will be practical difficulties in implementing this for a widely held company, a company that has subsequently wound up, or for foreign shareholders.
- Investment managers if they or their investors own shares in a company that faces an amendment of an earlier distribution, including the following issues:
    - In some cases, there would be a need to amend numerous historical tax statements of investors in the relevant fund or company – in some cases this might affect millions of Australians. These individuals will need to re-lodge tax returns at considerable cost and inconvenience.
        - The relevant funds or administrators would face extensive critical feedback about poor member experience completely outside their control.
        - A distribution to a non-resident would become subject to non-resident withholding tax. Managed funds would have under-withheld tax and the fund manager would have to wear the tax cost from a circumstance that was outside their control.
    - In many other cases, the cost of the change will be paid by current members of a managed fund or superannuation fund, in which case there would be inequity between historical and current members of the relevant funds.[3] Historical members would have received excessively high distributions, and current members would pay for this.
        - If the level of inequity were material, the relevant funds could face member legal action in response.

5.4 Scope of proposed measure

The FSC has concerns that the measure applies to an entire distribution even if the tests are only satisfied in relation to part of the distribution (EM at 5.36). The FSC considers this aspect of the legislation is not warranted.

The FSC **recommends** that the measure should only apply to that part of a distribution that is funded by a capital raising – that is, that part of a distribution that meets the tests in Schedule 5.

[3] For example, an Attribution Managed Investment Trust (AMIT) might use ‘unders and overs’ to deal with the change in the franking of a previous distribution.