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1 May 2013

Dear Mr Dijsselbloem

Consultation Document "Amendment Act 2014 to the Dutch Act on Financial Supervision" – Proposed Section 168a

We very much appreciate the opportunity to provide the Dutch Ministry of Finance with our views on the proposed Section 168A of the Dutch Decree on Conduct of Business Supervision of Financial Undertakings under the Dutch Act on Financial Supervision (the "**Revised Decree**").

The objective of the Revised Decree appears to be to prohibit investment firms subject to Dutch conduct of business supervision from paying to or receiving from third parties any commission/rebates in relation to the provision of investment services or ancillary services on the basis that:

- The existing Dutch rules on payment and receipt of commission/rebates (including transparency requirements) have proved to be insufficient to adequately address the issues arising from the payment and receipt of commission/rebates.
- The payment and receipt of commission/rebates may encourage investment firms to promote interests other than those of their clients, prejudicing their commitment to promote the interests of their clients in an honest, fair and professional manner[1].
- Direct payment of fees by clients for intermediary investment services and ancillary services will serve to make investment costs more transparent to clients.

We strongly support the Revised Decree for the reasons more fully described in the remainder of this response. In summary, we welcome that the Revised Decree should:

- reduce the risk of intermediary conflicts of interest affecting the products that are purchased by/for end investors (section 2.1);
- increase product competition, meaning a wider variety of products are available for Dutch investors to purchase (section 2.2);
- increase cost transparency (see section 2.3);
- reduce the risk of regulatory arbitrage (section 3.1); and
- encourage early transition to new intermediary charging models (section 3.3).

[1] Section 4:90(1) Wft

1. Background on Vanguard

The Vanguard Group, Inc. ("**VGI**") began operations in the USA in 1975 and is headquartered in Valley Forge, Pennsylvania, USA. Today VGI (together with its affiliates, as appropriate, "**Vanguard**") operates in Europe, Asia, Australia and Canada. In Europe, Vanguard Asset Management Limited ("**VAM**") (a wholly owned subsidiary of VGI) is based in London and has branch offices in Amsterdam and Paris, as well as a sister office in Zurich, Switzerland. VAM's Dutch branch has been in existence since 2011[2] and is passported under the Markets in Financial Instruments Directive ("**MiFID**") to provide a variety of investment services, including reception and transmission of orders, investment advice and placing of financial instruments without a firm commitment basis. As at 31 December 2012, Vanguard managed more than US$ 2.1 trillion in assets worldwide (making it one of the world's largest and most respected investment management companies). VAM currently manages US$ 32 billion of these assets and this figure is expected to grow significantly in the coming years as Vanguard further grows its European capabilities.

Vanguard aims to offer investors the highest value investment products and services available and has an unwavering focus on investor value and costs. VGI is owned by Vanguard's US domiciled mutual funds, which in turn are owned by the investors in those funds. This means that Vanguard's US-domiciled mutual funds are managed at cost, which keeps expenses low, maximising investor returns. VAM operates with the same intention and focus, which is reflected in our philosophy, policies and practices.

It is Vanguard's global policy not to pay third parties to distribute its funds, whether through providing commissions, rebates, shelf space fees or other payments or inducements. Instead Vanguard works with fee based investment professionals who appreciate Vanguard's low cost, quality diversified fund range.

VAM responds to this consultation as Vanguard is a provider of UCITS funds that are distributed in the Netherlands, rather than as an intermediary that would fall within the scope of the Revised Decree.

2. Vanguard's Support for the Revised Decree

Vanguard was a vocal proponent of the Retail Distribution Review ("**RDR**") in the United Kingdom, which was introduced on 31 December 2012 to, amongst other things, ban the payment and receipt of commission, remuneration or benefits of any kind in respect of advised sales of "retail investment products" to retail clients in the United Kingdom. For similar reasons we strongly support the Revised Decree on the basis that it should:

- reduce the risk of intermediary conflicts of interest affecting the products that are purchased by/for end investors;

[2] Prior to this, the Vanguard group had a presence in the Netherlands through a representative office of Vanguard Investments Europe S.A., a Belgian licensed investment management company/portfolio manager (which has subsequently been wound up).

- increase product competition, meaning a wider variety of products are available for Dutch investors to purchase; and
- increase cost transparency.

2.1 Reduced Risk of Conflicts of Interest

Under the current Dutch regime, intermediary firms can earn different amounts of money from product providers depending on which particular provider's product they select. The explanatory note to the Revised Decree suggests that investor awareness of the commissions being paid to intermediaries has not effectively mitigated the risk of remuneration bias impacting the selection of products by intermediaries. Indeed, it is our view that many investors fail to appreciate that commission payments increase underlying product cost and, therefore, have the potential to act as a drag on their investment potential. Currently the risk remains that intermediaries are incentivised to negotiate high levels of commission/rebates with product providers and that, in turn, their selection of fund units is motivated by remuneration from the intermediary firm, rather than the best interests of the end investor. This is both potentially detrimental to end investors and serves to undermine trust in the asset management industry.

The replacement of payment through product provider commission/rebates by investor service charges reduces the incentive for intermediary firms to select potentially less suitable products generating high commission payments over products with lower or no commission. As such, we would expect that the Revised Decree should remove product provider bias, thereby putting the needs and interests of investors ahead of the interests of intermediary firms.

2.2 Increased Product Competition

To the extent that product provider bias is reduced, we believe that more healthy competition will flourish between investment products based on their price and quality. As such, the prohibition of the receipt by Dutch intermediaries of rebates/commissions should allow competitive forces to work in favour of end investors, improving the extent and quality of investment products available.

Vanguard's view is that current Dutch intermediary remuneration arrangements involving commission/ rebates being paid by product providers may have an adverse impact on the range of investment products available to Dutch investors. Vanguard's own experience supports this conclusion. Whilst our range of low cost funds is available to all intermediaries, we have been most successful with fee-based intermediaries that value Vanguard's cost-focussed approach. We have thus far generally been less successful in persuading commission/rebate based intermediaries to carry our funds on a commission/rebate free basis. In addition, we believe that the Revised Decree could increase the availability through Dutch intermediary platforms of "new" cost effective products that historically have not included a distribution fee in their product charges (such as exchange traded funds). Clients who use commission/rebate based intermediaries may be unaware and not appreciate that certain products are effectively not available to them. It seems to us that this outcome cannot be in the best interests of

investors in the Netherlands. We consider that the imposition of the prohibition on commission/rebates under the Revised Decree would be a decisive factor in resolving these access problems.

Product price and intermediary charging competition could also result in better value for money for investors. We believe that successful implementation of the Revised Decree could lead to a significant reduction in the charges of product providers that have to date not introduced "clean" share classes for Dutch distribution. Indeed, our experience in the United Kingdom has been that fund product charges have reduced by approximately 75 basis points since implementation of the RDR. Even if the aggregate cost of intermediary and product charges following implementation of the Revised Decree equates with current product charges, the increase in cost transparency will be in investors' best interests.

2.3 Increased Transparency

Vanguard believes that investors should be able to discern the cost of services they are paying for, including: intermediary services; the cost of the product; and any administration costs. Where product charges are kept at a level that allows a rebate to be routinely paid to an intermediary, the true price of both the product and the intermediary service is obscured. We believe that it is important that intermediary charges are not "disguised" as product charges. The Revised Decree should help achieve this objective. In addition, as mentioned above, we expect that the Revised Decree will aid investor led price competition.

3. Comments on the Revised Decree

3.1 Scope

Despite being wider than the scope of Article 24 of the 15 April 2013 draft of the European Council's revised MiFID, we strongly support the application of the Revised Decree to: (i) the provision of individual portfolio management, investment advice and execution-only services (ii) in respect of all MiFID instruments (iii) to retail and professional clients.

We agree with the statements in the explanatory note to the Revised Decree that product provider remuneration of intermediaries has the potential to inappropriately influence the provision of each of individual portfolio management, investment advice and execution-only services. In addition, there is a genuine risk that excluding one of these "traditional distribution" services from the scope of the Revised Decree could encourage intermediaries to alter their service offering to permit the continued receipt of commissions/rebates to the detriment of end investors. Indeed, prior to the implementation of the RDR the United Kingdom's Financial Services Authority expressed concern[3] that a number of intermediary firms were transferring retail clients from an advisory service (within the scope of RDR) to an individual portfolio management service (outside the scope of RDR) and that one factor in such decision may have been the ability of the intermediary firm to continue to receive product provider commission/rebates in

[3] See for example the FSA's Guidance on the Suitability of replacement business and centralised investment propositions: http://www.fsa.gov.uk/static/pubs/guidance/fg12-16.pdf

respect of the provision of an individual portfolio management service. The proposed approach by the Dutch Ministry of Finance should also help avoid much detailed consideration for both in-scope firms and the AFM as to the precise scope of services being provided by an intermediary to a particular client (for example, whether recipients of a discretionary management service also are receiving investment advice)[4]. Furthermore, this approach should also help avoid unnecessary confusion for product providers arising from having to determine in respect of each individual investor whether an intermediary is providing services that permit generation of commission/rebates or not.

We also applaud the Dutch Ministry of Finance's attempt to mitigate product bias (for example, between fund units and life insurance products) by introducing a level playing field for remuneration of intermediaries distributing "MiFID products" (pursuant to the Revised Decree) and "non-MiFID products" (pursuant to the current ban on inducements in relation to financial services providers, applicable as of 1 January 2013).

We note that the Revised Decree proposes to continue to permit investment firms to receive third party commission/rebates in respect of underwriting/placing on a firm commitment basis and placing without a firm commitment basis, provided that the firm complies with the requirements derived from Article 26 of the MiFID Implementing Directive (2006/73/EC). We understand that this is on the basis that these MiFID investment services are provided to the primary market, rather than the secondary market. We consider that there may be merit in the Revised Decree being drafted so as to explicitly reference this primary market distinction. This would avoid the risk that an investment firm seeks to categorise its secondary market distribution activities as placing without a firm commitment basis (rather than, for example, investment advice or execution-only services) in order to continue to receive product provider commission/rebates. Many intermediary firms will have permission to place MiFID financial instruments, as well as to provide individual portfolio management, investment advice and execution-only services.

Finally, we note the prohibition does not apply to commission necessary for the provision of the service concerned or which enables the service concerned[5]. We assume that in light of the wide definition of "commission" this exemption would apply to the provision by product providers of non-monetary benefits, such as educational materials, to intermediary firms which are necessary for such firms in the provision of investment services to end investors. At the same time, we would suggest that Section 168a(2)(b) of the Revised Decree should be interpreted narrowly. Otherwise, there is a risk that "distribution" payments made by product providers to intermediaries will simply be recharacterised as "necessary for the provision of the service concerned or which enable the service concerned", despite being of questionable value to the interests of investors.

3.2 Intermediary commission/rebates passed on to end investors

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[4] See, for example, the FSA's guidance to the industry about when about when discretionary investment management services might fall under the scope of the RDR on page 2 of the RDR Newsletter issued by the FSA in June 2011 (http://www.fsa.gov.uk/static/pubs/newsletters/rdr2.pdf).

[5] Section 168a(2)(b) of the Revised Decree.

We interpret Section 168a(1) of the Revised Decree as prohibiting the receipt (rather than retention) of commissions/rebates by intermediary firms subject to Dutch conduct of business supervision. In this regard, the Revised Decree is wider than Article 24 of the 15 April 2013 draft of the European Council's revised MiFID, which appears to permit the pass through of commissions/rebates to end investors.

We support the prohibition applying to the receipt (rather than retention) of commissions/rebates by intermediary firms subject to Dutch conduct of business supervision as we do not believe that the potential for product provider commission to bias the provision of intermediary services, or to undermine investor trust, can be properly dealt with while product providers continue to set commissions receivable by intermediary firms. There is a risk that in such case an intermediary may set its intermediary charges by reference to the rebate available to be paid by the product provider on the basis that this rebate will then be used by the end investor to pay outstanding intermediary charges. Moreover, where product provider commissions/rebates are to be passed on by an intermediary to an end investor, a product provider has limited ability to ensure that the commissions/rebate end up in the hands of the investor. Imposing contractual undertakings on the intermediary and mandating disclosure of the rebate to the end investor helps mitigate this risk, but does not remove the risk entirely. End investors do not need to suffer financially from such a prohibition. Current distribution arrangements which include the pass-through of commission/rebates to end investors can be replaced in a more transparent fashion by the introduction by product providers of "clean" share classes with differentiated pricing. The RDR has already resulted in a proliferation of such "clean" share classes.

In this regard, we note that the Revised Decree is consistent with the decision of the United Kingdom's Financial Services Authority (now the Financial Conduct Authority) under the RDR to ban retail investment advisory firms from receiving commission from product providers and rebating it on to the end investor[6].

3.3 One year transitional period

We fully support the strict one year transitional period proposed in the Revised Decree as we consider that this will help to ensure that investors fully benefit from the Revised Decree as early as possible. Providing an open-ended transitional regime for "trail commission" arising from transactions concluded prior to 1 January 2014 would have created a tail of business in respect of which commissions/rebates could continue to be paid for many years in the future, in contrast to new business. Such an approach would not actively have encouraged the intermediary community to fully engage in transitioning away from conflicted remuneration structures. In addition, it would have forced some product providers to continue to operate both "clean" and "bundled" share classes for the foreseeable future, further increasing the proliferation of share classes. The consequent confusion for investors in respect of the different share classes and additional costs arising for product providers (which in turn would likely have been borne by investors) would not have been a good outcome for investors.

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[6] See Rule 6.1A.4(2) of the Conduct of Business Sourcebook to the Financial Conduct Authority's Handbook of Rules and Guidance: http://fshandbook.info/FS/html/handbook/COBS/6/1A.

Nevertheless, the strict one year transitional period does not remove all risk in this regard entirely. During the one year transitional period, we would encourage the AFM to remain vigilant to intermediary procrastination as regards legacy pre-January 2014 investments, which may be encouraged by intermediaries seeking to preserve commission/rebate revenue flow rather than act in clients' best interests. The FSA identified this as a key risk during the implementation of RDR, despite having introduced comprehensive rules on the treatment of legacy pre-RDR investments[7].

3.4 Lessons learned from the RDR

The Revised Decree and explanatory note are clear and concise as to the Ministry's objectives in this area. Nevertheless, it is evident from the extent of materials produced by the United Kingdom's Financial Services Authority in respect of the RDR that the diversity of intermediary service level offerings and commission/rebate remuneration arrangements mean the precise perimeter of a prohibition on commission/rebate based remuneration can be difficult to fix down through legislation/regulation alone.

Our experience of the RDR suggests that the success of the Revised Decree can be increased as a result of the AFM being guided by four key principles:

1. Prevention of distribution channel bias;
2. Avoidance of product bias;
3. Prevention of intermediary procrastination; and
4. Implementation of a narrow definition of "commission necessary for the provision of the service concerned or which enables the service concerned".

The wide scope of the Revised Decree should help these principles be achieved and reduce the risk of regulatory arbitrage that was a concern at the time of implementation of the RDR. We would also support any further clarity/guidance that can be provided to the industry in respect of this initiative, such as:

- examples of good and poor practice; and
- regulatory monitoring of the market to identify (and prevent) bad practices that could indicate non-compliance with rules on suitability and clients' best interests, such as significant (i) increases in the sale of high commission-generating products leading up to the implementation of the Revised Decree; and (ii) reduction in intermediary activity in respect of legacy pre-January 2014 investments during the one year transitional period.

Thank you for the opportunity to comment on the Revised Decree. If you would like to discuss these comments further or our experience of the RDR in the United Kingdom more generally, you can contact

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[7] See section 1.7 on page 6 of the Financial Services Authority's Policy Statement 12/3: http://www.fsa.gov.uk/static/pubs/policy/ps12-03.pdf.

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Yours sincerely,

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