Vanguard INVESTMENTS®

22 December 2011

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
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Parliament House
Canberra ACT 2600
Australia

Senate Economics Committees, SG.64
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By email: corporations.joint@aph.gov.au, economics.sen@aph.gov.au

Dear Sir/Madam

Inquiry into Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011

Vanguard Investments Australia Ltd (Vanguard) makes this submission in relation to the proposed ban on volume-based shelf space fees in the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (**FOFA 2 Bill**) in Schedule 1, Item 24, Division 5, Subdivision A.

1. Vanguard

Vanguard is a wholly owned subsidiary of The Vanguard Group, Inc. which is based in the US and currently manages over US$1.8 trillion (A$1.7 trillion) for nearly 25 million individual and institutional investors. In Australia, Vanguard has been helping investors meet their long-term financial goals with low cost indexing solutions for nearly 15 years.

It is Vanguard's global policy to not pay incentives to sell, promote or provide access to our products. Therefore we strongly support the proposed amendments in the Bill to ban the receipt of certain remuneration which has the potential to distort the quality of advice received by investors, including volume-based rebates paid to dealer groups and advisers.

2. Volume-based rebates between product manufacturers and platforms

Vanguard has previously made a submission to the Department of the Treasury on the exposure draft of the FOFA 2 Bill (included at Attachment 1 to this submission) (**Submission to Treasury**).

In that submission, we outlined Vanguard's view that, for the legislation to achieve the objectives of the FOFA reforms, there should be a requirement to pass any volume-based benefit from product manufacturers to platforms

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through to the end investor. This is consistent with the practice of some major platform operators currently.

We submitted that even rebates that are considered by platforms and fund managers to reflect reasonable scale efficiencies may influence the product options that an adviser gets access to through platforms unless the cost benefit is delivered through to the end investor.

In the FOFA 2 Bill, the exemptions from the definition of volume-based shelf-space fee have been broadened from the exposure draft.

In the proposed section 964A(3), there is now an exemption for a "reasonable fee for service" as well as the exemption for a benefit "the value of which does not exceed an amount that may reasonably be attributed to efficiencies gained by the funds manager". There is no requirement to rebate any fee or benefit to the end investor. There is a risk that platform providers that currently rebate these payments to investors will cease to do so as these reforms permit the platform provider to retain the payment.

There is also very little guidance on what is a "reasonable fee" or "an amount that may reasonably be attributed to efficiencies gained". It is difficult to see these reforms bringing about any change in market practices with such wide and undefined exemptions.

The Explanatory Memorandum suggests that platform providers should take into account the relative bargaining power between the product manufacturer and the platform operator in determining whether a payment represents the reasonable value of scale efficiencies. This suggests that a product manufacturer may be able to continue to exert influence over the products offered to investors through platforms.

As outlined in more detail in our attached Submission to Treasury, we suggest that there should be a requirement to rebate the value of these payments through to the end investor. This would provide greater business certainty, would be consistent with the practice of some major platforms currently and would allow product manufacturers and platform providers to continue existing arrangements, provided that the benefit is passed through to investors.

Vanguard would be pleased to provide any further assistance or analysis in relation to these reforms. Please contact me on 03 8888 3832 or robin.bowerman@vanguard.com.au if you would like to discuss this matter further.

Yours faithfully,

Robin Bowerman

Principal and Head of Corporate Affairs and Market Development

Encl – Vanguard's submission to the Department of the Treasury consultation on the Exposure Draft - Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011

Vanguard INVESTMENTS®

21 October 2011

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Dear Sir/Madam

Exposure Draft - Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011

Thank you for the opportunity to comment on the exposure draft of the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (**Bill**) and associated explanatory material.

1. Background

Vanguard Investments Australia Ltd is a wholly owned subsidiary of The Vanguard Group, Inc. which is based in the US and currently manages over US$1.8 trillion (A$1.7 trillion) for nearly 25 million individual and institutional investors. In Australia, Vanguard has been helping investors meet their long-term financial goals with low cost indexing solutions for nearly 15 years.

Vanguard has an unwavering focus on investor value. The Vanguard Group is owned by our US domiciled mutual funds, which in turn are owned by the investors in these funds. This means that the funds are managed at cost, which keeps expenses low, maximising investor returns. Vanguard in Australia operates with the same intention and focus which is reflected in our philosophy, policies and practices.

In line with this philosophy, Vanguard is committed to supporting financial advisers in a way that puts investors' interests first. As such, Vanguard strongly supports the guiding principles of the Future of Financial Advice (FOFA) reforms, that financial advice should be in the client's best interests, that payments that distort the quality of advice should be minimised and that financial advice should be more accessible to investors.

It is Vanguard's global policy to not pay incentives to sell, promote or provide access to our products. Therefore we strongly support the proposed amendments in the Bill to ban the receipt of certain remuneration which has the potential to distort the quality of advice received by investors, including volume-based rebates paid to dealer groups and advisers.

This submission is directed to the proposals in the Bill that relate to volume-based payments between product manufacturers and platforms (Schedule 1, item 11, proposed Subdivision 5B).

2. Volume-based rebates between product manufacturers and platforms

Platforms can provide benefits of consolidated reporting and efficiencies of scale to investors. However, payments from product manufacturers to platforms can distort the process of selection of products available to investors

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through the platform without delivering the cost benefits of these efficiencies through to the investor. Rebates at this level serve two purposes:

(a) A pricing mechanism where the scale benefits of platform funds under management to the fund manager are factored into price negotiations.

(b) A product access or shelf space fee that may restrict or distort the investment menu available to advisers.

Some platform providers currently address this issue by negotiating rebates based on the scale they offer and removing the potential distortion by passing the price discount through to the end investor.

The Bill proposes to ban the receipt of volume-based benefits by platforms where "the value of the benefit exceeds the reasonable value of scale efficiencies obtained by the fund manager" (proposed paragraph 964B(2)(b)). The Bill attempts to create a distinction between a benefit that is a commercial pricing mechanism to reflect scale benefits to the product manufacturer and a benefit paid to obtain a preferential position on the platform, which could distort the advice offered to the end investor.

In our opinion, the test of what "exceeds the reasonable value of scale efficiencies" will be a difficult, if not unworkable, test to apply in practice. Scale efficiencies are difficult to quantify. This is likely to be an area of uncertainty and dispute.

In Vanguard's view, for the legislation to achieve the objectives of the FOFA reforms, there should be a requirement to pass any volume-based benefit from product manufacturers to platforms through to the end investor. This requirement would give business much greater certainty and ensure that the investor captures the benefit of the value of scale efficiencies that can be achieved through investing in platforms. Product manufacturers and platforms can continue existing arrangements, provided that the benefit is passed through to investors. This may also allow for greater competition between platforms and other technology solutions.

If there is no requirement to pass the rebates through to the end investor, even rebates that are considered by platforms and fund managers to reflect reasonable scale benefits may influence the product options that an adviser gets access to through platforms. Currently distribution arrangements often operate as a value chain. Banning payments within certain parts of the value chain may mean that distortions are retained, albeit shifted, particularly where an integrated group controls different participants within the value chain.

We submit that a more efficient and transparent mechanism more aligned with the original FOFA objectives of removing or avoiding payments that potentially distort the quality of advice given would be to require the value of any such payments to be passed through to the end investor. This is consistent with the practice of some major platform operators currently.

3. Additional comments

The proposed definition of a platform in the Bill as "a facility through which financial services licensees and their representatives can obtain information about financial products or a facility through which financial products are issued" in proposed sub-paragraph 964A(1)(b)(i), is very broad and perhaps could have unintended consequences by capturing agents of the fund manager such as custodians and registrars.

Vanguard would be pleased to provide any further assistance or analysis in relation to these reforms. Please contact me on 03 8888 3832 or robin.bowerman@vanguard.com.au if you would like to discuss this matter further.

Yours faithfully,

Robin Bowerman

Principal and Head of Corporate Affairs and Market Development