Costs and charges the Vanguard Way

We believe you should understand exactly what you’re paying for by being completely transparent in how we charge. This means clearly stating the costs of investing and showing each cost separately.

Read on to find out more about Vanguard’s approach to costs and how it differs from the industry norm.

Costs matter

While you can’t control what happens in the markets, you can control how much you pay to invest. Costs and expenses over the long term can erode investment performance because investment returns are reduced pound-for-pound by the costs incurred. By minimising costs, investors may improve their odds of meeting their investment objectives.

Because costs matter so much, we always ensure we take a fair approach in the interests of investors.

Cost types

Generally speaking, the costs of investing in a fund fall into three broad categories:

<table>
<thead>
<tr>
<th>Transaction costs</th>
<th>Running costs</th>
<th>Trading costs (ETFs only)</th>
</tr>
</thead>
<tbody>
<tr>
<td>The costs associated with investing in or exiting a fund, paid by investors as an up-front charge, over and above their investment into the fund. They’re usually incurred at the time of the transaction. Examples include:</td>
<td>The costs associated with running an investment, incurred on an ongoing basis and paid through the fund. Examples include:</td>
<td>Investing in Exchange Traded Funds (ETFs) entails broker fees and other costs. Please see p. 6 for a definition of ‘ETF’ and a discussion of the costs associated with investing in them.</td>
</tr>
<tr>
<td>• Purchase and redemption fees</td>
<td>• Annual Management Charge (AMC)</td>
<td></td>
</tr>
<tr>
<td>• Stamp Duty Reserve Tax</td>
<td>• Audit fees</td>
<td></td>
</tr>
<tr>
<td>• Initial and exit charges</td>
<td>• Administration fees (including costs such as custody fees, legal fees, trading fees and trustee fees)</td>
<td></td>
</tr>
</tbody>
</table>

This document is directed at professional investors only and should not be distributed to, or relied upon by retail investors. The value of investments, and the income from them, may fall or rise and investors may get back less than they invested. Please read on for a more detailed discussion of both types of costs and Vanguard’s approach to them.
A fair approach to transaction costs

Protecting investors from the cost of dealing

When an investor enters or exits a fund, the fund manager has to buy or sell underlying securities on their behalf. Dealing in underlying securities usually incurs transaction costs such as broker fees (the cost of buying or selling a security through brokers) and the bid/offer spread.

These costs can add up over time detracting from a fund’s potential returns. If the fund as a whole has to absorb those costs, then it affects every investor in the fund because those costs are subtracted from the value of their investment. In effect, all the fund’s investors are paying for an individual investor’s transaction.

Vanguard takes specific measures to protect investors and ensure that, wherever possible, each investor pays their own transaction costs. We think this is fairer than asking all existing investors in a fund pay those costs.

To do this, we collect a fee at the time of the transaction and pay that back to the fund. We do not retain these charges.

Protecting existing long-term investors

Preset dilution levy (PDL) on subscription and redemption

We may charge a preset dilution levy on both subscription and redemption fees on those funds where transaction costs are particularly high. This does not benefit Vanguard in any way – our fees exist solely for the benefit of existing fund investors.

Vanguard applies a preset dilution levy to funds which track markets that have higher costs or wide bid-offer spreads, such as bond funds and certain overseas markets. Wide spreads increase the cost of dealing for the whole fund and therefore dilute the value of the fund for existing long-term investors. To protect long-term investors from this we collect these fees and return the proceeds directly to the fund.

Bid/offer spread

In this context we’re referring to the difference between the buying and selling (or offer and bid) price of an underlying security, such as an equity or bond. The size of the spread is affected by factors such as current trading volumes and market conditions.

This works in the same way as buying and selling currency when you go on holiday. When you buy currency, you buy it at a higher price than someone who is selling that currency. The difference between the two represents the differing costs in the market, the bank’s costs and its profit margin. Institutions called ‘market makers’ do exactly the same thing with equities or bonds.
Dilution levy
As investors trade in and out of a fund, this can create expenses for the fund, especially for very large deals, as the fund manager has to buy or sell the underlying assets. In order to cover these costs and ensure that existing investors don't suffer, a dilution levy is applied to those specific investors, reflecting the value of these costs. The proceeds of the levy goes into the fund itself for the benefit of its investors and are not retained by the fund manager.

Initial charge
The charge the fund manager applies for absorbing your investment into a portfolio and is a percentage of your initial investment.

Dilution levy
When you invest you might also come across something called a dilution levy, which also helps protect existing investors from the dilutive effects of transactions costs. Just as with our purchase and redemption fees, a dilution levy does not benefit Vanguard – all the money collected goes straight back into the fund to protect long-term investors. In exceptional circumstances, such as in the case of very large deals, Vanguard may choose to use a dilution levy to protect the fund’s other investors. Have a look at our Prospectus, which you can find on our website (vanguard.co.uk), for further details, or ask your financial adviser for more details.

Initial charges and exit charges
You might see something called an ‘initial charge’ when you invest with some managers. These charges may differ from our preset dilution levies. These charges may not go back to the fund but to the fund management company and form part of its profit.
Stamp Duty Reserve Tax
Whenever UK equities are bought, or in some instances, when the shares of a UK fund investing in UK stocks are redeemed for in kind consideration, HM Revenue and Customs levies a tax called Stamp Duty Reserve Tax. This tax amounts to 0.50% of the value of the transaction, and applies whether the trade occurs in the UK or not. However, Vanguard assesses an entry fee of 0.40%* of the value of the transaction to the purchaser to cover the SDRT charge. SDRT is not a dealing charge imposed by the broker or fund manager but a self-assessed tax which applies to electronic or ‘paperless’ transactions only.

*The SDRT charge can sometimes be reduced by certain offsets. Vanguard calculated that an entry fee of 0.40% most closely represents the Funds' new transaction costs.

A fair approach to tax

Stamp Duty Reserve Tax
When Stamp Duty Reserve Tax (SDRT) is due on UK securities, we charge investors as part of the entry charge they pay upfront. This way we ensure that all investors pay their own taxes, rather than have the fund subsidise their tax for them.

As the other charges included within the PDL, this cost relates to individual investor transactions. In the interests of fairness we always try to ensure that longer-term investors aren't disadvantaged by those who invest for a shorter duration. We believe that this is not only clearer, but fairer too.

All tax treatment depends on an individual investors circumstances and is subject to change.
A transparent approach to running costs

**Annual Management Charge (AMC)**
When you invest with any fund manager, you will have to pay some running costs. These include an Annual Management Charge (known as the AMC) which covers the fund manager’s costs of managing the fund over the year.

However, with most managers you will also typically pay additional running costs out of your investment. These usually include administration fees, audit fees (where an independent auditor checks that all accounts are fair and honest), custody fees (paid to a custodian to safeguard the fund’s assets on behalf of the fund’s investors) and other operational expenses. The AMC, and these additional running costs, make up the fund’s Ongoing Charges Figure (OCF).

We take a different approach. We pay these costs out of our Annual Management Charge. This transparency helps give you a better understanding of the cost of your investment. Our AMC’s are between 0.07% and 0.55% as at 1st September 2014.

**Value-for-money investing**
In addition to our transparent charging structure, we also aim to keep our fund’s running costs to a minimum. We do that by keeping tight control of all our expenses and overheads. The lower your cost of investing in a fund, the more you get to keep of any potential returns.

---

**Annual Management Charge (AMC)**
The AMC covers the fund manager’s costs of managing the fund. It typically does not include dealing costs or additional costs such as audit fees.

**Ongoing Charges Figure (OCF)**
A figure for the total costs involved in managing and operating an investment fund. This includes the Annual Management Charge (AMC) which covers the fund manager’s own costs of managing the fund. With most managers, investors will also typically pay additional running costs, including administration fees, audit fees, custody fees and other operational expenses.
Costs for Exchange Traded Funds

We offer both traditional investment funds and Exchange Traded Funds (ETFs). ETFs may have different investment costs associated with them that you should be aware of.

**ETF costs in context**
Unlike other types of mutual funds (except Investment Trusts), ETFs trade through a stockbroker and have stockbroker fees and other trading costs involved when you invest. These costs will affect the decision your adviser makes about when and how to recommend using ETFs in your investment portfolio.

**Transaction amounts**
Some stockbrokers or online platforms may charge a flat fee for each trade. With your adviser’s help, you can consider how high this fee is relative to the amount that you are likely to invest in an ETF. If the trade is relatively small, it might not make sense to use an ETF, but with larger trades, it might.

**Regular savings**
Due to the trading costs involved in buying and selling ETFs, it might not make sense to use ETFs for regular investing. Your adviser will need to consider whether those charges offset the generally lower annual charges of ETFs.

**Time horizon**
Even though ETFs generally have lower annual charges, the trading costs of dealing in stockmarket shares can make the initial investment costs more expensive than a traditional index mutual fund. But over time, a lower annual charge can make it cheaper to hold an equivalent ETF. Your adviser will need to calculate that full cost of investing so that they ensure that you fully understand the costs of investing, both up front and over time.
Fund cost checklist

So now when you work with your financial adviser to build your investment portfolio you can ask about the fund costs and they can help you fully understand the cost of investing. You might want to ask your adviser to run a simple costs checklist like this one:

☑ Are all investment costs (including brokerage fees where applicable) made clear and shown separately in the fund documentation?

☑ Which investment costs will I pay up front and which are paid ongoing by the fund?

☑ Is Stamp Duty Reserve Tax (where applicable) collected from the individual investor making the transaction, or the fund?

☑ How are the fund’s long-term investors protected from the affect of other investors’ dealing costs?

☑ Are the fund’s running costs paid for by the Annual Management Charge, or the fund?

☑ Does the fund’s cost (including brokerage fees where applicable) represent real value for money?
Connect with Vanguard™ > vanguard.co.uk
  > Client Services > 0800 408 2065
  > Adviser Support > 0800 917 5508

Our Client Services team is available Monday to Friday from 09.00 to 17.00.

Vanguard Asset Management, Limited only gives information on products and services and does not give investment advice based on individual circumstances. If you have any questions related to your investment decision or the suitability or appropriateness for you of the products described in this document, please contact your financial adviser.

Important information
This document is directed at professional investors and should not be distributed to, or relied upon by retail investors.

The material contained in this document is not to be regarded as an offer to buy or sell or the solicitation of any offer to buy or sell securities in any jurisdiction where such an offer or solicitation is against the law, or to anyone to whom it is unlawful to make such an offer or solicitation, or if the person making the offer or solicitation is not qualified to do so. The information on this document does not constitute legal, tax, or investment advice. You must not, therefore, rely on the content of this document when making any investment decisions.

Issued by Vanguard Asset Management, Limited which is authorised and regulated in the UK by the Financial Conduct Authority.

© 2015 Vanguard Asset Management, Limited. All rights reserved.