European Fund and Asset Management Association

EFAMA's response to ESMA's call for evidence on the impact of the inducements and costs and charges disclosure requirements under MiFID II

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Executive summary

EFAMA, as the voice of the European investment management industry, strongly supports relevant and meaningful costs and charges disclosure. To achieve this, further adjustments to the MiFID II (and PRIIPs) disclosure framework are necessary. Our two main comments are:

First, the current MiFID II disclosures on costs and charges are intended to assist retail clients make informed investment decisions. Unfortunately, exactly the same disclosure rules apply for professional client and eligible counterparties. These disclosures provide essentially very little added value for such investors. More flexibility is essential. This can be achieved either by amending Article 50(1) of MiFID II Delegated Regulation to allow a limited application of the cost disclosure standards for professional clients and eligible counterparties, or by changing the current system from 'opt out' to an 'opt in'. Please find more information in our responses to Questions I and J.

Second, illustrations showing the cumulative impact of costs on return must learn from the current difficulties with the PRIIP KID in relation to performance scenarios and reduction-in-yield (RIY) cost disclosures. In essence, these illustrations should frame the cumulative impact of costs over an assumed holding period on a yearly basis and use a net return assumption of zero (i.e. investors get back their original investment after one year) instead of complicated RIY assumptions. Please see our detailed answers to Questions M to O.

Introductory comments

Before providing more detailed feedback to the questions, we would like to voice our dismay on two important points of procedure.

First, we question ESMA's decision to publish a crucial call for evidence on MiFID II cost and charges disclosures over the summer period with only six weeks to provide feedback. Collecting substantial responses over this naturally quieter period is much harder and, effectively, will not provide ESMA with the sought after feedback. We would therefore encourage ESMA to confirm any decisions made out of this Call for Evidence through a subsequent public consultation that should run over a three-month period.

Second, the current approach in the form of continuously updated Q&As is very burdensome for the fund management and wider financial industry. Each new clarification can lead to necessary changes to the underlying disclosure systems. These changes are very cumbersome to implement given that certain industry standards and understandings are required between product manufacturers, service providers and distributors in order to provide overall cost figures to the end clients (see more information below). We would therefore strongly suggest to make thematic Q&A updates to the disclosure section on a yearly basis, with enough time for the industry to implement these changes. The timing of such impending updates could also be announced in advance and would allow the involved parties to plan for these changes, thus adapting their systems in a cost-effective manner in time (i.e. providing changes to the cost disclosures at the start of each calendar year).

Moreover, in accordance with the amendments to the ESA Regulations as a result of the review of the European Financial Services Framework, we note that the ESAs are required to publish the questions in advance so that stakeholders have an opportunity to comment on them.

Last but not least, ESMA should also more thoroughly consider that MiFID II has changed the fundamental dynamics of cost disclosures. Whereas previously, static information in a standardised paper document (such as the UCITS KIID) was sufficient to fulfil the cost disclosure requirements, it is now essential to electronically transmit this information in the form of standardised data fields that ultimately allow distributors to utilise this data in order to provide investors with "all in" cost disclosures. Considerable efforts has been undertaken by the financial industry to standardise this essential flow of cost information between product manufacturers and distributors. In relation to MiFID II this industry agreement is found in the form of the European MiFID Template (EMT). Earlier this year, this initiative was formalised through a joint structure called 'FinDatEx' (Financial Data Exchange Templates) established by the European Fund and Asset Management Association (EFAMA), the European Banking Federation (EBF), Insurance Europe (link), the European Savings and Retail Banking Group (ESBG), the European Association of Cooperative Banks (EACB), and the European Structured Investment Products Association (EUSIPA). More information on this initiative can be found here.

Detailed answers

4.1 MiFID II disclosure requirements for inducements permitted under Article 24(9) of MiFID II

A: What are the issues (if any) that you are encountering when applying the MiFID II disclosure requirements in relation to inducements? What would you change and why?

Whilst this section is primarily aimed at distributors of financial instruments, we would like to add the following comment from the perspective of product manufacturers and service providers (in particular in relation to portfolio management).

We support the MiFID II's approach to extract the commission payments from the 'product' costs and present them as part of the distributor's 'service' costs to investors. This is crucial as commission payments vary depending on the individual distribution channel being used. This means that the PRIIP KID or UCITS KIID cannot provide the full picture to the investor due to their generic nature. While still not straightforward for investors, MiFID II cost disclosures should, at least, allow investors to better understand the major cost drivers of their investments and help them to reach informed investment decisions.

B: Do you use the ex-ante and ex-post costs and charges disclosures as a way to also comply with the inducements disclosure requirements? At which level do you disclose inducements: instrument by instrument, investment service or another level (please specify how)?

In some Member States that allow retrocession payments, it is very common to disclose information on inducements as part of the ex-ante and ex-post cost disclosures. We understand that ex-ante disclosures are generally made on the level of the investment service. We understand that some NCAs require a breakdown at the level of the individual financial instrument. Such an approach risks to overload investors with information. Thus, we think that more detailed disclosures should be provided only at the client's request, as most retail investors prefer and are aided by simple and aggregate figures.

C: Have you amended your products offer as a result of the new MiFID II disclosure rules on inducements? Please explain.

Some funds offer share classes that do not include distribution costs in order to cater for the needs of portfolio managers and independent advisors. These share classes are also essential in EU Member States that have banned retrocession payments. By investing in clean share classes, portfolio managers can avoid the process of repaying commissions to investors and thus, operate in a more efficient way.

D: Has the disclosure regime on inducements had any role/impact in your decision to provide independent investment advice or not?

Not applicable to fund and asset managers.

E: How do you apply ex-ante and ex-post disclosures obligations under Article 24 (9) of MiFID II in case of investment services provided on a cross-border basis? Do you encounter any specific difficulty to comply with these requirements in a cross-border context? Please explain.

The cross-border provision of MiFID II services generally takes place only in terms of portfolio management, mostly for third-party funds. Since inducements are not relevant in this context under MiFID II, we do not have any specific experience in this area.

F: If you have experience of the inducement disclosure requirements across several jurisdictions, (e.g. a firm operating in different jurisdictions), do you see a difference in how the disclosure

requirements under Article 24(9) of MiFID II and Article 11(5) of the MiFID II Delegated Directive are applied in different jurisdictions?

No comments.

G: Would you suggest changes to the disclosure regime on inducements so that investors or potential investors, especially retail ones, are better informed about possible conflicts between their interests and those of their investment service provider due to the MiFID II disclosure requirements in relation to inducements?

Since disclosures on inducements are implemented as part of the general ex-ante/ex-post cost disclosures, we do not see any specific need for changes to the disclosure regime.

H: What impact do you consider that the MiFID II disclosure requirements in relation to inducements have had on how investors choose their service provider and/or the investment or ancillary services they use (for instance, between independent investment advice and non-independent investment advice)?

It is very difficult to assess whether, in particular, disclosure of inducements has had any impact on the investors' choice of the distribution service or an investment channel. We are not aware of any market studies focusing on this aspect. However, we are convinced that separate disclosure of inducements, i.e. commission payments to distributors, facilitates investors' enhanced understanding of the main cost elements associated with a financial investment.

4.2 Costs and charges disclosure requirements under Article 24(4) of MiFID II

I: What are the issues that you are encountering when applying the MiFID II costs disclosure requirements to professional clients and eligible counterparties, if any? Please explain why. Please describe and explain any one-off or ongoing costs or benefits.

The MiFID II disclosures on costs and charges are clearly designed to assist retail clients making informed investment decisions. However, the added value of this type of aggregated information for professional clients and eligible counterparties is negligible at best.

In practice, asset managers are confronted with the provision of cost information in the context of individual portfolio management. This service is provided either directly to professional clients (separately managed accounts) or under delegation by fund management companies (which in many Member States qualifies as individual portfolio management under MiFID II).

However, Article 50(1) of MiFID II Delegated Regulation prohibits any deviations from these 'retail' standards in the context of portfolio management and investment advice. This applies to all categories of professional clients, including professional financial market participants such as banks, insurance companies and UCITS or AIF managers. These clients are generally aware of the costs or will seek (much more) targeted disclosures on specific items. As part of onboarding process between a professional client and portfolio manager, it is customary that specific cost items are identified for various purposes (e.g. accounting, investment analysis, reporting purposes etc.) and the supply of these items is then agreed upon bilaterally as part of the portfolio manager's mandate and contract. The current inflexibility is also felt by non-EU professional clients and eligible counterparties. As they reside outside the EU and are thus not caught by MiFID II, they need to receive additional disclosures which are driven by their respective local regulations instead of disclosures which make little sense in their local context. These experiences strongly underline that the current aggregated cost information is of little added value for professional clients and eligible counterparties, as it is simply insufficient for these clients' particular needs.

With regards to execution services, professional clients as defined in MiFID II's Annex II (e.g. credit institutions or investment firms), as well as eligible counterparties are particularly interested in a fast execution of their orders and the provision of ex-ante costs often results in inacceptable time delays. In addition, recurring orders of the same type are often placed (within a short period of time). In these cases, MiFID II requirements can result in the same cost information being delivered over and over again within this period. However, without making more substantial changes to the Level-1 Directive, amendments to the MiFID II Delegated Regulation could allow for more flexible disclosure standards in the context of execution services.

The necessary flexibility can be achieved by amending Article 50(1) of MiFID II Delegated Regulation in order to allow a limited application of the cost disclosure standards to all MiFID services rendered to professional clients and eligible counterparties. This amendment should allow these clients to waive altogether specific cost information based on contractual agreements. This would in particular be relevant for dedicated funds or mandates and could take the form of a one-time (revocable) declaration.

J: What would you change to the cost disclosure requirements applicable to professional clients and eligible counterparties? For instance, would you allow more flexibility to disapply certain of the costs and charges requirements to such categories of clients? Would you give investment firms' clients the option to switch off the cost disclosure requirements completely or apply a different regime? Would you distinguish between per se professional clients and those treated as professional clients under Section II of Annex II of MiFID II? Would you rather align the costs and charges disclosure regime for professional clients and eligible counterparties to the one for retails? Please give detailed answers.

As previously mentioned, the specific disclosure requirements laid down in Article 50 of MiFID II Delegated Regulation and further specified in the ESMA Q&As have been designed with retail investors in mind. They are not appropriate for professional clients.

Professional clients are much better informed about costs associated with investment services. In general, they know exactly what type of financial instrument they are looking for and which investment service they are interested in. In these cases presentation of aggregated costs in a standardised way is of secondary importance. Instead, professional clients often request tailored information for their accounting or regulatory reporting purposes which is provided on a contractual basis (cf. our response to the question above).

There are different options to address this problem. The first option is detailed in our answer to Question I. Another option is to change Article 50 of MiFID II Delegated Regulation from 'opt out' to 'opt in' for professional clients. This would mean that the professional clients receive information only if they expressly request it.

As mentioned above, delegation of the portfolio management function by a UCITS management company or an AIFM to another fund manager or an investment firm may be considered as individual portfolio management under MiFID II. However, under MiFID II, most of the requirements in terms of portfolio management have been developed with a retail-type service in mind. They do not accommodate the adaptations necessary in order to offer practicable, cost-efficient solutions for B2B relationships. Moreover, third-party portfolio managers are always exposed to a conflict of rules. On the one hand, they need to comply with the MiFID II requirements for individual portfolio management, but on the other hand, they are contractually obliged to fulfil all standards applicable to UCITS and/or AIF management on the basis of the delegation agreement.

Against this background, we are of the opinion that the activity of managing investment funds under delegation should be clearly exempted from the scope of MiFID II as sector-specific legislation applies. Such an exemption would reinforce proportionality under the MiFID II regime. It would also be in line with the current limitation of scope under Article 2(1)(i) MiFID II and could indeed be facilitated by a simple clarification with the following effect:

> (i) *collective investment undertakings and pension funds whether coordinated at Union level or not and the depositaries and managers of such undertakings**, including those operating under delegation***;

K: Do you rely on PRIIPS KIDs and/or UCITS KIIDs for your MiFID II costs disclosures? If not, why? Do you see more possible synergies between the MiFID II regime and the PRIIPS KID and UCITS KIID regimes? Please provide any qualitative and/or quantitative information you may have.

To our knowledge, distributors cannot rely exclusively on either the PRIIP KIDs or UCITS KIIDs for providing cost disclosures according to MiFID II. Other sources of information from product manufacturers are ultimately required. These are provided to distributors either bilaterally or via commercial data providers.

Not being able to rely on the KI(I)Ds and thus requiring additional data can be explained as follows: First, MiFID II requires the provision of aggregated (i.e. 'all in') cost figures by the distributor. This requires the latter to be able to summarise all costs incurred throughout the whole value chain, before adding his specific costs and disclosing this aggregated figure to the investor. As each disclosure is individual to each client and it requires IT systems to be in place. These, in turn, need machine-readable (i.e. electronic) transmission of this essential information, as it must be imported automatically (and without human errors by manually copying a figures from a KI(I)D) into a distributor's IT systems to produce such disclosures. The paper-based UCITS KIIDs and PRIIP KIDs were not designed for this purpose. Second, diverging disclosure rules and calculation methodologies currently exist between UCITS and PRIIPs which leads to different information being provided on the same financial instrument. However, these problems also extend to different methodologies being used in MiFID and PRIIPs (e.g. different assumption on what constitutes transaction costs and the use of RIY cost disclosures in PRIIPs that make performance assumptions – see below for more information). The problems between MiFID and PRIIPs are particularly crucial, as the PRIIP KID is intended to become the future standard for informing retail investors about investment products.

This problem of diverging information and the subsequent need for additional MiFID-specific data has therefore led industry participants to agree on the so called "European MiFID template" (EMT) which provides crucial ex-ante and ex-post cost information. The information contained in this template is standardised and meant to be transmitted in an electronic format in order to allow distributors to provide the required "all in" cost disclosures to investors. For more information, please see our introductory comments or find more information here.

Disclosure of product costs

Cost figures in the PRIIP KID are presented by using the reduction in yield (RIY) methodology which distributes and levels the costs over the recommended holding period. This also applies to one-off costs such as the entry fees for the purchase of fund units. MiFID II, on the other hand, stipulates that investment firms have to show fluctuations and spikes within the framework of ex-ante and ex-post cost information. This means, for example, that an entry fee must be presented in the year in which it is charged; the same applies to other one-off costs such as any redemption fees. Therefore the information on product costs in the current PRIIPs KIDs is generally not usable for the generating the aggregated information on cost under MiFID II.

Calculation of transaction costs

When distributing investment funds, transaction costs must be disclosed both under MiFID II and, as of 2022 (when the UCITS KIID is intended to be replaced by the PRIIP KID), as an element of the product costs.

Transaction costs consist of "explicit" costs (such as broker commissions, platform charges, transaction taxes, etc.) and "implicit" costs. Especially in fixed income markets, broker fees are not explicitly charged, but are included in the price margin of either the bid or ask price and thus account for implicit costs. This is undisputable in principle, as is the fact that MiFID II and PRIIPs both strive to capture such implicit charges. The MiFID II text provides further indications for the understanding of costs by specifying that "underlying market risks" (i.e. market movements) should not be considered a cost.

Nonetheless, the approach on how to estimate implicit transaction costs under the PRIIPs framework, the so-called "arrival price" methodology, systematically treats market movement in the price of an asset between the time of order submission and order execution (so-called "slippage") as a cost factor. Such market movement is therefore reflected in the transaction cost calculations and disclosed as cost to investors. Since movement in the price can be either positive or negative, the effect is that the actual identifiable costs of a transaction – the "explicit" costs – are in each single case distorted and either under- or overestimated in the eventual calculation results. The use of such distorted figures, sometimes discernible as negative transaction costs, entails high liability risks for product providers and distributors.

Please find below a simplified example of diverging cost disclosures:

Cost item	**Actual fund cost in % of the amount invested or NAV**	**UCITS KIID**	**PRIIP KID** (Moderate scenario: 5% RHP= 5 years)
Entry charge	3%	3%	0,64%
Exit charge	2% in the 1st year 1,5% in the 2nd year 1% in the 3rd year 0,5% in the 4th year 0% year onwards	2%	0%
On-going charges	0,85%	0,85%	0,90%
Transaction costs	0,25% (3 years average)	(excluded from UCITS KIID)	0,69%
Performance fee	0% last year 0,15% (5 years average)	0%	0,16%
Summary cost indicator			
Total cost (for an 10 000€ investment)			1.478 €
Impact on return (RIY) per year			2,38%

In our view, the MiFID II regime is the primary, overarching legislation that provides these high-level disclosure principles that other more specific disclosure legislations should draw upon. We hope that the current review of the PRIIPs Level-2 framework will align the PRIIP KID with MiFID II to ensure the presentation of the same cost information to clients. This should start with the removal of "slippage" as a cost in the ongoing PRIIP KID review.

From the investor's point of view, these divergences are hardly comprehensible and requires a considerable amount of explanation on the part of the distributors. The objective of transparency and investor protection is thus not taken into account. We think it should be one of the main goals to harmonise the different rules.

Calculation of ongoing costs for real asset funds

Moreover, the calculation of ongoing costs for real asset funds is not sufficiently clear either under PRIIPs or under MiFID II. In our view, these questions should be clarified in the context of the pending review of the PRIIPs implementing measures. Nonetheless, since their clarification is also of relevance for ensuring consistent and comparable cost disclosures under MiFID II, we urge ESMA to work towards timely solutions in the PRIIPs context and to promote a common understanding of relevant cost elements for both PRIIPs and MiFID II purposes.

L: If you have experience of the MiFID II costs disclosure requirements across several jurisdictions, (e.g. a firm operating in different jurisdictions), do you see a difference in how the costs disclosure requirements are applied in different jurisdictions? In such case, do you see such differences as an obstacle to comparability between products and firms? Please explain your reasons.

There are currently different interpretations among Member States whether PRIIPs disclosures/methodologies can be used for the purpose of MiFID II cost disclosures. This is an importance issue as distributors will not know which methodologies have been used to calculate the figures, thus hindering comparability between products.

M: Do you think that MiFID II should provide more detailed rules governing the timing, format and presentation of the ex-ante and ex-post disclosures (including the illustration showing the cumulative impact of costs on return)? Please explain why. What would you change?

There certainly is a point in providing investors with comparable information in a more standardised format and presentation for both the ex-ante and ex-post disclosure.

With regards to the illustration showing the cumulative impact of costs on return, there are essential insights regarding the PRIIPs' performance scenarios and the connected reduction-in-yield (RIY) cost disclosures (as they are based on the return of the moderate performance scenario) that must be considered. It is impossible correctly to predict the future performance in any meaningful way. The situation is aggravated the longer the potential investment horizon. Certain methodologies chosen to show such future scenarios (such as the current PRIIP KID) even carry the risk of misleading investors.

It is therefore essential to frame the cumulative impact of costs on return for an assumed holding period on a yearly basis (e.g. a 5-year recommended holding period is assumed, but the costs are displayed as yearly figures). Furthermore, it should not use a RIY model (i.e. which includes assumptions about a future investment return), but rather assume that the investors gets back their original investment (i.e. a net return assumption of zero).

In any case, such an exercise, must be conducted with all stakeholders and should not be decided in a Call for Evidence held over the summer period. We would expect an appropriate consultation process with ample time to discuss these issues in detail. Moreover, an adequate period for implementation should be provided, with the aim of avoiding excessive and avoidable costs for the intermediaries.

N: For ex-ante illustrations of the impact of costs on return, which methodology are you using to simulate returns? Or are you using assumptions (if so, how are you choosing the return figures displayed in the disclosures)? Do you provide an illustration without any return figure?

Please consider our general comments on the illustrations of the impact of costs on return in our answer to Question M.

In our opinion and as stated above, the illustration should reflect a certain time horizon with cost information provided on an annual basis and no estimations of the potential return of the investment are made (i.e. using a net return assumption of zero presuming that the investors get back their original investment).

We believe that such assumptions are clear, readily understandable for the client, appropriate for comparison between different services and not deceptive for investors (performance estimates used for the illustrations can be considered by investors as a promised return by investors). These assumptions avoid incurring the same critical issues that emerged in the PRIIPs framework with performance scenarios.

O: For ex-post illustrations of the impact of costs on return, which methodology are you using to calculate returns on an ex-post basis (if you are making any calculations)? Do you use assumptions or do you provide an illustration without any return figure?

Please consider our general comments on the illustrations of the impact of costs on return in our answer to Question M.

P: Do you think that the application of the MiFID II rules governing the timing of the ex-ante costs disclosure requirements should be further clarified in relation to telephone trading? What would you change?

No comments.

Q: Do you think that the application of Article 50(10) of the MiFID II Delegated Regulation (illustration showing the cumulative impact of costs on return) helps clients further understand the overall costs and their effect on the return of their investment? Which format/presentation do you think the most appropriate to foster clients' understanding in this respect (graph/table, period covered by the illustration, assumed return (on an ex-ante basis), others)?

In principle, illustrations of the cumulative impact of costs on return could be helpful for clients in order to better understand the overall costs and their importance on the return perspectives of an investment.

However, the challenge with such illustrations is the level of assumptions needed and the impact of such assumptions on the relevance of the ultimate figures for the individual investor. Furthermore, such fictitious return based on a number of assumptions can also systematically overstate the performance of financial products, as is the case with the current PRIIP KID. Against this background, we would caution ESMA against considering a standardised approach to cost illustrations based on uniform assumptions regarding holding periods and/or growth rates.

R: Are there any other aspects of the MiFID II costs disclosure requirements that you believe would need to be amended or further clarified? How? Please explain why.

In line with our response to question K, we are concerned about the general application of the PRIIPs methodologies into the MiFID context. In fact, the PRIIPs methodology is causing widespread problems in its application, generating figures that in some occasions may be even misleading for clients, in particular in relation to the calculation of implicit transaction costs when the actual transaction cost methodology (arrival price) is used.

Since synergies between regulations aimed to improve a consistent transparency to investors and, at the same time, to avoid not necessary burdens to intermediaries, we would support any necessary change in the PRIIPs Regulation and we believe that these changes could be reflected, where appropriate, also in the MiFID context.

In this regard, in line with the MiFID II requirements and applying a proportionate approach, implicit costs should be estimated using alternatively the spread of the transaction without slippage or a standard spread.

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