ESMA CALL FOR EVIDENCE: Impact of the inducements and costs and charges disclosure requirements under MiFID II
CNMV Consultative committee

The Advisory Committee of the CNMV has been set by the Spanish Securities Market Law as the consultative body of the CNMV. This Committee is composed by market participants (members of secondary markets, issuers, retail investors, intermediaries, the collective investment industry, etc) and its opinions are independent from those of the CNMV.

INTRODUCTION

ESMA Call for evidence on the impacts of the inducements and cost and charges disclosure requirements under MiFID II fits in the context of article 90 of MiFID II which provides that, before 3 March 2020, the Commission shall, after consulting ESMA, present a report to the European Parliament and the Council on, inter alia, "the impact of the requirement to disclose any fees, commissions and non-monetary benefits in connection with the provision of an investment service or an ancillary service to the client in accordance with Article 24(9), including its impact on the proper functioning of the internal market on cross-border investment advice". In its mandate sent to ESMA on 23 May 2019, the European Commission requested ESMA to: "assess together with the NCAs whether firms comply with inducement and cost disclosure rules in practice, whether the application varies across Member States and, if positive, how. During this process, the Commission invites ESMA to analyze and provide an assessment of the effects of these rules for both professional and retail clients. ESMA's analysis should be guided by the broader consideration of the extent to which investors have benefited from the new rules thus far".

Spanish CNMV Advisory Committee (hereinafter "the Committee") welcomes this Call for evidence and wants to give the following input:

As a general comment, some stakeholders regret have been given a very short period over the summer break to provide feedback on the disclosure of the topics included in the call for evidence. As a consequence, the committee would like to encourage ESMA to confirm any decisions made out of this call through a subsequent public consultation that should run over a three month period.

QUESTIONS

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?

The call for evidence focuses on the disclosure rules relating to inducements. The Committee would also like to point out that many of the implementation challenges relating to inducements rather relate to other areas of the regime such as divergent legal interpretations by competent authorities on the scope or other legal interpretations.

In this sense, one of the most important issue industry is facing is the different scope for inducements concept understood by different NCAs. Especially relevant is the consideration as inducements for placing investment service payments.

Although firms should assess all payments or benefits received against the inducement rules. In the specific context of a firm providing placing services to an issuer, and also distributing new financial instruments to investment clients, it should be agreed that the fees received by the firm from the issuer client directly relate to the provision of a MIFID investment service to this client. As such, these payments would constitute a client fee or payment and should not be considered as a third-party payment or benefit under the inducements rules in Article 24(7), (8) or (9) of MiFID II.

This approach is fully in line with MiFID II rules, as it must be kept in mind that inducements are forbidden in portfolio management and independent advice and it should be hard to understand that MIFID II is preventing all these clients to benefit from the primary market access.

This is the approach taken by some regulators, but not by others. Industry needs legal certainty so it must be stated clearly at European level.

Not only this matter is relevant regarding MIFID II application, but also for the CMU development. If these payments are considered as inducements, the banning of inducements regarding portfolio management and independent advice services already mentioned, will imply a rigorous restriction for the emissions in Europe, as potential clients will be severely reduced.

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 general, distributors use the cost and charges disclosure ex-ante and ex-post to disclose inducements.

In some markets, the disclosure differs between ex ante and ex post:

- The ex-ante information generally relates to the concrete transaction.
- The ex post disclosure relates to the financial instrument (so that several orders of the same instrument will be aggregated). The client has the possibility to receive a more detailed disclosure showing costs, charges and inducements for each transaction on demand.

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

Product offer has not been adjusted due to MiFID II disclosure rules but for rules on acceptable inducements. These rules have affected the distribution of products, not only at European level, but also creating national divergences.

Regarding portfolio management or independent investment advice, some firms have decided to restrict the inclusion of certain products within the scope of their services to avoid any legal risk.

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

Some members of the industry have decided not to provide independent investment advice for many reasons, one of them being inducement rules.

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.

Different approaches from supervisors across Europe in relation to ex-ante and ex-post disclosure obligations difficult the provision of cross border services and increase legal uncertainty, when provided.

As far as this committee is aware, some local supervisors have created specific frameworks for the ex-ante and ex-post obligations, providing specific criteria or views that they intend to apply in their supervisory activity. But, in some cases they have done so in private basis (i.e.: through bilateral communications with the firms in their territory), without further publication, thus creating (i) unleveled playing field; (ii) legal uncertainty for market players; (iii) market fragmentation.

In terms of legal certainty, the Committee welcomes the provision of detailed information about specific obligations of the regulation which are not clear, but this guidance should be provided at a European level. Furthermore, due to the greatest importance of these ex-ante and ex-post obligations in the market, we would welcome if ESMA could provide an open list of safe harbors to facilitate compliance with those obligations.

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?

Differences appreciated between jurisdictions do not relate to the disclosure itself but to implementation issues like mentioned before (scope for disclosure obligations).

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?

Regarding the disclosure regime on inducements, rather than suggesting changes, what is needed is a common approach in all the jurisdictions about the requirements scope.

In this sense, it will be very confusing for clients that some payments are considered as inducements and subject to inducements banning, disclosure and/or enhancing quality test in some countries, while in other jurisdictions they are not treated as such.

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)?

The new inducements regime has implied under certain circumstances, higher upfront costs. Clients are not willing to pay for this extra-cost and thus, requesting more simple services (i.e. executing only vs independent advice) reducing at some extent their protection.

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.

Professional clients and eligible counterparties operate professionally on capital markets. They have significantly higher knowledge and experience than retail investors. This perception is reflected in some MiFID II areas as suitability test. Both their need for information and their need for protection are significantly lower than that of retail investors. At the same time, professional clients and eligible counterparties place a large number of orders with high investment amounts compared with retail investors and attach great importance to rapid order execution.

Ex -ante cost disclosure requirements to professional clients and eligible counterparties are seen as an administrative burden which generates costs to investment firms with very limited positive impacts.

Eligible Counterparties cannot usually wait to receive a trade by trade cost information and they prefer a generic ex-ante cost information available on a website. Nevertheless, there is no guarantee from any EU Regulator that this kind of disclosure is a safe harbor if agreed among ECs.

Ex-post cost statements also require an exception for professional clients and eligible counterparties. Practice shows that these customer groups are over-informed and massively constrained by the provision of ex-post cost information. In addition, there is a high level of bureaucracy without benefit for all parties involved.

Another problem is related to the concept of "customer", because in some relationships, for example between credit institutions, it is difficult to determine precisely who the customer is, and therefore to apply the costs and charges reporting requirements. In this sense, one might also raise questions around costs transparency for professional clients in the area of competition law. Basically, a professional client can be a customer in one transaction and a competitor in another. Disclosing the costs (and a breakdown of the costs) could have a possible impact on competition between professional clients that might not be intended by the regulator.

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.

In relation to the particular questions in the call for evidence:

(i) Based on the proportional approach that should inspire MiFID II, cost disclosure requirements for these clients, should be subject to an opt-in regime. That would allow these clients to receive this information whenever they want (in general terms or on a trade by trade basis) avoiding administrative burdens in those situations in which they do not need/want the information. In order to avoid unintended consequences, investment firms could be obliged to inform these clients about this opt-in regime. This opt-in regime may be of special interest for the professional clients specified above and not only for information on cost and charges but for any other information requirements.

This "opt-in" regime will be more aligned with PRIIPs regulation, only applicable for retail clients

It should also be noted that these clients could always request to be treated as retail clients, so any entity wondering to be protected will be able to ask for that protection. Additionally, in the normal course of business, if an entity is acting as a client, it is market standard to provide any relevant information related to the trade/service that it might be requesting (i.e.: charged costs). As a result, these clients protection would not be hampered.

(ii) Notwithstanding the preference above to switch the entire framework to an opt-in regime, specific "pain" points are specified below:

- Information in ranges or by maximum amounts to be charged should be allowed;
- The information about the impact of the costs in the return should not be applicable.
- The pre-trade information should be allowed to be provided in webpages without a need of further actions/approvals.

(iii) All professional clients should be treated in the same way, including those treated as professional clients under Section II of Annex II of MiFID II. However, for this clients the investment firm could be obliged to specifically inform about the loss of protection in this field due to the change in the client category, when the client request to be upgraded.

(iv) Notwithstanding the arguments above, eligible counterparties and professional clients *per se* are the entities for which the current framework makes less sense. Considering the nature of these entities, the services and products they provide and the fact that some of them have a license to distribute the same financial instruments, the need to disclose cost information is not justified.

(v) Special mention deserves the case of the management by delegation of collective investment undertakings and pension funds. Although MiFID does not apply to their management companies (by explicit exclusion in Article 2.1.i of MiFID II), there is a paradox that when said managers in turn delegate the management of all or part of the portfolio to another manager, the delegated manager may be subject to the application of MiFID, without possibility to apply the eligible counterpart category (not allowed for portfolio management services). One of the consequences of this indirect MiFID application is the obligation to provide information that in many cases is not useful. This situation recommends revisiting the wording of article 2.1.i of MiFID II (to include in the scope of the exemption the case of delegation) and, although out of the scope of this call for evidence, also the wording of Article 6 of UCITS Directive (to remove explicit mention to pension funds).

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.

Due to the different developments among industry members, some entities do use KID methodologies for professional clients while others do not have any synergy.

Besides, this Committee wants to insist on the need that the terminology and the way of presenting costs and charges resemble PRIIPS. It is important as not only entities would take advantage of technological developments and documentation prepared for this purpose, and would avoid unnecessary costs and give greater complexity to internal procedures; but also the understanding of the clients would be facilitated, one of the main purposes pursued by these rules.

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.

Yes, mainly in ex-ante cost information, the content (generic/personalized; aggregated/itemized) and delivery process (periodical, trade by trade) is very different.

The illustration of the impact of costs on return of investment is also very different among jurisdictions/investment firms.

Regarding some key concepts related to cost disclosures, like "Fair Value", if a definition of its elements or methodology wants to be defined, it should be done at European level. If not, the main consequence national definitions is that clients will be confused and investment firms will see how their information about cost and charges is distorted.

This Committee wants to insist of the need or harmonization for key elements, like fair value, and also the need to consult with stakeholders. ESMA Q&As are considered as appropriate for some situations but in this case an open consultation should be needed.

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?

It would contribute to increase legal certainty and to a more leveled playing field:

(i) Having an open list of ways to provide the illustration showing the cumulative impact of costs on returns. Some authorities have bilaterally and privately stated that some ways of showing that impact is not correct (i.e.: illustration of the returns with and without costs) but there has been not real arguments supporting those decisions, no alternatives have been provided as safe harbors and no disclosure has been made to the market about that position, so other players or supervisors might be using/allowing that model and others might not.

(ii) More detailed and common rules could be provided in terms of fair value calculation as stated in question L. Fair value is a key concept in terms of cost calculation, as the implicit cost is calculated as the difference between sale/purchase price to the client and fair value. If the calculation methodology of the fair value differs among national supervisors, the information to be received by clients will not be symmetric and one of the goals of the cost disclosure regime would be harmed. Gold plating should be avoided in this field.

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?

Regarding methodology is important to remark that while justified, different methodology should apply depending on the type of product. It is important to consider the particularities of the product when calculating its profitability to better reflect reality

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?

Different approaches are being used through the industry.

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?

Yes, and also in case of electronic trading and financial instruments in which the cost information could fluctuate due to market conditions.

Telephone and electronic trading: The client normally needs flexibility and wants to speed up the process. Consequently, the client may waive its right to obtain the pre-trade information about costs and charges. Reading the costs while simultaneously sending an email with the cost sheet to the client delays the trade, sometimes losing price momentum of the trade.

Additionally, in some financial instruments in which the cost figure may fluctuate due to market conditions, it is not clear where the balance between updated information and timing of ex-ante disclosure should be.

For instance, a firm may provide ex-ante information about implicit cost of a derivative transaction in due time before trading (i.e.: the day before), but the market may move during the following hours, impacting the fair value of the product and the costs. If that is the case, the firm should need to update the cost information to the client before trading and if the trade is done immediately after the provision of such information then the information could not be considered to have been provided in due time.

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 our opinion, clients received too much information which makes the process of reading/understating/processing really hard for them who cannot have the time or even desire of investing so much time on doing it.

Furthermore, the experiences with PRIIPs clearly demonstrate that the return cannot be predicted and any information in this regard might be misleading for the client. Therefore, the committee would like to propose that deleting the requirements to inform on the impact of costs on return should be considered.

It would be better to display the costs, to display the historical return of the investment and to explain if the return displayed is gross / net of which costs.

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.

No other issues than the ones defined through the questionnaire have been found as needed for more clarification.