POSITION PAPER

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

ESBG (European Savings and Retail Banking Group)

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ESBG

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

Question 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)?

Yes, inducements are disclosed within the costs and charges disclosure. In some markets, the disclosure differs between ex ante and ex post:

- The ex-ante information generally relates to the concrete transaction (apart from the possibilities foreseen by ESMA to use cost grids for certain products like shares).
- 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.

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

No.

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

No, the disclosure regime on inducements had no impact on the decision to provide independent investment advice. In ESBG Members' experience, the vast majority of clients are not willing to pay for advice, therefore there are very few advisors providing independent advice.

Question 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?

We do not see how investors can get better and major information on inducements as they already receive a correct, comprehensive and understandable report on inducements.

Question 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 disclosure regime on inducements had no impact on the investor`s decision to ask for independent investment advice. As already stated above in answer D, in some markets the vast majority of clients are not willing to pay for advice, therefore very few advisors providing independent advice exist.

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

Question 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.

MiFID II actually failed to adapt investor protection to the characteristics of each investor category (retail investors, professional clients, eligible counterparties). The same disclosure obligations with regard to costs, inducements, etc. apply to all three investor categories; no consideration was given here to the special features or different protection requirements.
For the requirements related to professional clients and eligible counterparties, ESBG believes that these are superfluous because wholesale business partners are on the same level as financial institutions and know conditions and the prices of various financial service providers. Furthermore, a strict interpretation that professional clients and eligible counterparties must be provided with a transaction-based ex ante cost and inducement disclosure (hereafter "ex ante") would run counter to the practices of wholesale business. The transaction-based ex-ante in particular completely bypasses the goal in the wholesale area, since:

- Transactions are often subject to great time pressure (second trading) and are largely closed electronically (chat) or by telephone;
- Wholesale business partners usually use electronic trading platforms (e.g. Swift, Bloomberg, FIX, etc.) that are adapted to the special needs of such market participants/users. (Platform providers are not under the scope of MiFID II; any changes cannot be done by users);Wholesale business partners themselves have knowledge of current market and pricing conditions and know how to assess their impact on their transaction;
- Providing a transaction-based ex ante would significantly delay the transaction, which in many cases will lead to unintended price fluctuations.

Also for professional clients the level of protection required is much lower than for retail clients as by definition of MiFID II, Annex II a professional client is a client "who possesses the experience, knowledge and expertise to make its own investment decisions and properly assess the risks that it incurs." As a result, when applying the costs and charges disclosure requirements under MiFID II Article 24(4) (i.e. the costs and charges disclosure requirements) investment firms face strong reactions.

Not only eligible counterparties but also professional clients feel patronized and spammed with information as there is neither an information asymmetry nor a knowledge gap. Receiving such information that is not needed or wanted by the recipient is not the benefit that was intended by the regulator but a burden.

As already stated, the disclosure obligations are more a burden than a benefit for professional clients and eligible counterparties. The amount of implementation costs and maintenance costs depends on the level of disclosure obligation. Currently, financial institutions inform their professional clients and eligible counterparties with cost grids. The compilation and update of such cost grids is highly time and cost consuming.

If professional clients and eligible counterparties would have to be provided with transaction-based ex ante cost information every time they order a financial instrument, the financial institutions would have to build IT-implementation techniques which would be even more time and cost consuming. Furthermore the whole practices, which are now highly standardised and electronically, would have to be adapted

through the delay which would result from the transmission of a transaction-based ex ante costs disclosure.

Question 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.

1. **Review**

As part of the review, the exemption under Article 30 of MiFID II, under which most of the requirements do not have to be applied to transactions executed with eligible counterparties, should be extended to include the information requirements. Furthermore, there should be no obligation to disclose costs ex ante and ex post vis-a-vis professional clients (which would be in line with the requirements under PRIIPs).

2. **Clarification via Q&A**

In the meantime, until the review of MiFID II is implemented, it should be clarified that the obligations of costs information can be fulfilled vis-à-vis professional clients and eligible counterparties by providing cost grids. Providing comprehensive standardized information (cost grid) helps to avoid the problems that would be caused by transaction-based information. Against this background, it is not surprising that cost information in wholesale business via cost grids is a common practice in all European markets.

From our point of view, the current legal requirements leave room for the interpretation that professional clients and eligible counterparties can be informed via a cost grid:

- Art. 24 (4) MiFID II requires investment firms to provide appropriate information. This demonstrates that the granularity of the information can vary depending on the recipient:
    - Retail clients should generally be provided with transaction based cost information (however, in its latest Q&A, ESMA acknowledges that in some cases even retail clients can be provided with a cost grid).
    - It is obvious that professional clients and eligible counterparties do not need the same amount of information as retail clients. As already mentioned in answer I, wholesale business clients know the conditions and prices of various financial service providers and often determine the terms of their transaction. This means that for these clients, information via a cost grid would be appropriate.
- Furthermore, Art 24 (5) MiFID II requires that the information shall be provided in a comprehensible form and in such a manner that clients or potential clients are reasonably able to understand the nature and risks of the investment service and, consequently, to take investment decisions on an informed basis. The requirement to provide information that enables the client to make investment decisions on an informed basis clearly demonstrates that investment firms are allowed to distinguish between different client categories when it comes to information requirements. In this context, it is important to mention that the legislator allows investment firms to assume that professional clients have the necessary level of knowledge and experience (see Art. 54 (3) and 56 (1) Delegated Regulation (EU) 2017/565). This shows that the legislator is of the

view that professional clients generally have a sufficient level of knowledge and experience. Therefore, many information requirements only apply to retail clients (i.e. the PRIIPs regulation).

Due to the importance of this issue, we would suggest publishing a Q&A clarifying that with regard to professional clients and eligible counterparties it would be sufficient to provide a cost grid instead of a transaction based ex ante cost information.

With regard to the question related to have more flexibility to disapply certain of the costs and charges requirements to such categories of clients, we believe that, for the reasons mentioned above under answer I and J, the costs and charges disclosure requirement shall not apply to transactions with professional clients and eligible counterparties.

If the European legislator rejects our proposal of an exemption of professional clients and eligible counterparties to the costs and charges disclosure requirement, we would support a comprehensive opt out for both client categories.

In our opinion, there should be no distinction between elected and per se professional clients. In this respect, it should be taken into account that the European legislator presumes the same knowledge and experience for all professional clients. Therefore, many information requirements apply to retail clients only (i.e. the PRIIPs regulation).
With regard to the question related to align the costs and charges disclosure regime for professional clients and eligible counterparties to the one for retails, we believe that an alignment would intensify the problems, professional clients and eligible counterparties face with the costs and charges information (see answer I). Professional clients and eligible counterparties need to be excluded from the costs and charges disclosure obligation (see answer J).

Question 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.

No. In our experience, some banks receive comprehensive cost information from the data provider. The reason for this is, that the distributor needs the cost data in a format which is technically workable, because they create the MiFID costs and charges information automated and electronically. The data provider receives the costs and charges information directly from the manufacturer of the product.

A major problem is the different calculation of costs under PRIIPs and under MiFID II. This regards the treatment of inducements, for instance. While product costs under the PRIIPs Regulation include inducements, the product costs under MiFID II are presented without inducements because they need to be added to the service costs under MiFID II1.

This means for clients, they receive two different sets of information on product costs for the same financial instrument (if it is both a PRIIP and a financial instrument under MiFID II), even if the information in both cases is based on the same investment amount.

Example: Investment amount of €10,000. One bank used product information sheets on the same product using an investment amount of €10,000.

[1] See ESMA: Q&A on MiFID II and MiFIR investor protection and intermediaries topics (ESMA 35-43-349), section 9, Information on costs and charges, answer to question 7

- The "PRIIPs-information sheet" showed product costs of €246.28 or 1.38% p.a. in accordance with the PRIIPs Regulation.
- The "MiFID II-information sheet" showed product costs of €111.27 or 0.56% p.a. as calculated under MiFID II.

This discrepancy is difficult for clients to understand and has to be explained to them. It results from of contradictory calculation requirements in EU legislation. In future legislative processes it should be ensured that thematically related legislative projects are better coordinated with one another. This applies especially to the upcoming reviews of MiFID II and the PRIIPs Regulation, and also to the work on the various sustainability projects currently underway. The aim should be to use uniformly defined terms in all legislative texts and to take account of possible interaction.

If a product is a financial instrument within the meaning of MiFID II, we would recommend not to present the costs in the PRIIPs KID in order to solve the problem of reconciling the PRIIPs Regulation and the MiFID II Delegated Regulation. This would avoid giving clients contradictory information while nevertheless informing them about the costs in accordance with the requirements of MiFID II

We would like to mention that in the case of investment funds, we believe that the UCITS KID gives adequate information about the real cost borne by the client. On the contrary, we consider that PRIIPs methodology gives different results to UCITs in case of ongoing cost or not realistic results in case of transaction cost. With the aim of ensuring adequate investor protection and presenting information in a clear, simple and useful way, it is needed a more consistency between both Regulations.

Question 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?

In the ex ante information the costs are calculated under the assumption that the return is zero (meaning that the initial investment amount does not alter over the recommended holding period).

Since the distributor is not able to predict the return ex ante any assumption would be pure assumption that might be misleading for the investor as he gets the impression that there is a high probability that he will receive the return mentioned in the information sheet.

In this context, it is to be noted that one of the biggest problems of the PRIIPs regulation is its rules on the presentation and calculation of performance scenarios. Banks regularly receive incredulous queries from customers at a loss to understand the figures shown. Even the financial watchdog run by a national consumer protection agency released a press statement saying that the scenarios in their present form do not offer investors a robust basis on which to make a decision. The ESAs have also addressed the problem and recently stated publicly that the performance figures calculated in accordance with Level 1 and Level 2 requirements could give rise to unrealistic expectations on the part of clients. To counter this, the ESAs suggest that manufacturers include a warning in the KID. They even recommend that the following wording, which is not included in detail in the PRIIPs Regulation or Delegated Regulation, should be highlighted in some way (e.g. by using bold print): *"Market developments in the future cannot be accurately predicted. The scenarios shown are only an indication of some of the possible outcomes based on recent returns. Actual returns can be lower."*

To our knowledge the ESAs are still searching for a methodology that would improve the actual requirements in order to avoid such immense problems caused by the actual requirements.

Please note that we do not use assumptions. Due to the negative experiences under PRIIPs we strongly oppose the idea to introduce an obligation to simulate returns in the costs and charges information. As explained above, the costs are calculated under the assumption that the return is zero. Apart from that, the investor gets further explanations: he will be shown how the costs spread over the time. In the first year, there are entry costs, than ongoing costs and at the end there might be exit costs; for each year the clients are shown concrete figures. Furthermore, there is an explanation that for the calculation of costs a return of zero has been assumed.

Question 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?

The ex post information is already quite comprehensive showing all the costs and inducements that have accrued over the year. Therefore, there is no concrete statement on the performance.

The investor gets the information that the costs accrued are reducing the return of the investments.

Question 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?

The requirements to inform the investor ex ante on costs and inducements on a durable medium have created huge problems for telephone trading. Therefore, we highly support the new Q&A 23 and 28 where ESMA has foreseen the opportunity to use standardised cost grids in some cases and to provide the ex ante on a durable medium after the transaction if the use of cost grids is not allowed. This is a great relief for banks and investors. In the MiFID II review, the two possibilities created in Q&A 23 and 28 should be included in the Level II legislation in order to create a higher legal certainty. With regard to the possibility to provide the ex ante after the transaction the concrete wording should be aligned with the wording of Art. 13 (3) PRIIPs regulation. The alignment would take account of the fact that many PRIIPs under the PRIIP regulation also qualify as a financial instrument under MiFID II so that distributors have to provide both, a PRIIPs KID and an ex ante cost information.

Furthermore, it should be clarified that the procedure described in Q&A 28 can be used for orders given via fax or letter. If the (retail) client submits an order via fax or letter, the investment decision has been already taken. A submission of an ex ante prior to the investment decision and submission of the order by the client is factually impossible. In such cases it has to be sufficient that the client receives the ex ante costs and charges information on a durable medium after the execution of his order (in cases where the client orders products with product costs so that the using of cost grids is not possible).

Question 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)?

As we have explained above, we do not see any benefit to refer to returns as MiFID II Level I requires an information on costs and inducements and not on yield. 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, we suggest to delete the requirements to inform on the impact of costs on return.

In contrast, the information on anticipated spikes and fluctuations of the costs is quite helpful in the ex ante information as the investor will be informed that the entry costs are quiet high and that he should hold the instrument for a certain time due to the costs.

In its Q&A ESMA has explained that MiFID II has no preference for a certain format. Therefore, it is up to the distributors to decide on the format of their illustration. This scope is useful for the financial institutions and should be kept. In the some markets tables are often used which are known by the clients from other information such as the PRIIPs-KIDs.

Question 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.

1. **No obligation for an explicit approval of the client to use a durable medium instead of paper**

The obligation to get an explicit approval from the client to submit documents on a durable medium other than paper (Art. 3 sec. 1 MiFID II Delegated Regulation (EU) 2017/565) should be deleted. In times of digitalization and sustainability, the financial institutions should be able to decide which medium is appropriate until it is ensured that the document can be received by the client. For example, the bank should be able to rely on the fact that the client agrees on PDF-documents if he informs his bank about his e-mail address or has an electronic postbox. In this respect, we like to point out that many clients are aware of sustainable aspects and reject the production of paper piles.

2. **Possibility to opt out from the costs disclosure regime for experienced retail clients**

Experienced retail clients should have the possibility to opt out from the obligation to receive information on costs and charges and inducements. The legislator and/or the supervisory authority (e.g. ESMA) should therefore define the criteria for an "informed retail client". On such basis, an informed retail client should be able to decide on the amount of information he wants to receive from his bank. In particular in the securities business the active and experienced clients consider the redundant costs and charges information needless and would like to opt out.

3. **Clarification that the costs disclosure regime only relates to purchase orders**

The legal requirements aim for the customer to take investment decisions on an informed basis (Art. 24 sec. 5 MiFID II). This shows that the legislator only had the purchase of a product in mind, because the client only takes an investment decision when buying a product not in the case of a sell order. In case of a sell order other aspects than the costs usually are in the focus of the client's intention to sell a certain product (such as the assumption of a price decline or personal need for liquidity etc.).

Therefore, several legal requirements of the MiFID Delegated Regulation (EU) 2017/565 do not fit in case of sell orders, in particular:

- The illustration showing the cumulative effect of costs on return (Art. 50 sec. 10 MiFID Delegated Regulation);
- The illustration showing any anticipated spikes and fluctuations (Art. 50 sec. 10 MiFID Delegated Regulation).

MiFID II does not indicate how it should be calculated the cost of transaction. Consequently, to calculate this cost we use the method set out in PRIIPs Regulation. Under this Regulation, the cost of transaction means an opportunity cost than a real cost because the aim is to calculate the cost of the best option not

executed. This has created confusion among the investors, we believe it would be more beneficial to inform the investors about the real cost. We believe that this issue should be addressed in the MiFID II review in order to establish in the Regulation how to calculate the cost of transaction.

4. Calculation of transaction costs

We would like to add a comment in relation to the distribution of investment funds, transaction costs must be disclosed both under MiFID II and in PRIIPs KIDs as an element of product costs from 2022.

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. There is no doubt, in principle, 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.

We believe that 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.

These divergences are difficult to understand by the investors and consequently they require a considerable amount of explanation by the distributor. Therefore, the spirit of this legislation, investor protection, is not taken into account. For this reason, this objective should be taken into account by the time of harmonising these regulations.

About ESBG (European Savings and Retail Banking Group)

ESBG represents the locally focused European banking sector, helping savings and retail banks in 20 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. An advocate for a proportionate approach to banking rules, ESBG unites at EU level some 1,000 banks, which together employ 780,000 people driven to innovate at 56,000 outlets. ESBG members have total assets of €6.2 trillion, provide €500 billion in SME loans, and serve 150 million Europeans seeking retail banking services. ESBG members are committed to further unleash the promise of sustainable, responsible 21st century banking.

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