September 2019

EBF response to ESMA's call for evidence: Impact of the inducements and costs and charges disclosure requirements under MiFID II

General comments

ESMA has so far produced Q&s on cost and charges disclosure on an ongoing basis. Most of these Q&As have gradually addressed the ex-ante disclosure, while very few Q&A have been released on the ex-post periodic disclosure. This approach proved is not the most efficient since:

i. clarifications have been provided too late when intermediaries have already made very large investments to adopt their own procedures;
ii. clarifications are fragmented and sometimes unclear or not applicable;
iii. clarifications provided did not address the most important issues;
iv. any change to the procedures already implemented by intermediaries aimed at following the ESMA's clarification provided from time to time requires proper planning which takes into account the related costs and implementation times.

At this stage, in case ESMA should decide to go on providing further clarification on this subject we strongly recommend the use of the Guidelines tool instead of the Q&As in order to:

i. allow intermediaries to take part in the consultation process by making their own contributions (Q&A does not provide any prior discussion with the industry) based also on the experience gained in the implementation of these complex requirements;
ii. ensure a more organic and systematic approach to interpretation;
iii. allow the industry to plan the necessary further changes and the related costs.

The call for evidence focuses on the disclosure rules relating to inducements. We 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 regarding the "quality enhancement" regime, the principle of

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proportionality and application to primary market transactions. Whilst noting that the mandate to ESMA is restricted to disclosure, we would welcome a more extensive study on the impact of the inducement rules in MiFID II.

It should be noted that the industry (both manufacturer and distributor from all sectors including the EBF) is heavily engaged in self-regulatory work through FinDatEx[1], under the governance of EU wide associations including EBF, to create a better standard and more harmonized framework for data exchange related to cost & charges and target market data. One of the consequences of the MiFID II cost & charges regime is that this has become a truly massive data exercise between manufacturers and distributors. This data exercise should be taken into consideration by the legislators and the regulators when setting out the rules. The industry's self-regulatory work will take some time to finalize and implement, and the regulator should be aware of and should take this into consideration.

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?

- **Scope of requirements: underwriting and placing investment service**

In applying disclosure requirements in relation to inducements, one of the most important issue that industry is facing is the different scope of application of inducement requirements as understood by different NCAs. This is even more true regarding inducements for underwriting and placing investment service.

Although firms should assess all payments or benefits received against the inducement rules, in the specific context of a firm providing underwriting and 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.

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

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.

- **Implementation issues**

In our experience, sometimes it can be very difficult to apprehend the meaning of MIFID II classification and terminology.

[1] https://www.findatex.eu

Before the implementation of MIFID II, banks already had to disclose inducements, but didn't have to aggregate them with the rest of the cost information.

We realize that the previous way to disclose inducements was less transparent and that a detailed (instead of an aggregated) disclosure of such inducements may not enable investor's full perception of applicable costs.

However, the aggregation of the different components (costs and inducements) means that unless there are clear supervisory guidelines, each producer or distributor may be disclosing figures that aren't necessarily comparable, meaning that the underlying components may not be the same, thus creating possible unfair competition, be it between producers, institutions or national markets.

You can see below issues

- Inconsistencies when presenting ex ante costs and inducement:

When looking at cost from a retail client perspective, it is easier to comprehend that a financial product has a total cost made of number of elements, which is consistent with the way UCITS KIID and PRIIPs KID are designed. When inducements are classified as service costs under MiFID II it creates some inconsistencies between product costs under MiFID II, and the product costs under UCITS KIID/PRIIP KID, where it is included in the product cost. This doesn't make sense for most retail clients, as it does not match the product focus of the KIIDs/KIDs and means inconsistent information for the investor. The inconsistency also creates a problem of which data to use for the inducement disclosure – the rate in the agreement between distributor and manufacturer or the rate on the fund (EMT). In practice the inducements element could be shown as a separate line and displayed as a "whereof inducement" of the total product costs, which then includes the rate in the agreement between manufacturer and distributor and showing the investor the part of the product cost which is de-facto paid and thereby the payment potentially creating conflict of interest. This would help retail clients to get a clear view.

- Inconsistencies when presenting ex post costs and inducement:

In relation to the ex post cost statement, it has been a challenge that the inducements are typically paid to the distributing bank once per month or per quarter by the product manufacturer. This means that there is a time delay of up to a quarter between the point when inducements are charged by the manufacturer and the point when it is received by the bank.

For investment funds, there is a challenge regarding the individual client calculation. Inducements are calculated and booked based on principles which are retrospective and done on the basis of the total assets held by all clients in the specific instrument. In these situations, the individual calculation will be theoretical based on the agreed inducement fee / fee percentage. We therefore suggest that it should be accepted to calculate inducements based on the agreed inducement fee/fee percentage.

B: Do you use the ex-ante and ex-post costs and charges disclosures as a way to also comply with the inducement's 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.

If the inducement is related to an instrument, at instrument level, ex-ante, and in an aggregated way, ex-post. If the inducement is related to a potential investment service, in a generic way ex-ante, and at client level and in an aggregated way, ex-post.

Some distributors may also disclose differently depending on distribution channel and whether the client intends to buy just one instrument or whether we are looking at a client's total portfolio. The main point is that it is important that flexibility is retained so that we can tailor disclosure based on the client context.

C: Have you amended your products offer as a result of the new MiFID II

Product offer has not been adjusted due to MiFID II disclosure rules but because of rules on acceptable inducements (for example, collective investment institutions clean classes offering for discretionary clients) has not been modified by MiFID II as a whole"

As mentioned under "general comments", the cost & charges rules require large volumes of data to be exchanged between manufacturer and distributor. Some manufacturers are not subject to MiFID II and have therefore not been able to deliver the data needed, including information on inducements. In some cases, banks have chosen not to distribute products from manufacturers which are not able to provide necessary data under MIFID II, hence limiting their offering.

Even though not being common to amend any product due to these rules, it is our perception, however, that several fund managers have reduced management fees and removed inducements paid to distributors. This has not necessarily reduced the impact on final investors, as operators reintroduced subscription and reimbursement fees.

However, these rules have affected the distribution of products, not only at European level, but also by creating national divergences, like the one mentioned on answer to question A regarding underwriting and placement fees.

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

Yes, some of our members 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 among supervisors across Europe have been applied in relation to ex-ante and ex-post disclosure obligations and have made difficult the provision of cross border services and increased legal uncertainty.

Some specific examples of difficulties relating to disclosure are:

(i) The cumulative effect of costs on return: There is no clear information in the market about what and how this information should provide and it may be questioned if this illustration is of any use to investors. A preferred solution would be to delete this requirement. If that is not possible, it is important to get more guidance from ESMA in order to increase legal certainty and help clients to better understand the information received. In that connection it is important to take the characteristics of different types of financial instruments into account.

(ii) The interaction between article 59.4m) and article 50.9 of the Delegated Regulation 2017/565: Whilst particular supervisors are considering that implicit costs of the product should be disclosed for all products and services on a trade by trade basis in T+1 based on article 59.4m), most of the market considers that article 59.4m) would only be applicable to commissions and expenses (by difference to the cost and charges mentioned in article 50.9) charged by third parties during the execution of the order, that the investment firm might be assuming in the first instance and is after charging the end client. A preferred solution would be to delete this requirement. If that is not possible, single position provided by ESMA would be needed.

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?

Different jurisdictions have different levels of visual and calculation guidance. In some, there are no local interpretations, which lead to asymmetric implementation between cross border entities.

Through a cross-comparison between four jurisdictions (Belgium, France, Italy, Germany), differences were shown with regards to the layout structure (some had vertical tables, other horizontal ones), costs were not always shown in % and in some cases product costs were no shown. Additionally, several differences in interpretation were discussed regarding the notion of 'recommended or market' and ex-ante in good time.

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?

No, the current rules on conflict of interest are sufficient for the needs of retail investors.

In our opinion, the MIFID II costs categories may not provide better information for investors, namely because providers of different types of products may have different interpretations of inducement disclosure rules, terminology and calculation methodologies.

MIFID II rules discourages banks to use inducement as a form of remuneration but this could be the most efficient way, in the client perspective, especially in countries where there is a bias between inducements and commissions fiscal treatment. In this perspective, MIFID should be more neutral between inducements and direct commissions approaches, and (1) enforce a clearer need to disclose conflicts of interest and (2) have a stronger supervisory action on product selection procedures and governance.

As explained in answers to questions A and C, regarding the disclosure regime on inducements, rather than suggesting changes, what is needed is a common approach among jurisdictions of the application of the requirements and of the scope of the requirements. 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. Once again, the payments related to underwriting and placing investment services would be a very good example where different approaches are being taken by regulators.

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)?

According to the ESMA Q&A No 13, third party payments received by investment firms in connection with the investment service provided to a client shall be itemised separately within the aggregated costs and charges, consistently with the example there illustrated. This implies that inducements must be deducted from the relevant product costs and expressed both as a cash amount and as a percentage.

On the basis of this clarification, applicable both to ex-ante and ex-post costs and charges disclosure, to our knowledge almost intermediaries have linked the inducements disclosure to the costs and charges disclosure. Consequently, the two disclosures have been developed with the same approach. The ex-ante inducement disclosure is ISIN based calculated, even though inducements are illustrated to investors as related to the relevant investment service provided. The ex-post inducement disclosure is calculated with reference to each single financial instruments or to the relevant group of financial instruments and inducements are illustrated to investors as related to the relevant investment services provided.

In our experience we:

- believe that the inducement disclosure is clear, comprehensible and complete. Therefore, we do not see merit for further detailing it;

- perceive the implementation of the MiFID II inducements disclosure as a strengthening of the MiFID I ones, but at the same time as a confirmation of the approach already adopted. Consequently, we think that it did not produce any impact at all in the characteristics of the service model adopted by intermediaries nor on the investment decisions of the clients.

In the short term we have noticed an increased awareness among investors, however, not leading to movement of investors as regards selection of service provider. Investors seem much more focused on total costs rather than on the inducement costs and individual components of the total costs as a starting point. The element of inducements is not different in this context. Based on the general cost picture it may be that more do-it-your-self type clients have moved more into the passive investment fund space but then we are also bringing the whole active vs. passive discussion in play, not only the MiFID cost & charges regime. In addition, factors such as data access have an impact on which products and services which are offered clients. But this is an effect of MiFID II as a whole and not only the disclosure of inducements.

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.

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 MiFID II to the extent that no suitability test has to be carried out for these types of customers concerning execution-only business. 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. Professional clients and eligible counterparties are price-sensitive and therefore regularly maintain business relationships with several investment firms. Today, it is common EU-wide market practice for professional clients and eligible counterparties to make investment decisions at short notice on the basis of parallel quotes from several investment firms. They neither need nor wish to receive ex-ante cost information, especially as they would have to bear the market price risk for the period of preparation and provision of the ex-ante cost information. Technically, it is also not possible to provide them with such information due to the order channels used - e.g. connection via interfaces such as FIX. For these client categories, an exception should therefore be created for ex-ante cost reporting.

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.

Basically, all professional clients and eligible counterparties are aware of the precise costs of their decisions. Therefore, the rules of MiFID II in the professional market are unnecessary and basically a cost burden with de-facto no benefit to professional clients. Secondly in some professional markets the speed of a trans-action is crucial to the client and the client is bothered by the fact that an ex-ante cost disclosure must be presented before the decision to trade can be taken and executed. The best example is phone markets on FX derivatives. The MiFID II cost and charges regime is really not fitted to match derivative markets neither by way of process nor content. It seems as if the cost and charges regime and the language and methodology of the investment world and retail world has been pushed over the professional derivative markets and it does not fit.

Besides the lack of interest from professional clients, 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.

Considering the recent ESMA Q&As we see a challenge in providing adequate ex-ante costs and charges information to clients in all instances. The information must describe the specific costs and charges of a specific investment and not just more general information about the costs and charges associated with this investment type. We would suggest to leave more room to agree the level of information with the clients (see also the answer to question J), in particular regarding products that are traded via the telephone or via chat where it is not always practical or in the interest of the client that information shall be provided before entering into the trade. Please also see the answer to question P about telephone trading.

As a consequence of the above, the EBF takes the view that both professional clients and eligible counterparties should be able to opt-out of cost disclosure requirements.

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.

'A MiFIDII/MiFIR/PRIIPS Regulation Impact study'[2] showed clients, professional more than retail client, would like to have a choice of waiving suitability reports and ex-ante cost disclosure. The more experienced the client, the more they felt bothered or annoyed by the mandatory information. Professional clients show no interest in detailed costs information, because they generally tend to be interested in the aggregated cost figure. Cost disclosure might in cases be of (some) value towards retail clients but not necessary in a professional secondary bond market. The cost disclosure seems artificial, takes a lot of costs and effort, while professional clients have no interest in it.

Besides the lack of interest from professional clients, 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.

The EBF is aware of the possibility to agree on limited application of the cost & charges rules in certain situations set forth in Article 50 (1) of the Commission Delegated Regulation (EU) 2017/565. However, in EBF's view this is not sufficient taking the needs of eligible counterparties and professional clients into account and the EBF is therefore strongly in favour of amending Article 50 (1) by introducing an opt-out possibility for these client types.

A point which seems to be a contradiction in the intersection between MiFID and PRIIPs is that while PRIIPs only covers disclosure to retail clients, it is expected that the PRIIPs principles and methodologies should be transferred into cost disclosures under MiFID and cover professional clients and eligible counterparties.

Eligible counterparties should have the responsibility to figure out the cost picture on their own, and there should be full flexibility for authorized and supervised investment firms as eligible counterparties to sort out the costs between themselves.

[2]https://die-dk.de/en/topics/press-releases/mifid-ii-driving-customers-away-capital-markets/

Often professional clients and eligible counterparties will use multiple distributors and sometimes also multiple custodians. The ex-ante and ex-post cost disclosure rules are meant to provide the investor with an overview of total costs connect-ed to a product or a portfolio. Since product and services are often provided by different companies, the client never obtains a full overview which renders much of the cost disclosure irrelevant. It should be optional for these clients to switch off the cost disclosure completely. We do not support that clients can switch off individual parts of the disclosures as this would require substantial IT development.

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.

According to the ESMA Q&A No 7, 13 and 14, intermediaries have to aggregate costs and charges in connection with the investment service and costs and charges associated with the financial instrument and ensure that:

- any inducements mentioned as costs of the PRIIP should be added to the costs of the investment services and deducted from the costs of the PRIIP (as mentioned in the KID);
- third party payments received by investment firms in connection with the investment service provided to a client shall be itemised separately;
- the aggregated costs and charges shall be totalled and expressed both as a cash amount and as a percentage;
- the disclosure to the client shall be consistent with the example illustrated within the Q&A No 13 (so called table of the Q&A ESMA No 13);
- ex-ante calculations must be done on a best effort basis.

The necessary consequence of ESMA's clarifications is that intermediaries often cannot use PRIIPs KID and UCITS KIID for disclosure of product costs (which are, moreover, conceived to illustrate the maximum amount of the possible costs) as they need to receive data likely to be directly processed on the basis of the actual amount of each transaction (or the assumed investment amount in line with recital 78 MiFID II and ESMA's Question 22 & 29) and given that some information is, in some cases, duplicated or not present.

Both KIDs and KIIDs should ensure they treat, organize and disclose costs according to the same rules and format. We would recommend additional clarification and examples regarding definitions of product related costs and service related costs in the PRIIPS KID as well as ongoing funding related costs.

Practical problems concerning transaction costs in the EMT

Distributors must provide their (retail) customers both ex-ante and ex-post an aggregated total cost overview of the costs of its (investment) services added to the costs of the (investment) products based on MiFID II. For the costs of investment products distributors should be able to rely on manufacturers, that must include cost information in information documents such as the PRIIPs key information document ("PRIIPs KID") and / or the key investor information document ("UCITS KIID"). There is thus, a logical connection between manufacturers and distributors.

Distributors are in a large part dependant on data from product manufacturers. Relying on the PRIIPs KIDs or UCITS KIIDs therefore seems logical, but because of flawed methodologies, inconsistent or missing data the current practice is that distributors only in few instances can rely on PRIIPS KIDs and/or UCITS KIIDs for MiFID II costs disclosures from manufacturers. We have informed the Dutch supervisor in multiple occasions on these issues.

The biggest issue is the PRIIPs costs calculation methodology. Distributors believe that the prescribed PRIIPs methodology for implicit transaction costs and the (partly) consequent lack of (consistent) data could currently lead to a misleading picture of the implied transaction costs within investment funds by fund managers to banks (and to the consumer).

Problematic methodology regarding transaction costs

The PRIIPs transaction cost methodology is based on partially unsuitable assumptions that might ultimately result in misleading information for (retail) investors. It systematically leads to market movements (also referred to as "slippage") being included in the calculation of transaction costs within a fund. Including these market movements means that the implicit transaction costs shown to investors are in many cases overestimated or underestimated. Investors can therefore get a confusing and misleading picture of the actual transaction costs within an investment fund.

There is much industry criticism on the above described PRIIPs methodology for calculating, in particular, the implicit transaction costs. Product manufacturers themselves also believe the methodology is flawed and should not be relied upon. For example, in its press release of 22 December 2017, EFAMA has already warned that the methodology for calculating transaction costs can be (potentially) misleading. In the position paper “EFAMA's evidence on the PRIIP KIDs shortcomings” of 28 June 2018, EFAMA also explained this further. This position has been emphasized once again in our Dutch Member’s (NVB) response to the ESA's consultation on amendments to the Delegated PRIIPs Regulation of 8 November.

The methodology for calculating transaction costs described above yields confusing and unreliable figures: on an almost constant basis, transaction costs are either over- or underestimated. In a significant number of cases, these wrong estimations lead to total negative transaction costs that are presented to investors. This would mean that clients would be rewarded in gross performance for the "negative costs" that a fund manager incurs for his portfolio management. Although this is theoretically possible due to the efficient trading of a fund manager, it will generally be necessary to pay for the portfolio management activities of a fund manager (buying and selling securities). Negative costs for the above services are therefore not easy to explain to a consumer in practice. Besides, due to the slippage method, transaction costs can not only be negative but also unrealistically high.

Due to the volatile and (sometimes) extreme outcomes that the method generates, managers of investment funds in practice deal very differently with the delivery of (implicit) transaction costs via the EMT ("European MiFID II Template") to distributors.

1) Investment fund managers can choose not to fill in the fields. From MiFID II, these parties do not (always) have the same cost transparency obligations that a distributor has towards consumers. Investment fund managers do not want to distribute inconsistent or misleading information and can therefore choose not to provide the distributor with transaction costs via the EMT. **("Empty fields"**); or

2) Non-representative, or even extreme, outcomes pose a risk to investment fund managers. In the interest of the distributor and the end customer, investment fund managers can therefore correct the transaction costs in the EMT to a number that, in the opinion of this manager, gives a more realistic and representative picture of the transaction costs incurred within an investment fund. This can also lead to a decision to set the implicit transaction costs to 0 in the case of negative costs. **("Corrected fields"); or**

3) Investment fund managers provide the transaction costs in the EMT on the basis of the prescribed PRIIPs method, despite their opinion that the extreme outcomes in some cases could be misleading. ("**Completed fields**")

Current practice, as the 3 examples above show us, is by no means desirable for distributors. As a result of the PRIIPs methodology, managers of investment funds feel forced to make claims that they do not dare to give in the light of their fiduciary (care) duty.

FinFiles, a data vendor with which a number of Dutch distributors work, has investigated the current situation. This shows that a significant proportion of investment fund managers provide negative transaction costs for their investment products, set the costs to 0 or do not provide any data at all.

These three categories represent a risk for distributors in relation to their MiFID II obligation with regard to cost transparency.

EMT veld 08070 "Financial Instrument Transaction costs ex post"

08070	Transaction cost ex post	
0 (corrected)	**10681**	**12,28%**
0-99	44901	51,62%
1-99	3	0,00%
-99-0 (negative)	**2634**	**3,03%**

99.99 (corrected)	**2728**	**3,14%**
Other (Empty)	**26043**	**29,94%**
Totaal	86990	100%

Table 1. Survey moment 09-2019 (source: FinFiles)

As described in the introduction, based on MiFID II, distributors must provide their (retail) customers both ex ante and ex post an aggregated total cost overview with regard to the costs of the (investment) services added to the costs of the (investment) products.

Distributors, who depend on the delivery of data by manufacturers, receive transaction costs from these manufacturers through the EMT in the form of negative, corrected or empty fields (see Table 1). It is important that if distributors do not receive transaction costs data from these product developers (empty fields), they must estimate or calculate these costs themselves on the basis of MiFID II. These assumptions that distributors make are therefore based on estimates that do not give the end consumer **any** certainty about the accuracy of the costs shown.

In our opinion, this situation is undesirable. ESMA indicates that distributors should follow the PRIIPs methodology, including "slippage". Where ESMA itself indicated earlier in its Final Report that market calculation should not be included when calculating this under MiFID II. Distributors should be able to rely on data provided by investment fund managers, whether or not via data vendors, and whether or not based on the EMT template. That is at odds with current practice where all transaction cost fields in an EMT are actually under discussion. A coherent cost methodology between PRIIPs, MiFID II and UCITS is both for customers and financial institutions desirable.

European governance

The granularity of the data which intermediaries need to receive from manufacturers (asset managers and structured products manufactures) in order to calculate accurately the aggregated ex-ante and ex-post costs and charges have been deeply analysed, jointly by manufacturers and distributors, within the European Working Group in order to develop a standardized flow of information, named European MiFID Template (EMT), for each financial instrument. The EMT provides two different sections, respectively dedicated to ex-ante and ex-post costs and charges.

Given the importance of ensuring the effectiveness of the EMT over time, the European Working Group has evolved into a new stronger and clearer governance structure, the Financial Data Exchange Group ("FinDatEx"), supported 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 Co-operative Banks (EACB) and the European Structured Investment Products Association (EUSIPA).

As a matter of fact, many EU intermediaries use only the EMT (which is ISIN based and produced by manufacturers) in order to calculate accurately the ex-ante and ex-post costs and charges of financial instruments.

However, stakeholders face diverging requirements. Diverging requirements mean that product costs in the KID are calculated on a different basis to the cost information pursuant to MiFID II. The treatment of inducements differs, for instance. While product costs have to be presented under the PRIIPs Regulation inclusive of inducements, inducements are classed as service costs under MiFID II, so product costs are exclusive of inducements. For clients, this means that they are provided with differing product costs for the same product (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 of €10,000. At a large German bank, for example, the same product recommended for an investment of €10,000 was shown to have product costs of €246.28 or 1.38% p.a. in accordance with the PRIIPs Regulation and product costs of €111.27 or 0.56% p.a. as calculated under MiFID II. This discrepancy, which has to be explained to clients and is difficult for them to understand, is a result 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. A possible solution to the problem of reconciling the PRIIPs Regulation and the Delegated Regulation with MiFID II would be to dispense with the presentation of costs in the KID if the product in question was a financial instrument within the meaning of MIFID II. This would avoid giving clients contradictory information while nevertheless informing them about the costs in accordance with the requirements of MiFID II.

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 different interpretations and implementations of the MiFID/PRIIPS requirements among different jurisdiction. Banks in Europe have received different levels of guidance from different supervisors. In some cases, these local interpretations lead to asymmetric implementation between cross border entities. We urge supervisors to construct a common understanding and guidance regarding current costs and charges legislation, without creating new or additional rules. The constant updates of and changes in the ESMA Q&A's are an example of asymmetric interpretations between jurisdictions.

Furthermore, although not directly related to costs and charges, we would like to highlight in this section the adverse impact that local legislation has on intra-European competition. Regulators that operate on 'an island' (i.e. constructing local legislation instead of following European market practice) should be aware of the interconnectedness of financial markets. The ban on inducements in the Netherlands (local legislation) in the light of MiFID II (with a European passporting system) leads for example to market entrants in the Netherlands that advertise with 'free trading' or 'zero commission fees'. These entrants actually operate on, for example, a German passport (where there is no ban on inducements). Supervisors and regulators should once more be made aware of the fact that local legislation (or local interpretation of European rules) have an adverse impact on competition and is not in the best interest of clients.

Different interpretations around costs and charges therefore, should be avoided at all times. We do however see different interpretations (and enforcing of legislation) in the fields[3] of:

1. Layout and segregation of Service costs and Product costs

At the time of the introduction of the MIFID II regulations, Dutch banks constructed their cost classification based on art. 24: 4 paragraph c Directive 2014/65 EU in conjunction with art. 50 paragraph 2 sub a and b of the 2017/565 delegated regulation. It appears from these articles that information must be provided in advance and afterwards (re. the costs and charges) with regard to all costs and charges that are charged by the investment firm, for investment and / or ancillary services that are provided for the client and all costs and associated related to the development and management of financial instruments (under a). In addition, it is specified that the provisions in sub a are received from third parties in connection with the investment service provided for a client, separately specified and a total of aggregated costs and charges is calculated.

The Dutch banks see various interpretation options for financial institutions in the above-mentioned regulations and in addition in the table (Annex II table Regulation 2017/565). This is due to the fact that there are concepts with regard to the cost items that appear in both tables, but also because the cost aspects and the examples are susceptible of different interpretations. For example, there are cost items that appear in both tables, but they serve or apply to the product or service. There is no clear definition of what is meant by **1) Service costs** and **2) Product costs**. Especially, costs that seem to not fit in with either category, seem open to different interpretations. For example, swing pricing or implicit costs like market spreads could be interpreted as both service- and product costs. In practice, this means that financial institutions make their own consideration with regard to these cost aspects, which leads to various interpretations between different jurisdictions (and even, within jurisdictions).

2. Swing Pricing

Banks see inconsistencies in the enforcing of costs & charges regulation in the area of swing pricing. Dutch banks have warned the regulator on multiple occasions about the impossibilities, inconsistencies, and bottleneck regarding the disclosure of swing pricing.

First of all, we doubt whether there is a legal basis to disclose swing pricing. MiFID II refers to PRIIPS for the costs to be shown with investment funds (MiFID Art 51 Delegated Act: investment firms must also provide information about costs that are not included in the KID). However, in Annex VI of the PRIIPs Regulation, reference is made to costs such as the surcharge and deduction: these are among the transaction costs within the fund:

Where a PRIIP has a pricing mechanism that offsets the impact of dilution from transactions in the PRIIP itself, the amount of benefit accruing to the ongoing holders of the PRIIP from anti-dilution mechanisms may be deducted from the transaction costs incurred within the PRIIP using the following methodology: (a) the monetary amount of any anti-dilution levy, or other payment in connection with a transaction in the PRIIP itself, that is paid to the PRIIP may be subtracted from the total transaction costs (b) the benefit to the PRIIP of issuing units (or otherwise enabling investment in the PRIIP) at a price other than the mid-price, or of cancelling units (or otherwise enabling redemption of funds from the PRIIP) at a price other than the mid-price, provided that the PRIIP itself receives

[3] Please note, these are illustrative examples. The examples are not limited by this list. In addition, there could be more examples of different interpretations and enforcing of the rules between jurisdictions.

the benefit, shall be calculated as follows and may be subtracted from the total transaction costs: (i) the difference between the price of units issued and the mid-price, multiplied by the net number of units issued; (ii) the difference between the price of units cancelled and the mid-price, multiplied by the net number of units cancelled.

In the PRIIPs appendices, the surcharges and discounts are not mentioned as costs to be shown separately. It is therefore **not mandatory for UCITS or AIFs to calculate and report them**. It is up to the fund manager to report the correct percentage (total) portfolio transaction costs to his distributors so that they can meet the MiFID II obligations. If the netted surcharges and deductions are not included therein, the stated percentage of portfolio transaction costs may be a fraction too high: the investor could see costs that are slightly too high.

Second, there is an absence of data. This stems, in part, from the missing legal basis for UCITS and AIF's to disclose swing pricing. They, therefore, offer no or limited and non-standardized insight into swing pricing. Also, we have been made aware of the Luxembourg regulator CSSF standpoint that swing pricing should not be referred to as costs. Lux funds (a majority of the European fund market) may only publish the "swung NAV" from CSSF. No publishing of "clean NAV's" means the impossibility to make swing pricing transparent for distributors.

Third - even if there would be a legal basis for the disclosure of swing pricing and clean NAV's would be presented – we believe disclosing the swing pricing in execution only and investment advice area could lead to investor confusion or misleading. Where in DPM (for example with a block order) the investment manager might know (because of the significant size of the order) in advance whether the swing pricing mechanism will be activated or not, and therefore if there will be made (additional) costs re. the order. With significant smaller orders (i.e. in execution only or advice) customers have no insight, in advance, whether the swing will be in their advantage or disadvantage.

3. The cumulative effect of the costs on the return of the investment

We see different interpretations of the requirement to provide clients with an illustration of the cumulative effect of costs on the return of an investment. For presenting the ex-ante effect we see different practices on the expected return, the holding period, and the costs that should be included in the calculations.

As to the (expected) return of the investment, Belgian practice is that calculations are based on an expected return rate of 0%. Dutch practice however is that investment firms apply 4% expected return rate. In terms of annualized percentages, this amounts to the same. However, in terms of cash amount, there will be a difference depending on the expected rate of return that is used for the calculation.

As to the holding period, we see discrepancies in the time periods that supervisors suggest be used in ex-ante cost disclosures. ESMA Q+A's do not mention any specific time period, but do imply that investment firms base their calculations on the recommend holding period that the manufacturer uses in the PRIIPS KID. Also, Dutch practice is that investment firms base cost disclosures on the investment horizon or expected holding period for the specific client. Belgian practice is that calculations are based on three horizons: 1 year, 0.5 recommend holding period (RHP) and full RHP. Of course, this greatly impacts the amount of data on the disclosure.

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?

We don’t believe it is necessary to clarify in more detail the format and presentation of the costs and charges disclosure as ESMA has already clarified the content of this disclosure through the table provided with the Q&A No 13 and of the itemised breakdown to be provided to clients.

The use of this table for the ex-ante disclosure does not leave room for different approaches as it is necessarily ISIN based. Differently, its application to the ex post periodic reporting leaves room to define the proper level of aggregation, especially when the relationship of the intermediary with the client includes several investment services (portfolio management, investment advice, executive investment services). In view of this, the approaches can be differentiated, but we do not believe it is necessary to regulate the level of aggregation of the costs and charges disclosure as it should reflect the service model provided by each intermediary. On the contrary, we believe ESMA should allow some flexibility on reporting presentation (based on each account or service or all accounts or services).

As far as it relates the timing of the ex post periodic reporting it must be taken into account that:

- it is not possible to set the timeline which must be respected by intermediaries in providing their clients with this reporting without setting the timeline by which manufacturers must provide intermediaries with the ex post cost and charges flow of information. At this stage there is no single timeline with which different manufacturers communicate ex post costs and charges data. This is especially crucial in the case of asset managers manufacturers who can either provide data referred to the calendar year (which means that the data related to the calendar year arrive in line towards the end of the month on March of the following year) or to the fiscal year (e.g. from 01/07 to 30/06 or from 01/10 to 30/09);
- intermediaries need time to: i) review the quality and consistency of the data received from manufacturers and to require more qualitative data in order to carry out their calculation; ii) define the proper methodologies and algorithmics, often affected by the peculiarity of the methodologies adopted by different manufacturers; iii) the quality check of their own methodologies and results. On this regard, the commitment of intermediaries in this first year of implementation of their new procedures and calculation methodologies has been really high.

It is a delicate balance between enabling clients to compare service providers and instruments and providing the flexibility to the service provider to ensure that the disclosure is clear and not misleading.

However, we believe more clarity is needed regarding the handling of entry and exit costs. This is particularly the case for financial instruments such as funds, which may operate with swing pricing or subscription and redemption fees which are not known until the total net subscription/redemption amount for all subscribers and redeemers is known.

Furthermore, it could be considered whether to define a specific time horizon or at least provide more guidance for calculating ex-ante costs and charges to ensure that comparability is increased between service providers.

It could be considered whether it would be beneficial for industry and regulators to have a joint process of developing and calculating some examples of costs and charges disclosures to increase a uniform interpretation of what to include in the calculations and how to disclose. Not with the purpose of having more regulation but to ensure uniform interpretation.

Template ex-ante and ex-post (investments) :

Changes to the format and presentation should be made along with answer to question A on presentation of inducements in the ex-ante cost presentation. Furthermore, the terminology in the reporting template should be made simpler for the retail client to receive information that is understandable and simple. We suggest the following templates – a minimum report for the client that just want the top line costs and a larger template with details for some client types and available for instance on demand.

With regards to guidance on the content and how to comply with the regulation on ex-ante costs we still believe that more guidance should be given with respect to methodology. We think that guidance should make a clear distinction between portfolio management, advise and execution-only trading situations. There should also be a classification on different types of investment service costs and a mapping between type of service cost template fields in the three different standards investment situations (portfolio management, advice and execution-only). We can deliver a framework proposal for such a guideline on request but the main conclusions being.

- ✓ Execution-only:
  Only include service costs that are directly linkable to the trans-action and treat other related service costs as individual services (ex-ante re-ports) (ex. custody fees). Include all product costs.
- ✓ Advice:
  Treat advice as a separate service (ex-ante report) and following trans-actions as execution-only trades (ex-ante reports). All other related services are to be treated as separate services (ex. custody fees).
- ✓ Portfolio Management:
  Estimate all cost components in the portfolio agreement. This is a very separate approach where most cost components need to be estimated under many assumptions. (ex. Estimated number of trades).

Without further guidelines on ex-ante cost disclosure the content of the ex-ante reports are likely to differ significantly across Europe and across distributors. Secondly the guidelines should explain how to comply with the rules in the OTC derivative space and the template for OTC derivatives should look very different since terminology in the derivative markets are very different. The current template does not make sense for clients trading OTC derivatives.

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?

There are different practices in the market.

Some intermediaries, in order to provide clients with an illustration showing the cumulative effect of costs on return, have not tied the information in question to any indication of the potential return of the investment (considering zero return) and have illustrated the impact of the different types of aggregated costs on the amount invested.

This approach is justified by the following reasons:

- the information is immediately understandable by client, as it is based on the investment regardless of the market effect over time on the potential return of the instrument;
- it avoids the risk that the use of estimated yield may be considered by investors as a promised return;
- since cost information is sensitive to assumptions about estimated performance and ex-ante information and it could also be used for a comparison of services/products, assuming a return of 0% is considered to be a preferable choice, easily practicable as well as transparent, and not misleading, for the investor;
- it is not possible for intermediaries to refer in any case to the return reported in the KI(I)D, taking into account that: i) the PRIIPs KID reports 4 performance scenarios, the structured UCITS KIID reports 3 performance scenarios, and it is not possible to determine which of them is the most reliable; ii) the UCITS KIID does not show any prospective performance; iii) there are financial instruments without KID and KIID.

According to the above considerations, we believe that it would be necessary to modify the relevant MiFID II provision, requiring intermediaries to disclose to their clients the impact of costs and charges on the amount invested instead of the impact on the return of the investment.

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 EBF would be cautious in supporting any methodology. We would favour a flexible approach where each bank should be able to pick the methodology which suits the best its activity.

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?

Clarifications provided by the ESMA Q&A No 28 do not properly meet the needs and peculiarity of the telephone trading, practically limiting the possibility of adopting this activity to the only investments without any product costs.

Instead we confirm:

- the importance of identifying a solution able to reconcile the need to provide the former information "in good time" with that of the typical speed of execution of telephone operations;

- that in such circumstances the regulatory requirement could be considered to be fulfilled where:

- the client has previously been provided, before the transaction, with the ex-ante information on costs and charges through the recorded telephone conversation and of the fact that the conversation is recorded and a copy of the registration remains available at his request;

As an example, in the case of telephone trading, clients expect orders to be accepted and executed immediately. At the same time, the vast majority of these clients are experienced clients with a large number of (recurring) transactions. Cost information on permanent data carriers cannot be made available in a timely manner due to postal delivery times. Typically, clients cannot or do not want to use the Internet at this moment, but rather the telephone. We ask for retail client to be able to opt out in the case of telephone orders. For professional clients and eligible counterparties there is a need for exceptions to the ex-ante cost reporting in general, including but not limited to telephone orders)

Please also note that the above comments also apply for other types of electronic communication such as chat.

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)?

While the new costs and charges disclosure requirements could gradually help investors to appraise the overall costs of their investments, we doubt that they could also help investors to understand how the overall costs impact the return of their investments as the relationship between costs and performance cannot be properly evaluated with reference to one year. A preferred solution for EBF would be to delete this requirement.

If kept, we believe that a flexible approach should be favoured and that no methodology should be imposed by regulators as we don't think the illustration helps clients' understanding. It is important to point out that fictitious returns should not be used solely for illustrative reasons. For many retail clients, fictitious returns are disruptive as these returns can neither be promised nor are reasonably likely. It is our position, there-fore, that the effect on the return must be communicated without the requirement to disclose an actual return nor fictitious return.

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.

Consistently with our previous answers N, P and Q, we believe that following amendments are necessary:

- to amend Art. 24 (4) of the MiFID II in order to require intermediaries to disclose to their clients the impact of the aggregated costs and charges on the investment, instead of the impact on the return of the investment; Thus, there should not be a requirement in MiFID II to disclose illustrative effects on return;

- to amend Art. 50 of the Commission Delegated Regulation (EU) 2017/565 adding a specific provision focused on the ex-ante disclosure to be provided in case of telephone orders. In case of distance communication such as telephone should be possible to provide information of costs on the same conditions as it is possible to provide the suitability report. It should also be possible for clients to opt-out.

We also understand that it would be important to provide a more detailed framework, and examples, otherwise each institution disclose ex-post costs in different ways, making it harder for clients to compare. Details regarding, for example, how the information is organised (regarding various levels, for example, through portfolio or financial instrument) and what would be considered as an anticipated spike (e.g. can a performance fee be qualified as an anticipated spike?) or fluctuation in costs should be standardized.

- The scope of the obligation to inform payment arrangements or other formalities/performance (recital 83 and Art. 50 (3) of the Commission Delegated Regulation (EU) 2017/565) should be clarified, for instance, through examples, namely whether if it only applies when fees are to be paid or represent an amount in other currencies. Also, to require conversion rate for all transactions in the ex post report is not proportionate and of very little benefits to retail investors.
- There should not an obligation to obtain the customer's explicit consent to the use of other durable data media

The process of obtaining the customer's consent to make regulatory documents available on a durable medium other than paper in accordance with Article 3(1) of the delegated regulation should be adapted. The bank should be free to choose the durable medium on which it transmits the information to the customer, provided that it can be assumed from its point of view that the information reaches the customer.

For example, if the customer provides the e-mail address for communication purposes, the information should be provided by e-mail as a PDF file or, if online banking is used, it should be possible to retrieve the PDF file. Such an adaptation of the Level II regulation would take account of the objectives of digitisation and sustainability. In order to meet selective customer interests, an opt-in option for paper provision could be included in Level II.

- Amend Art. 24 (4) of the MiFID II in order to require intermediaries to disclose to their clients the impact of the aggregated costs and charges on the investment, instead of the impact on the return of the investment;

- Amend Art. 50 of the Commission Delegated Regulation (EU) 2017/565 adding a specific provision focused on the ex-ante disclosure to be provided in case of telephone orders.

Ahead of any change to MiFID, we would strongly advise to:

- Ask supervisors on which practices throughout the market, they have a common opinion on and on which topics they don't;
- Support of level 1 MiFIDII/MiFIR text: an extensive review/refit of level 2/3, not just quick fix
- reiterate that any IT change in infrastructure is extensive. This is why any change in the regulation should be carefully assess, in particular considering how much administrative, legal & compliance and other costs have already been made by banks regarding costs and charges.

- Lead an impact study / consumer testing on cost disclosure: The ex-ante cost disclosure is a mandatory document which informs clients about all (ancillary) costs associated with the securities transaction and the financial product concerned. This must be provided to the client, prior to concluding a trade, in durable form (meaning in hardcopy or by e-mail, fax, in an electronic mailbox, or via a website). The objective is to increase transparency of the investment in terms of its cost structure, and to facilitate comparison, also with rival products or services. Yet this objective – which is also built on the concept of informed decision-making, is largely not reflected in clients' perceptions: in fact, only 42.7% of clients assign benefits to ex-ante cost disclosure[4].
- Lead and Impact study / consumer testing on PRIIPS: A document with a simple structure that is identical across all providers and restricted to a maximum of three pages would indeed be suitable for preventing clients from being flooded with information. Yet if clients ultimately do not (or cannot) trust this document, a fundamentally sound approach is rendered meaningless. This dichotomy is also reflected in the results[5]: 69.0% of clients said that they do not read the document. Consequently, 72.5% do not see any trust-building effect. The statement: "The key information document/product information sheet and key investor information provide a good basis for comparison in order to take better decisions" is rejected by 67.9% of clients. Overall, regulators' target would thus appear to have been missed
- Align with future review of Insurance Distribution Directive (IDD).

[4] Final Report: Ruhr-Unversität Bochum. MiFID II/MiFIR/PRIIPs Regulation Impact Study: Effectiveness and efficiency of new regulations in the context of Investor and Consumer protection (Bochum, 2019), p. 20
[5] idem

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About the EBF