

## ESMA

ESMA35-43-1905

### **Call for evidence on impact of the inducements and costs and charges disclosure requirements under MiFID II**

Finance Finland (FFI) welcomes the opportunity to respond to ESMA's call for evidence relating to the impact of inducements and cost and charges disclosure requirements in MiFID II.

Finance Finland represents the majority of banks, insurers, finance houses, securities dealers, fund management companies and financial employers operating in Finland. It has 347 member organisations.

#### **General remarks**

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 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 is heavily engaged in self-regulatory work through FinDatEx to create a better standard for data exchange between manufacturers and distributors related e.g. to cost and charge. The industry's self-regulatory work will take some time to finalise and implement, and the regulator should be aware of that.

FFI would like to stress that the implementation of MiFID II has required significant investments in new infrastructure and procedures (IT systems, staff training etc.) It is therefore utmost important that all the possible changes are evidence-based and includes consultations with stakeholders as well as consumer testing activities. Sufficiently long implementation period should be given in order to adapt to any regulatory changes. In addition to this, supervisors should retain from unexpected interpretations and supervisory practises which might cause changes in the infrastructure.

FFI's members are of the view that although legal certainty and harmonization is important, the complexity and level of detail should not be increased. FFI supports the general requirement on Level 1 that end-clients shall receive clear, correct and comparable information on all costs and charges which relate to the provision of investment services and financial instruments. However, on Level 2 and 3, the complexity of the rules has created a lot of legal uncertainty which in turn has led to divergent applications in the market.

## 4 Questions

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

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

There are many implementation challenges and divergent interpretations by competent authorities.

It is sometimes artificial to apply the disclosure requirements in relation to inducements within a business concern, where the outcome is depending on the structure and organization of the company. This has no added value for the investors.

When looking at this from a retail client perspective it is easier to comprehend that a financial product has a total cost which consist of a number of elements, which is also how the UCITS KIID and PRIIPs KID are designed. To then move the inducements element to the service cost section of the MiFID cost disclosure is simply illogical for many retail clients, as it does not match the product focus of the KIIDs/KIDs. In practice the inducements element could be shown as a separate line and displayed as a “whereof” of the total product costs. To sum up, information requirements under MiFID and PRIIP should be consistent in order to help retail clients to understand it.

**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)?**

This is depending on the company, investment instrument, distribution channel, whether the client intends to buy just one instrument or whether we are looking at a client’s total portfolio. At general level some FFI’s members include disclosure on inducements in various reports. The most important thing is that the flexibility is retained so that it is possible to focus disclosure on the client context.

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

All the MiFID II rules, not disclosure rules, have amended the product offer at some extend among FFI’s members. One example of this is inducement free share classes due to ban on inducements for portfolio management. Another example is restriction of certain products especially to retail clients due to the new target market regulation. The main reason for reduction of product offering is the complexity of the rules and legal uncertainty, which have caused the restriction of product offer especially to the retail clients.

The main reason for this is the complexity of the rules and legal uncertainty, which have caused the restriction of product offer especially to the retail clients. This in not in line with the objectives of the CMU project. Investment firms are not able to offer “a

full range of offer” to the retail clients, which means that they are not able to get the same return to investments as professional clients and eligible counterparties.

Referring to the massive data exchange exercise as mentioned under “general remarks” an investment firm could potentially at some point come to a position where it needs to remove a product because of lacking data or erroneous data.

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

To our knowledge, disclosure regime on inducements has not affected FFI’s members decision to provide independent investment advice or not.

**E: How do you apply ex-ante and ex-post disclosures obligations under Article 24 (9) of MiFIDII 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.**

FFI’s members have not reported any specific difficulties relating to cross-border action.

**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?**

FFI’s members have not reported any specific difficulties relating to cross-border action.

**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 more regulation is needed. Currently the clients, especially retail ones, face information overload due to extensive information requirement of MiFID II and many other legislations. We are referring to study conducted by *Ruhr Universität Bochum (2/2019): MiFID II/MiFIR/PRIIPs Regulation Impact Study: Effectiveness and Efficiency of New Regulations in the Context of Investor and Consumer Protection*. Information requirements should be simplified in order to help the clients to find out the relevant information of the product or service in 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 nonindependent investment advice)?**

FFI’s members do not consider that requirements in relation to inducements have driven clients to be more active in their choice of service provider. Many clients focus

on the total cost picture in general, and not individual components of the total costs like inducements. Changes are mainly supply-side driven (see question C).

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

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

Many professional investors and eligible counterparties find the detailed and complex information on cost & charges in MiFID II burdensome and have expressed a preference to opt out of the rules. We are in favor of an opt-out regime for eligible counterparties and a much wider limited application regime for professional clients than what the Delegated Regulation and the ESMA Q&A provide for today. A limited application regime irrespective of which investment service that is provided.

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.

**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.**

We are referring to the previous answer (see answer I).

In addition to this, per se professionals and professionals under Annex II of MiFID II could be treated the same as regards cost disclosure.

**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.**

Practices vary across FFI's members. PRIIPs methodologies have been relayed to a certain degree when calculating cost disclosures. However, distributor's service costs need to be added to the production costs.

FFI's members are in favor of a closer alignment between MiFID II and PRIIPs e.g. relating to methods for calculation and disclosure.

**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.**

FFI's members have not reported their experiences on this.

**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?**

FFI's members are of the view that although legal certainty and harmonization is important, the complexity and level of detail should not be increased. FFI supports the general requirement on Level 1 that end-clients shall receive clear, correct and comparable information on all costs and charges which relate to the provision of investment services and financial instruments. However, on Level 2 and 3, the complexity of the rules has created a lot of legal uncertainty which in turn has led to divergent applications in the market.

**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?**

Practices vary between FF's members.

**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?**

Practices vary between FFI's members, which means that also the output of these calculation may vary and results are not necessarily comparable with each other.

Some members are reporting in euros e.g. changes in the market value and actual return figures like returns or cash flows (e.g. earned interests or dividends). Both gross and net returns are reported. In some cases, cost reporting might contain parts where only returns are reported. Some express costs as a percentage.

**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 rules on cost and charges in case of distance communication should be the same as for the suitability report and the PRIIPs KID, i.e. that should be possible to

deliver the cost and charge disclosure after concluding the trade, if the exception as stated for the suitability report and PRIIPs KID respectively is fulfilled.

It should also be possible to present costs and charges of financial instrument with product costs by providing to clients a grid or table displaying the relevant cost in a way described in ESMA's Q&A number 23 on cost & charges, which states the conditions to inform clients of the relevant costs and charges just once, or on a regular basis, but not before each transaction.

**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)?**

Ffi is of the opinion that the illustration of cumulative effects on return doesn't help clients further understand the overall costs and their effect on the return of their investment. Fictitious returns might be misleading from the retail client's point of view.

The effect on the return must be communicated without the requirement to disclose an actual return nor fictitious return. We suggest also the deletion of this requirement in the context of the ex-ante cost disclosure or, at least, that it is limited to investment services where the firm has insight into clients' portfolios through the provision of investment advice or portfolio management and where investments are made in financial instruments with the purpose to generate a performance or return on investment. An illustration of cumulative effects on return is not well suited for products where the purpose is hedging and not trading.

**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.**

We are referring to the Nordic Securities Association's answer at this point.