European Securities and
Markets Authority

Final Report

ESMA’s Technical Advice to the Commission on the impact of the inducements and costs and charges disclosure requirements under MiFID II

31 March 2020 | ESMA35-43-2126

Table of contents

1. Executive Summary 4

2. MiFID II disclosure requirements for inducements permitted under Article 24(9) of MiFID II 5

3. Costs and charges disclosure requirements under Article 24(4) of MiFID II...................22

1. Executive Summary

Reasons for publication

Article 90 of Directive 2014/65/EU ("MiFID II") provides that the European Commission ("Commission") shall, after consulting the European Securities and Markets Authority ("ESMA"), present a report to the European Parliament and the Council on certain aspects of the functioning of MiFID II and of Regulation (EU) No 600/2014 ("MiFIR").

ESMA received a formal request (mandate) from the Commission on 23 May 2019 to provide technical advice on several technical issues stemming from MiFID II and MiFIR, including certain investor protection topics. The mandate focuses on technical issues which follow from MiFID II and MiFIR and is available on the Commission website[1].

Contents

This final report solely deals with technical advice in relation to certain investor protection topics under MiFID II. In this respect, in the mandate from the Commission, ESMA was requested to focus on the impact of:

- the second paragraph of Article 24(9) of MiFID II on the provision of investment services and ancillary services other than portfolio management and investment advice provided on an independent basis; and

- Article 24(4)(c) of MiFID II on the provision of investment services and ancillary services.

This report summarises the feedback received to the Call for Evidence published by ESMA on 17 July 2019[2] and the rationale behind ESMA's final proposals.

Next Steps

The final report has been submitted to the European Commission on 31 March 2020.

[1] Available at: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190523-mifid-mifir-esma-technical-advice-request_en.pdf.

[2] Available at : https://www.esma.europa.eu/press-news/esma-news/esma-launches-call-evidence-certain-investor-protection-topics-in-context. The public responses to the Call for Evidence have been published and are available at: https://www.esma.europa.eu/press-news/esma-news/esma-publishes-responses-its-call-evidence-certain-investor-protection-topics.

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

Background/Mandate

1. MiFID II distinguishes between the rules that apply to the investment services of portfolio management and investment advice on an independent basis and to all other investment services.

2. Article 24(9) of MiFID II states that investment firms are not regarded as fulfilling their obligations under Article 23 or Article 24(1) where they pay or are paid any fee or commission, or provide or are provided with any non-monetary benefit in connection with the provision of an investment service or ancillary service, to or by any party except the client or a person on behalf of the client, other than where the payment or benefit:

   a) is designed to enhance the quality of the relevant service to the client; and

   b) does not impair compliance with the firm's duty to act honestly, fairly and professionally in accordance with the best interest of its clients.

3. Article 11(2) to (4) of the MiFID II Delegated Directive[3] specifies the conditions that must be met for the fee, commission or non-monetary benefit to enhance the quality of the service to the client.

4. In addition, Article 24(9) of MiFID II provides that firms comply with certain disclosure requirements. Firstly, the existence, nature and amount of the payment or benefit, or, where the amount cannot be ascertained, the method of calculating that amount must be clearly disclosed to the client, in a manner that is comprehensive, accurate and understandable, prior to providing the relevant investment or ancillary services.

5. Furthermore, where applicable, the investment firm shall inform the client on mechanisms for transferring to the client the fee, commission, monetary or non-monetary benefit received in relation to the provision of the investment or ancillary service.

   Disclosure requirements applicable to permitted inducements under MiFID II

6. The disclosure requirements of the second paragraph of Article 24(9) of MiFID II are detailed under Article 11(5) of the MiFID II Delegated Directive which requires both ex-ante and, in certain circumstances, ex-post disclosures of permitted inducements.

[3] Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits.

7. On an ex-ante basis, firms shall disclose to the client information on the payment or benefit concerned, in a manner that is comprehensive, accurate and understandable (in accordance with the second paragraph of Article 24(9) of MiFID II). Such ex-ante disclosure may be done in a generic way for minor non-monetary benefits only. Other non-monetary benefits (i.e., those who may not be considered as minor) and monetary benefits received or paid by the firm in connection with the investment or ancillary service provided to a client shall be priced and disclosed separately (in accordance with the Article 11(5)(a) of the MiFID II Delegated Directive).

8. In this respect, MiFID II is stricter than MiFID I which offered (under certain conditions) the possibility to provide clients with summary disclosure for all permitted inducements, not just for minor non-monetary benefits.

9. In addition, Article 11(5)(b) and (c) of the MiFID II Delegated Directive provides for the following ex-post disclosure requirements:

   a) where an investment firm was unable to ascertain on an ex-ante basis the amount of any payment or benefit to be received or paid, and instead disclosed to the client the method of calculating that amount, the firm shall also provide such client with the exact amount of the payment or benefit received on an ex-post basis; and

   b) at least once a year, for as long as ongoing inducements are received by the firm in relation to the investment services provided to the relevant clients, the firm shall inform its clients on an individual basis about the actual amount of payments or benefits received or paid. Minor non-monetary benefits may, however, be described in a generic way.

   In implementing the above requirements, firms shall look to the rules on costs and charges.

10. Lastly, Article 66(6) and (7) of the MiFID II Delegated Regulation provide for the following specific disclosure requirements:

   a) firms shall inform clients about the inducements that they may receive from execution venues. The information shall specify the fees charged by the investment firm to all counterparties involved in the transaction, and where the fees vary depending on the client, the information shall indicate the maximum fees or range of the fees that may be payable; and

   b) where an investment firm charges more than one participant in a transaction, the firm shall inform its clients of the value of any monetary or non-monetary benefits received by the firm in accordance with Article 24(9) of MiFID II and Article 11 of the MiFID II Delegated Directive.

Extract from the Commission's mandate for advice

ESMA is therefore invited to provide technical input to the Commission on each of the following topics.

[…]

(h) the impact of the requirement to disclose any fees, commissions and non-monetary benefits in connection with the provision of an investment service or an ancillary service to the client in accordance with Article 24(9), including its impact on the proper functioning of the internal market on cross-border investment advice.

The Commission invites ESMA to assess together with the NCAs whether firms comply with inducements and costs disclosure rules in practice, whether the application varies across Member States and, if positive how. During this process, the Commission invites ESMA to analyse and provide an assessment of the effects of these rules for both professional and retail clients. ESMA's analysis should be guided by the broader consideration of the extent to which investors have benefited from the new rules thus far.

Analysis following feedback from stakeholders

Issues (if any) encountered by stakeholders when applying the MiFID II disclosure requirements in relation to inducements (Question A)

Level of aggregation of the disclosures

11. Several respondents highlighted that they found it challenging to capture inducements at the individual client or financial instrument level, for two reasons: (i) certain inducements may be calculated based on the total assets held by clients of the firm in a specific financial instrument or (ii) they may be of value for the firm and its clients generally but no specific breakdown can be attributed to specific clients. One respondent raised this issue in relation to non-monetary inducements more specifically (research).

12. MiFID II aimed to strengthen the MiFID requirements for third party payments and benefits, including the disclosure requirements. The disclosure of inducements may be done in a generic way for minor non-monetary benefits only. Other non-monetary benefits (i.e., those which may not be considered as minor) and monetary benefits received or paid by the firm in connection with the investment or ancillary service provided to a client shall be priced and disclosed separately.

13. In this respect, MiFID II is stricter than MiFID I which offered (under certain conditions) the possibility to provide clients with summary disclosure for all permitted inducements, not just for minor non-monetary benefits.

14. ESMA is of the view that generic disclosures do not allow clients to realise the impact that inducements may have on the service they receive and therefore favours the approach taken under MiFID II and does not consider that amendments to Article 11(5) of the MiFID II Delegated Directive are required in this respect, except to clarify that the ex-ante and ex-post disclosures (where applicable) should, at all times, be made at an ISIN-by-ISIN level.

Presentation of inducements as service costs in the costs and charges disclosures

15. Others argued that the presentation of commission payments to distributors which are linked to the sale of a product should be harmonised across the MiFID II costs disclosures, the UCITS KID and the PRIIPS KID. In the UCITS KIID and PRIIPS KID, they are included in the total product costs. In the MiFID II costs and charges disclosures, they must be presented as service costs (as per Article 50(2), second indent, of the MiFID II Delegated Regulation and as also clarified by ESMA's Q&A 9.7 on investor protection). Such respondents argue that it is misleading for retail clients who cannot compare the MiFID II costs disclosures with figures in the UCITS KIID or PRIIPS KID. Most respondents that argued against or supported the MiFID approach would like to see the commission payments to distributors shown in a separate line as "whereof inducements" of the total product costs. However, on the same topic, several respondents supported the approach adopted in the ESMA Q&A on the basis that the UCITS KIID and PRIIPS KID did not give investors the full picture in this respect.

16. In this respect, ESMA believes that the approach taken under MiFID II is correct, taking into account the objective of the MiFID II inducement disclosure requirements which is to allow clients to realise the impact inducements may have on the service they receive and why their service provider may have certain incentives to act in a certain manner. Commission payments may be paid by the client together with product costs but they are ultimately received by the distributor and therefore correspond to a fee indirectly paid by the client to the distributor for its distribution services. It is therefore consistent, in the MiFID II costs and charges disclosures, to have commission payments to distributors appear as service costs, as per Article 50(2), second indent of the MiFID II Delegated Regulation and the guidance provided in ESMA's Q&A 9.7 on investor protection. Nonetheless, for comparability reasons, a subtotal (that would not be central in terms of client information) could be presented that would be consistent in terms of scope, with PRIIPS figures (i.e., with inducements not being reclassified as service costs).

Experienced retail clients

17. A few respondents also deplored that experienced retail clients are not given the possibility to opt-out from receiving disclosures on inducements. Such respondents raised that, because of the impossibility to opt-out from some of the MiFID II information requirements, some experienced retail clients are moving from advised business to non-advised business.

18. MiFID II provides for the following categories of clients: eligible counterparties (within the meaning of Article 30(2) of MiFID II), professional clients *per se* (within the meaning of

Section I of Annex II of MiFID II), professional clients on request (within the meaning of Section II of Annex II of MiFID II) and retail clients. An experienced retail client may request to be treated as a professional client and waive some of the protections afforded by the MiFID II conduct of business rules if its firm finds, after an adequate individual assessment, that the conditions set out under Section II of Annex II of MiFID II are met (in relation to which please see also ESMA's Q&As 11.2 to 11.6 on investor protection). Therefore, MiFID II already provides a mechanism for retail clients, if they request it and fulfil certain conditions, to transfer to a less protected category of clients.

19. ESMA considers that it is not appropriate to create a new category of clients – sophisticated retail clients - under MiFID II for the purposes of the inducements regime. Issues raised regarding the application of the regime to more sophisticated retail clients should be addressed through the possibility for retail clients to be treated as professional clients on request, provided they meet the conditions described in Section II of Annex II of MiFID II. ESMA wishes to recall though that MiFID II does not allow any opt out for professional clients from the disclosure of inducements. Some flexibility for this client category could nevertheless be afforded in compliance with Recital 86 of MiFID II, and Recital 63 of the MiFID II Delegated Regulation and ESMA is making proposals in this respect in the section dedicated to the disclosure of costs and charges. ESMA also wishes to recall that Recital 69 of the MiFID II Delegated Regulation allows some flexibility in terms of information to clients provided in case of multiple transactions of the same type of financial instruments.

20. Respondents also raised certain issues not directly related to the disclosure requirements for inducements *per se* but to the MiFID II inducements regime more generally, as explained in the following paragraphs.

Different interpretations of the concept of inducements depending on the jurisdiction

21. Some respondents commented on the diverging approaches taken by EU competent authorities in relation to remuneration received by firms acting as underwriters or placing agents for issuers. Respondents reported that, while some competent authorities take the view that Article 24(9) of MiFID II does not apply to such commissions or fees (for different reasons), others have taken a more conservative approach and apply Article 24(9) to such type of remuneration (where an investment service is provided to the end-investor).

22. Article 24(7) and (8) of MiFID II provides, in relation to independent investment advice and portfolio management, that firms should not accept and retain fees, commissions or any monetary or non-monetary benefits paid or provided by any third party or a person acting on behalf of a third party in relation to the provision of the service to the client. Article 24(9) of MiFID II also provides that firms shall not be regarded as fulfilling their obligations under Article 23 (*Conflicts of interest*) or Article 24(1) (firms must act honestly, fairly and professionally in accordance with the best interests of their clients) of MiFID II where they pay or are paid any fee or commission, or provide or are provided with any non-monetary benefit in connection with the provision of an investment service or an

ancillary service, to or by any party except the client or a person on behalf of the client, except where such inducement meets certain conditions.

23. In ESMA's view, placing agent fees (whether or not the firm is acting on the basis of a firm commitment) should be disclosed under Article 24(9) of MiFID II where the firm acting as placing agent also provides an investment service to the investor buying the financial instruments it is placing, as it is clear that the remuneration perceived for the placing service is connected to the provision of the investment service to the investor buying the financial instrument.[4] Likewise, underwriting fees should be disclosed where the firm participating in the underwriting also sells the financial instruments issued to investors. However, if the firm is not selling or placing the financial instruments issued and is only performing all or part of the underwriting to the issuer, such fees would not be in connection with the provision of an investment service to the investor and therefore would not, in ESMA's view, have to be disclosed.

24. ESMA anticipates that further analysis might be appropriate in this area, in particular with regard to the application of inducements requirements to the provision of underwriting or placing in case of IPOs.

Different interpretations of the quality enhancement condition under Article 11(2) of Delegated Directive (EU) 2017/593

25. A number of respondents also reported that competent authorities sometimes have differing interpretations of the quality enhancement criteria for acceptable inducements. Some seem to have adopted a limited and exhaustive list of inducements that meet the quality enhancement condition. Others have examples of acceptable inducements in their national legislation (as in Article 11(2)(a) of the MiFID II Delegated Directive) but also accept other kinds of inducements if they meet all the conditions set out in Article 11(2) of the MiFID II Delegated Directive.

26. Article 24(9) of MiFID II provides that firms shall not be regarded as fulfilling their obligations under Article 23 (*Conflicts of interest*) or Article 24(1) (firms must act honestly, fairly and professionally in accordance with the best interests of their clients) of MiFID II where they pay or are paid any fee or commission, or provide or are provided with any non-monetary benefit in connection with the provision of an investment service or an ancillary service, to or by any party except the client or a person on behalf of the client, except where such inducements:

    a) are designed to enhance the quality of the relevant service to the client; and

    b) does not impair compliance with the investment firm's duty to act honestly, fairly and professionally in accordance with the best interest of its clients.

[4] See in this context Article 40 para 3 MiFID II Delegated Regulation.

27. Article 11(2) of the MiFID II Delegated Directive further provides that "*a fee, commission or non-monetary benefit shall be considered to be designed to enhance the quality of the relevant service to the client if all*" of a number of conditions are met, including that "*it is justified by the provision of an additional or higher level service to the relevant client, proportional to the level of inducements received, such as:*

    a) *the provision of non-independent investment advice on and access to a wide range of suitable financial instruments including an appropriate number of instruments from third party product providers having no close links with the investment firm,*

    b) *the provision of non-independent investment advice combined with either: an offer to the client, at least on an annual basis, to assess the continuing suitability of the financial instruments in which the client has invested; or with another on-going service that is likely to be of value to the client such as advice about the suggested optimal asset allocation of the client; or*

    c) *the provision of access, at a competitive price, to a wide range of financial instruments that are likely to meet the needs of the client, including an appropriate number of instruments from third party product providers having no close links with the investment firm, together with either the provision of added-value tools, such as objective information tools helping the relevant client to take investment decisions or enabling the relevant client to monitor, model and adjust the range of financial instruments in which the client has invested, or providing periodic reports of the performance and costs and charges associated with the financial instruments.*"

28. In ESMA's view, it is clear that the use of the terms "*such as*" in Article 11(2) means that the list of quality enhancing services of this article is not an exhaustive one and that other services may be regarded as fulfilling the conditions of Article 11(2)(a) even if they are not included in that list.

29. On the other hand, ESMA also acknowledges that, for supervisory convergence purposes, having a non-exhaustive list of quality enhancing services may lead to differing interpretations by national competent authorities and hence to the creation of an uneven level playing field. However, without thorough prior market research, the introduction of an exhaustive list of quality enhancing services in Article 11(2) of the MiFID II Delegated Directive might inappropriately limit jurisdictions with certain unique market features. In line with the position taken by ESMA at the time of the advice for previous Level-2 work, ESMA therefore advises to refrain from such an exercise until the subject of inducements is further advanced by the Commission.

The existence of an uneven level playing field between MiFID products and comparable non-MiFID products

30. Some respondents regretted the distorted competition resulting from the stricter inducement rules under MiFID II, compared to the rules applicable to comparable investment products such as insurance products which are subject to rules on

inducements that do not go as far as requiring that permitted inducements be designed to enhance the quality of the service.

31. ESMA agrees that comparable investment products should be subject to the same rules, unless there is a compelling reason supporting divergent rules. As such, ESMA considers that MiFID-like investment products, such as certain insurance products, should be subject to similar inducement rules to the MiFID II ones.

Complete ban on inducements for all MiFID investment services

32. One respondent advocated a complete ban on inducements to avoid potential conflicts between the interests of investment fund managers and intermediaries on the one hand and the interests of investors they serve on the other hand.

33. The responses received to Questions C, D and H (see below), assert that the MiFID II inducement rules did not impact (i) firms' decision to provide independent investment advice rather than non-independent investment advice, (ii) which products are offered as part of firms' catalogues and (iii) how investors choose service providers and investment and/or ancillary services.

34. According to one consumer association at European level (advocating a ban on inducements), disclosures should have had an impact on advisers' and clients' behaviour, because they discourage advisers from recommending products with unacceptably high commissions and they allow clients to opt for the cheaper product. However, according to this consumer association, in practice, clients (mostly retail clients) still find it difficult to understand how commissions may affect the independence of advice. Furthermore, they may not have the required knowledge to adjust their behaviour to the disclosed conflict of interest. One respondent also underlined the outcome of a recent study conducted for BaFin that shows the limited effect of information disclosure related to inducements and costs – no matter their design and comprehensibility – on clients' behaviour. However, it is worth noting that according to that study, the majority of investors regard the information as useful and thus want to receive the disclosure. Furthermore, retail investors' choice might be more influenced by the personal relationship with the provider or advisor, the perceived quality of the service and the perceived diversity of products offered rather than the mode of payment for a service (inducements-based or fee-based). One respondent noted that in some markets, the vast majority of clients are unwilling to pay for advice and that for that reason very few advisors providing independent advice exist.

35. Two jurisdictions (The Netherlands and the United-Kingdom) have already banned inducements in relation to retail investment products with, in accordance to the NCAs of these jurisdictions, a certain success. Indeed, in accordance with the view of the AFM, the inducements ban encourages the distribution of more cost-effective investment products to consumers, reduced conflicts of interest for advisers, while increasing competition between product manufacturers to the benefit of consumers. As a matter of fact, the distribution of less expensive products in these jurisdictions emerges, amongst others, by two independent studies, recently published: Morningstar Global Investor

Experience Study 2019: Fees and Expenses on Funds and ETFs and in the first Annual Statistical Report (2019) by ESMA. However, it was also noted that, if a Union-wide inducement ban were to be introduced, the impact would likely vary across Member States based on the prevalence of the existing distribution models. This is because such a ban may not have the desired consequences depending on the structure of specific national markets. In the case of Member States with bank-centric distribution models, there is a risk that, because of the loss of incentives to sell third party products, banks could react by increasing closed-architecture models. Indeed, inducement bans could be "circumvented" by firms through "vertical integration practices" between banks and asset managers and only group products might be offered to end-clients. In this case, the bank would provide a service (the distribution of its products) to the management company which, instead of paying the bank through a fee rebate, would pay the bank by way of a dividend or a capital reserve at the level of the management company. In addition, certain retail clients' access to advice might be impaired. Conversely, the inducement ban has the potential to result in the growth of the fee-based independent advice sector across the Union. Such a stark market transformation, however, might take time. In the short term, banks might decide not to offer advisory services to retail clients and redirect them to execution-only services. In the view of the Dutch NCA this may also result in an uptick in portfolio management and robo-advice services.

36. Therefore, at this stage, ESMA does not recommend to the Commission to ban inducements completely for all retail products across the Union. ESMA is of the view that the Commission should first assess (i) the impact the MiFID II inducements regime has had on the distribution of retail investment products across the Union, (ii) the impact of such a ban depending on the different distribution models existing in the Union and (iii) what potential additional actions could be taken to counterbalance the risks of undesired consequences linked to a ban on inducements (as described above). The Commission could use the opportunity of the analysis that will follow its on-going consultation on the review of the MiFID II/MiFIR regulatory framework to progress on this important investor protection topic.

37. In addition, banning inducements for MiFID products may create an uneven playing field with other types of products (for instance, insurance products) and inducements should thus be considered more globally and not just under MiFID II.

38. Therefore, at this stage, ESMA recommends to the Commission to rely on alternative options to improve clients' understanding of inducements and the functioning of the existing MiFID II regime (please refer to paragraphs 60 to **Error! Reference source not found.**).

Tackling inducement-like phenomenon in closed architecture

39. One consumer association found it regrettable that the MiFID II inducement disclosure rules only address situations where the distributor of the product or advisor is distinct from the manufacturer. For this respondent, the issue is as acute and even more widespread in captive distribution models to which Article 24(9) of MiFID II and Articles 11 *et seq*. of the Delegated Regulation do not apply. This respondent therefore

recommended to broaden the scope of the concept of “inducements” under MiFID II (thereby extending the scope of application of the MiFID II inducement rules) or to adapt such rules to the closed architecture model.

40. As described above, some jurisdictions have bank-centric distribution systems. In such jurisdictions, in the view of some stakeholders, banning inducements alone may be counterproductive for the reasons previously described. In addition, even in other jurisdictions, banning inducements without, at the same time, tackling the inducement-like phenomenon in closed architecture may possibly lead to a switch to a more vertically integrated distribution model, which could be counterproductive.

41. ESMA believes that, in the context of the further analysis to be conducted, additional actions would need to be considered to also tackle investor protection issues arising in closed-distribution models.

42. For instance, one option could be to strengthen MiFID II requirements on the assessment of suitability. Currently firms providing investment advice and portfolio management are required to “*assess, while taking into account cost and complexity, whether equivalent investment services or financial instruments can meet their client's profile*” (Article 54(9) of the MiFID II Delegated Regulation). It could be made clear that firms, even if operating in closed-architecture models, should assess their products against third-party products and should provide details in the suitability report of any cheaper and less complex alternatives. For maximum efficiency, ESMA is of the view that such process should already be carried out at the point of elaboration of the firm’s catalogue of products (i.e., centrally).

43. When considering the suitability, it should be borne in mind that MiFID II introduced new rules on remuneration to ensure that firms consider clients’ best interests when distributing products. MiFID II requires, amongst other things, that “*remuneration policies and practices shall be designed in such a way so as not to create a conflict of interest or incentive that may lead relevant persons to favour their own interests or the firm's interests to the potential detriment of any client*” (Recital 41 of MiFID II Delegated Regulation). In addition, the firm “*shall not make any arrangement by way of remuneration, sales targets or otherwise that could provide an incentive to its staff to recommend a particular financial instrument to a retail client when the investment firm could offer a different financial instrument which would better meet that client’s needs*” (Article 24(10) of MiFID II).

44. Another option could be to enhance record keeping on the financial instruments distributed to clients in the preceding twelve months. In this respect, it would be important for firms to keep specific records on how frequently firms distributing financial products (either on an advised or non-advised basis) actually sell products which are issued or provided by the firm itself or by entities having close links with the firm. This type of information could complement the existing requirement for advisors to disclose on an ex-ante basis the product base for their analysis and should in any case be kept at the disposal of the relevant national competent authorities. This information, which is currently not usually available in a structured way to national supervisors and ESMA,

would allow them to better understand the structure and investment flows in their markets and to identify issues and areas where to intervene (either through enforcement or by suggesting regulatory actions).

45. A further option would be to apply the quality enhancement requirements also to situations where – in a closed architecture – no inducement, i.e., third-party payment or other benefit, has been received by the distributing entity. Here too, it can be assumed that the distribution services were not provided free of charge and, if the client did not pay for them directly and if no inducement is apparent, there is a presumption that the "inducement" is hidden in the closed architecture, be it in form of reserves at the level of another group entity, dividends, revenue in excess of the product costs, etc.

46. Lastly, it would be advisable, in the mid- to long-term, to invest in financial education to make retail investors aware and conscious of the importance of independent fee-based advice.

Ongoing inducements are not disclosed

47. The same consumer association raised that both information on inducements that are paid at the point of sale and inducements on an ongoing (for instance, annual) basis should be disclosed.

48. In ESMA's view, inducements paid on an ongoing basis (after point of sale) are already captured by Article 24(9) of MiFID II and Article 11(5) of the MiFID II Delegated Directive. Indeed, Article 11(5)(c) provides that "*at least once a year, as long as (on-going) inducements are received by the investment firm in relation to the investment services provided to the relevant clients, the investment firm shall inform its clients on an individual basis about the actual amount of payments or benefits received or paid*".

Use of the MiFID II costs disclosures to comply with the inducement disclosure requirements (Question B)

49. The vast majority of respondents indicated that they indeed use the ex-ante and ex-post costs and charges disclosures as a way to comply with the inducement disclosure requirements.

50. Consequently, most respondents reported that the inducement disclosure follows the level of aggregation of the costs disclosures. Therefore, the level of aggregation and disclosure of inducements may vary between ex-ante and ex-post. As a result, a majority of respondents reported disclosing inducements at the level of the financial instrument on an ex-ante basis (as per the guidance provided by ESMA in Q&A 9.22 on investor protection which relates to ex-ante costs and charges disclosures). For ex-post disclosures, responses varied more widely, ranging from disclosures made at the level of the financial instrument to those made at the level of the portfolio or client with certain respondents specifying that more detailed disclosures (for example, at the level of the financial instrument) were provided upon request from the client. One respondent noted that the choice of the methodology for ex-post disclosures differs according to the

organisational model adopted by each intermediary and the type of relationship established with the client.

51. Several respondents advocated for some flexibility to be retained in the regulatory framework so that disclosures can be tailored to the client.

52. ESMA agrees that firms may comply with their investment disclosures through their costs and charges disclosures as the latter also include inducements. This is made clear by Article 11(5), second paragraph of the MiFID II Delegated Directive which states that, in implementing the inducements requirements, firms "*shall take into account the rules on costs and charges*" set out in Article 24(4)(c) of MiFID II and in Article 50 of the MiFID II Delegated Regulation.

53. As such ESMA is of the view that there is no need to clarify in the MiFID II Delegated Directive that firms may use the costs and charges disclosures to also comply with their inducement disclosure obligations. However, where firms choose not to use the costs and charges disclosures to comply with their inducement disclosure obligations or where the costs and charges disclosure requirements do not apply, ESMA recalls that firms must follow the same level of aggregation to disclose inducements as in the costs and charges disclosures and that this could be further clarified in the MiFID II Delegated Directive.

Impact of the MiFID II inducement disclosure rules on investment firms' product catalogue and decision to provide independent investment advice (Question C and D)

54. The majority of respondents reported that their product offering has not been amended as a result of the new MiFID II inducement disclosure provisions.

55. However, several respondents replied that the MiFID II inducements regime, not just the disclosure rules, has had an impact on their catalogue of products, mostly causing a reduction of the range of products offered. The issues mentioned are largely the same as the ones raised in response to Question A, namely: (i) legal uncertainties regarding the application of the concept of inducements (see paragraph 21 above), (ii) different interpretations of the quality enhancement condition under Article 11(2) of the MiFID II Delegated Directive (see paragraph 25 above) and (iii) the application of the proportionality principle. On the positive side, several other respondents mentioned that the inducements regime has been a driver in the creation of more clean share classes which are offered to portfolio managers and firms providing independent investment advice.[5]

56. In addition, many respondents replied that modifications to their product offering have not only resulted from the inducements regime, but rather its combination with other MiFID II rules such as the product governance framework. In addition, access to necessary data from manufacturers (caused by the inducements regime but also the costs and charges disclosure rules) was mentioned by a few respondents as a driver

[5] These share classes were already offered in EU member states that have banned inducements.

causing a reduction of the products offered as, in some cases, manufacturers have not been able to provide sufficient data on inducements or cost and charges and, consequently, some investment firms have decided to temporarily stop the distribution of those manufacturers' products.

57. From responses received to Question D, it emerges that the inducement disclosure regime has had a limited impact on financial services providers' decision to offer independent advice or to refrain from it. Several respondents noted that in their jurisdictions and in most cases for historical reasons, investors are not ready and willing to pay for advice (including for independent investment advice). For this reason, even in jurisdictions where rules similar to the MiFID II inducements regime had been introduced a few years ago (e.g., Germany), respondents reported that the provision of independent investment advice had not been able to establish itself in a meaningful manner.

58. Only two respondents answered that the MiFID II regime on inducements has had an impact on firms' decision to provide independent advice. According to those respondents, the inducement rules have contributed to firms' decision not to offer independent advice.

59. Based on feedback received from the majority of respondents, the MiFID II inducement disclosure rules have not had the positive impact expected; furthermore, they have not facilitated the development of independent investment advice. This was mainly because investors were not ready and willing to pay for advice. According to the feedback received from one consumer association, the reason for this is that clients (mostly retail clients) find it difficult to understand how commissions may affect the independence of advice, and that they do not draw any conclusions from and do not take any actions based on the disclosed conflict of interest.

60. As already set out in paragraph 38 above, ESMA considers that, at this stage, the Commission should explore a number of options to improve clients' understanding of inducements and how the existing MiFID II regime helps clients understand inducements and the impact they may have on advice. Note also in this context that some retail clients may just neither have the time, the inclination or the financial knowledge to fully understand the effect inducements may have on investment advice and other investment services provided to them.

61. Firstly, the Commission may want to improve the existing inducements disclosures by:

    a) clarifying in the MiFID II Delegated Regulation that the ex-ante and, where required, ex-post inducements disclosures should always be made on an ISIN-by-ISIN basis thereby showing clients where the firm is most incentivised to recommend and sell a product (i.e., showing clients with what product the firm makes the most money);

    b) introducing the obligation to include, in all inducements disclosures, an explanation, in layman's terms, of the terms used to refer to inducements (for instance, third-party payments). Such explanation should be sufficiently clear and use simple terms to ensure that retail clients understand the nature and impact of inducements. ESMA recommends the following language:

    "*Third-party payments are payments received by [name of the firm or firms (if more than one)] for selling this product to you and is part of the costs that you incur for* *the service provided by [name of the firm], even though you do not pay such costs directly to [name of the firm].*"

62. Secondly, ESMA would recommend that the Commission bolsters the MiFID II requirements around quality enhancing services. ESMA believes that the firm should bring to the attention of its clients the specific quality enhancing services that the client is already benefiting from or that the client could benefit from. Otherwise, inducements could be spent on quality enhancing services of which the client is not aware of. The list of such quality enhancing services should be easily accessible and updated on a continuous basis.

Cross-border application of the MiFID II inducement disclosure requirements (Questions E and F)

63. A few respondents highlighted that they did not provide investment services on a cross-border basis and therefore were not be in a position to report on the application of the disclosure provisions in this context.

64. Several respondents raised that differences in the interpretation and application of the MiFID II inducements regime, cause significant difficulties in complying with the disclosure requirements when firms operate on a cross-border basis. The issues raised the most were the same as the ones already summarised in paragraphs 21 to 25 above:

    - different interpretations of the concept of inducements depending on the jurisdiction; and
    - different interpretations of the quality enhancement condition under Article 11(2) of Delegated Directive (EU) 2017/593.

65. Most respondents who reported different implementations and applications of the MiFID II inducements regime across EU member states called for harmonisation at EU level.

66. Regarding the diverging interpretations of the concept of inducements, ESMA would like to cross refer to paragraphs 21 to 23 above.

67. Regarding the different interpretations of the quality enhancing service under Article 11(2)(a) of the MiFID II Directive, please see our views described in paragraph 29.

Suggested changes to the MiFID II inducement disclosure rules (Question G)

68. Most respondents were of the view that it was preferable not to modify the current disclosure regime on inducements but to work on supervisory convergence instead. Many raised the issues described above in paragraphs 21 to 25 as a source of confusion for investors who, as a result, do not receive the same level of investor protection depending on their jurisdiction. ESMA has already replied to these comments in previous paragraphs.

69. Only a minority of respondents called for changes to the MiFID II inducements disclosure regime. Some advocated a simplification of the rules (arguing that it would be beneficial for investors) without, however, providing any specific suggestions. One respondent noted that the MiFID II rules should be more neutral between inducements and direct commissions approaches but should strengthen the obligation to disclose conflicts of interests in a clearer way. Another called for firms to have the obligation to establish a clearer link between inducements received and the quality of the service.

70. Moreover, it was suggested to resolve the inconsistency between MiFID II and other disclosure regimes such as the PRIIPs Regulation or the UCITS Directive. To that end, one respondent suggested that MiFID II should only require the intermediary to specify that part of the product cost that remunerates the intermediary for the distribution of the product, leaving everything else to the PRIIPs and UCITS disclosures.

71. One consumer association expressed that the current disclosure regime was too opaque and complex for the average individual investor. This respondent advocated more transparency on the concept of "inducement" *per se* and what it entails (that such a commission increases the risk of conflict of interests of the distributor). Another consumer association expressed reluctance regarding the ability of the disclosure requirements to address conflicts of interest and rather called for a ban on commission.

72. ESMA notes that replies to these or similar comments have already been provided in previous chapters.

Impact of the inducement disclosure requirements on how investors choose their service providers and investment and/or ancillary services they use (Question H)

73. Diverging views were expressed by respondents on whether the MiFID II inducements disclosure requirements have had any impact on how investors choose their service provider and/or the investment or ancillary services they use.

74. According to many respondents, the current data does not allow for any conclusions on whether these disclosure requirements have had any impact on the investors' choice of distributors/advisors. Similarly, a few other respondents highlighted the difficulty to assess the impact of such requirements and pointed out that so far, no market studies provided an answer to this very question.

75. However, a significant number of respondents were of the view that the inducements disclosure requirements have had no or very little impact on clients. As observed by a few respondents, the independence of their advisors is not, in many jurisdictions, a key criterion for investors' choices which are much more influenced by personal trust, the perceived quality of the advice or the diversity and range of products offered. One respondent also underlined the outcome of a recent study conducted for BaFin that shows the very limited effect of information disclosure of inducements and costs – no matter their design and comprehensibility – on clients' behaviour.

76. By contrast, several members noted that MiFID II disclosure requirements impacted the distribution market, and the distributors' business models. One respondent, however, responded to this that changes in the offering of products and services were often supply driven (e.g., by access to data or legal uncertainty) and not a result of investors' choice.

77. Finally, two consumers' associations restated that there is little evidence to suggest that the inducements disclosure has had a meaningful impact on the behaviour of consumers. One of them stated that consumers find it difficult to understand how commissions may affect the independence of advice and that consumers often do not have the required knowledge to understand the disclosed conflicts of interests. The other consumer association, while sharing this view, pointed out the negative evolution in the distribution of retail investment products with regards to conflicts of interests and warned of the negative consequences this had on the markets as a whole.

78. Based on feedback received from the majority of respondents and as already set out above, it seems that the MiFID II inducement disclosure rules have not had the positive impact expected. As already set out in paragraphs 36 to 38 above, ESMA suggests that the Commission first assess the impact the MiFID II inducements regime has had on the distribution of retail investment products across the Union and, second, what impact a ban would have on the different distribution models throughout the Union. The recent consultation launched on the review of MiFID II/MiFIR may offer the opportunity to the Commission to go more in depth in the analysis of these important topics. The Commission should also consider what potential actions could be taken to counterbalance or at least mitigate the risks of unintended consequences of a ban on inducements. As set forth above, in the meantime, clients' understanding of inducements and how the existing MiFID II regime works, should be improved. Lastly, ESMA suggests that the Commission evaluates the impact the inducements ban has had in the two jurisdictions which have already introduced it (the Netherlands and the United Kingdom) and whether the ban has had any unintended consequences for retail clients.

Technical advice

The Commission should assess (i) the impact the MiFID II inducements regime has had on the distribution of retail investment products across the Union, (ii) the effects a ban on inducements would have on the different distribution models existing in the Union and (iii) actions that could be taken to mitigate the risk of undesired consequences of an inducements ban. To assess the potential positive or negative effects of a ban, the impact of the bans as introduced in the Netherlands and the United Kingdom should be examined.

ESMA would recommend that such impact assessment be carried out and any following actions be taken in relation to all retail investment products, not just MiFID financial instruments.

In the meantime, ESMA proposes to improve clients' understanding of inducements and the effect they have on the distribution of investment products and the existing MiFID II disclosure.

Improving client's understanding of inducements

The Commission should improve the comprehensibility and clarity of the existing inducements disclosures by:

- clarifying in the MiFID II Delegated Regulation that the ex-ante and ex-post inducements disclosures should always be made on an ISIN-by-ISIN basis thereby showing clients where the firm is most incentivised to recommend and sell a product (i.e., showing clients with what product the firm makes the most money); and
- introducing the obligation to include, in all inducements disclosures, an explanation, in layman's terms, of the terms used to refer to inducements (for instance, third-party payments). Such explanation should be sufficiently clear and use simple terms to ensure that retail clients understand the nature and impact of inducements. ESMA recommends the following language:

  "*Third-party payments are payments received by [name of the firm or firms (if more than one)] for selling this product to you and is part of the costs that you incur for the service provided by [name of the firm], even though you do not pay such costs directly to [name of the firm].*"

Bolstering the MiFID II requirements regarding the quality enhancing services

Firms should bring to their clients' attention the specific quality enhancing services that they are already benefiting from or that they could benefit from if they requested or used the service. The list of such quality enhancing services should be easily accessible and updated on a continuous basis.

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

Background/Mandate

79. MiFID II clarified, strengthened and expanded the scope of the costs and charges disclosure requirements.

Costs and charges to be aggregated

80. MiFID II provides which costs and charges shall be included in the costs disclosure (Annex II of the MiFID II Delegated Regulation) and clarifies that third-party payments (inducements) should be included in the costs disclosure provided to clients (but be identified separately in the disclosure).

81. Under MiFID II, the costs disclosures may not be done in a generic way but must be transaction specific. ESMA has provided technical clarifications on these requirements including the possibility to provide ex-ante information on an assumed investment amount (please see ESMA's Q&As 9.22, 9.23 and 9.24 on investor protection).

Professional clients and eligible counterparties

82. The MiFID II costs disclosure requirements apply to all categories of clients with the possibility for professional clients and eligible counterparties (according to Article 50(1) of the MiFID II Delegated Regulation), in certain cases, to opt-out of the application of the detailed requirements described in Article 50 of the MiFID II Delegated Regulation. Recital 74 of the MiFID II Delegated Regulation provides a non-exhaustive list of some MiFID II costs and charges disclosure items that investment firms may, at the request of the client, agree not to provide.

83. MiFID II, however, excludes such possibility (the limited application of the costs disclosures for professional clients and eligible counterparties) in the following situations (Article 50(1) of the MiFID II Delegated Regulation): i) for professional clients, a) where the services of investment advice or portfolio management are provided or b) where, irrespective of the service provided, the financial instruments concerned embed a derivative; and ii) for eligible counterparties, where, irrespective of the investment service provided, the financial instruments concerned embed a derivative and the eligible counterparty intends to offer them to its clients.

Scope of the ex-ante disclosures

84. Article 24(4) of MiFID II requires "*the information on all costs and associated charges must include information relating to both investment and ancillary services, including the cost of advice, where relevant, the cost of the financial instrument recommended or*

marketed to the client and how the client may pay for it, also encompassing any third-party payments".

85. Based on this article, the MiFID II Delegated Regulation distinguishes situations where full ex-ante cost disclosures must be provided and where the cost disclosures only need to include the costs and charges related to the investment and/or ancillary service provided.

86. According to Article 50(5) of the MiFID II Delegated Regulation, "full" ex-ante disclosure has to be provided where the investment firm recommends or markets financial instruments to clients or where the investment firm providing any investment services is required to provide clients with a UCITS KIID or PRIIPs KID in relation to the relevant financial instruments. In such cases, the costs disclosures shall disclose the aggregated costs and charges related to i) the financial instrument and ii) the investment or ancillary service provided.

87. In the remaining (residual) situations, investment firms only need to inform their clients about all costs and charges relating to the investment and/or ancillary service provided (Article 50(6) of the MiFID II Delegated Regulation).

Relationship with information on PRIIPS

88. Recital 78 of MiFID II clarifies that for costs relating to the financial instrument, investment firms may rely on the information that the product manufacturer or issuer of the financial instrument is obliged to publish under existing Union law: "Where sufficient information in relation to the costs and associated charges or to the risks in respect of the financial instrument itself is provided in accordance with other Union law that information should be regarded as appropriate for the purposes of providing information to clients under this Directive." Therefore, investment firms should be able rely on information on costs of the relevant financial instrument as disclosed in the prospectus and the UCITS key investor information document (KIID) or PRIIPs key information document (KID).

89. However, Recital 78 also makes clear that reliance on such disclosure documents is subject to the assumption that all costs relating to the financial instrument are disclosed in that document: "However, investment firms or credit institutions distributing that financial instrument should additionally inform their clients about all the other costs and associated charges relating to their provision of investment services in relation to that financial instrument."

90. The MiFID II costs disclosure rules do not include any rules regarding the method of calculation and presentation of the ex-ante (or ex-post) costs and charges disclosures (e.g., the period over which the costs and associated charges are to be calculated and disclosed). Hence, investment firms could rely on the PRIIPS KID or UCITS KIID as a basis for their MiFID II costs disclosures.

91. Based on feedback received from some national competent authorities and market participants, it seems that, even where the MiFID II and PRIIPS/UCITS costs disclosures overlap, investment firms do not rely on the information available in the PRIIPs KID or in the UCITS KIID for their MiFID II costs disclosures. This has created divergent interpretations and applications of the costs disclosures rules across the European Union, which makes it difficult for clients to compare costs between products, investment firms and Member States.

Timing of ex-ante disclosures

92. According to MiFID II (Articles 24(4) and 25(6)) and the MiFID II Delegated Regulation (Article 46(2) and (3) and Article 50), firms must provide ex-ante information about costs and charges in good time before the provision of investment services or ancillary services to clients or potential clients and on a durable medium (or by means of a website (where it does not constitute a durable medium) provided that the conditions specified in Article 3(2) of the MiFID II Delegated Regulation are satisfied). Such requirements are technology neutral.

93. In practice, this raised some issues for telephone trading. ESMA already clarified[6] that, where an investment service concerning a financial instrument with no “product costs” is to be provided or in the residual instances where the firm is not required to disclose “product costs”, the ex-ante information about costs and charges may be provided to the client in the form of a costs grid/table – e.g., at the time of the onboarding. In other cases, before the provision of each investment service or ancillary service, the firm may offer to the client either: a) a delay of the transaction in order to provide the ex-ante information about costs and charges in a durable medium prior to the provision of the service; or b) the provision of the ex-ante costs information over the phone prior to the provision of the service (thereby fulfilling the requirement that the information must be provided in good time) and, simultaneously, to provide that same information in a durable medium (or through a website in accordance with Article 3(2) of the MiFID II Delegated Regulation).

94. It may, however, be appropriate to assess whether the level 1 and/or level 2 rules need to be clarified further in this respect.

Illustration showing the cumulative effect of costs on return

95. MiFID II imposes on investment firms a new obligation: to provide an illustration showing the cumulative effect of costs on return when providing investment services. Such illustration must be part of the costs disclosures both on an ex-ante and ex-post basis and should meet the following requirements: a) to show the effect of the overall costs and charges on the return of the investment; b) to show any anticipated spikes or fluctuations in the costs; and c) to be accompanied by a description.

[6] ESMA’s Q&A 9.28 on investor protection.

96. The illustration is aimed at helping clients to further understand the overall costs and their effect on the return of investment. Article 50(10) of the MiFID II Delegated Regulation does not prescribe the format of presentation of the illustration, leaving flexibility in this regard (it can take multiple forms, among others a graph, a table or a narrative, as clarified in ESMA's Q&A 9.2 on investor protection). However, it may be appropriate to analyse how this requirement has been applied and to reassess the need of such illustration being provided in a more standardised format in order to allow investors to compare products more effectively and to ensure that investment firms indeed show the "impact" that costs may have on the return (not just aggregated cost figures) .

97. For ex-post illustrations, the firm has the possibility to calculate actual returns. Depending on the method used to calculate the return on an ex-post basis, numbers may vary. It may also be valuable to have feedback on which methods firms are using to calculate actual returns and whether this depends on the type of financial instrument or the type of investment service provided.

Periodic ex-post disclosures

98. MiFID I, implementing Directive 2006/73/EC, already established certain post-sale reporting obligations for firms providing execution of orders other than portfolio management (Article 40), portfolio management (Article 41) or holding client financial instruments or funds (Article 43).

99. Under Article 50(9) of the MiFID II Delegated Regulation, an investment firm is required to provide annual post-sale aggregated information about costs and charges related to both the financial instrument(s) and investment and ancillary service(s) if it has recommended or marketed financial instruments (or has provided the client with a KID/KIID) and it has an ongoing relationship with the client during the year (such as portfolio management or an ongoing advisory relationship).

100. Similar to the rules on ex-ante disclosures, the ones relating to the ex-post requirements do not provide a detailed framework on which investment firms may rely on for their ex-post disclosures (for instance, at which level – portfolio/transaction/financial instrument – the costs should be disclosed). It may thus be appropriate to consult on whether more detailed rules are needed and what those rules, if any, should say, especially with a view to facilitate comparability.

Extract from the Commission's mandate for advice

ESMA is therefore invited to provide technical input to the Commission on each of the following topics.

[…]

The Commission invites ESMA to assess together with the NCAs whether firms comply with inducements and cost disclosure rules in practice, whether the application varies across Member States and, if positive how. During this process, the Commission invites ESMA to analyse and provide an assessment of the effects of these rules for both professional and retail clients. ESMA's analysis should be guided by the broader consideration of the extent to which investors have benefited from the new rules thus far.

Analysis following feedback from stakeholders

Issues (if any) encountered by stakeholders when applying the MiFID II cost disclosure requirements to eligible counterparties and professional clients and suggested changes (Questions I and J)

101. A large majority of respondents raised issues with the application of the costs and charges disclosure requirements under MiFID II to professional clients and eligible counterparties. The main and most frequently raised issues are:

- professional clients and eligible counterparties have the necessary knowledge and market experience to take informed decisions;

- they don't need standardised and mandatory costs information as they already receive the necessary information that they negotiate with their service provider and which is tailored to their needs and often more detailed. This is particularly true for non-EU clients because their needs are driven by different regulations;

- there is no reason why the principle of proportionality applied to other MIFID II requirements should not apply to the costs and charges disclosure requirements;

- for these categories of clients who often trade heavily, the MiFID II requirements create an overflow of unwanted and useless information;

- it is often difficult to assess who is the client and who is the service provider which can lead to a two-way exchange of costs information;

- the disclosure of costs between professional clients and eligible counterparties may raise competition issues;

- the application of the ex-ante costs disclosure requirements may lead to delays in the execution of transactions for participants for whom time is of essence and may therefore have a negative impact on best execution;

- the current flexibility allowed to professional clients and eligible counterparties under Article 50(1) of the MiFID II Delegated Regulation is unclear and not practical as it is too restricted;

- the application of the costs disclosures under MIFID II to professional clients and eligible counterparties is inconsistent with the PRIIPS framework that only applies to retail clients; and

- the application of the costs disclosure requirements to principal risk markets (all-in price) on which professional clients and eligible counterparties heavily trade is unpractical.

102. However, when it came to the proposed changes to the MiFID costs and charges disclosure regime applicable to professional clients and eligible counterparties, responses were much more divergent. Five options were raised by several respondents:

- The total disapplication of the costs and charges disclosure requirements under MiFID II to professional clients and eligible counterparties

  Disapplication was the option that was raised the most by respondents. While most recommended and called for a disapplication of the requirements to both professional clients and eligible counterparties, a few respondents only called for a disapplication for eligible counterparties (with a different regime applying to professional clients). One respondent also suggested that disapplication should only apply with respect to non-complex financial instruments (in this instance, for eligible counterparties and professional clients equally).

  A few other respondents suggested to disapply the costs and charges disclosure requirements to eligible counterparties and professional clients, but with the possibility to opt-in. This approach is, in fact, similar to the one described in the paragraph above as eligible counterparties and professional clients can request to be treated as retail clients for more protection.

- The possibility to opt-out of the costs and charges disclosure requirements under MiFID II for professional clients and eligible counterparties

  This option was the second most popular among respondents. A couple of respondents, however, only proposed this option for eligible counterparties. Still others only wanted to introduce the opt-out mechanism to eligible counterparties and professional clients *per se, i.e., not to professional clients on request*.

- Amending Article 50(1) of the MiFID II Delegated Regulation

  Some respondents recommended amending Article 50(1) of the MiFID II Delegated Regulation to allow more flexibility for eligible counterparties and professional clients to disapply the costs and charges disclosure requirements more freely. A few of the respondents favouring this option, however, thought it suitable for professional clients only (with one of the two options above applying instead to eligible counterparties). One respondent suggested this option should be open to professional clients and retail clients as well (for retail clients, however, only for non-packaged products).

- Extending the application of Article 30 of MiFID II to costs and charges disclosure requirements

  A couple of respondents favoured this option, which is applicable only to eligible counterparties, even suggesting that such extension should be made for all information requirements under MiFID II.

- One respondent suggested a multi-layer regime which would work as follows:

  - ➢ Eligible counterparties would be able to opt-out completely of the MiFID II costs and charges disclosure regime but, on request, could become subject to a “proportionate regime” (i.e., information related to service costs only and through tariff grids);
  - ➢ Professional clients would be brought into a “proportionate” regime (i.e., information related to service costs only and through tariff grids), but could request more detailed information; and
  - ➢ Retail clients would be subject to the “full regime” (i.e., information on both product costs and service costs on a trade-by-trade basis) where the product is a Packaged Retail and Insurance-based Investment Products (PRIIPs) and the “proportionate regime” for other products (i.e., information related to service costs only and through tariff grids).

103. For the short term, several respondents also suggested amending ESMA’s Q&A 9.19 on investor protection to allow for more flexibility for professional and eligible counterparties.

104. Several respondents also demanded that the MiFID II costs disclosures be waived for, or that it should be clarified that they do not apply to, non-EU investors.

105. Only a small minority of respondents did not call for more flexibility or the disapplication of the MiFID II costs and charges disclosure requirements to professional clients and eligible counterparties. Two respondents (also industry associations) expressed that no changes to the regime were needed and that the MiFID II costs and charges disclosure regime was adequate for the protection of all categories of clients.

106. The majority of respondents suggested not to differentiate between *per se* professional clients and clients who request to be treated as such under Part II of Annex II of MiFID II because the knowledge and experience of such clients have been assessed by the firm on an individual basis and judged satisfactory. However, one respondent was of a different view and reported that they usually provide more detailed costs information to clients who request to be treated as professionals compared to *per se* professionals. One respondent also suggested to disapply the costs disclosure requirements to professional clients *per se* and to allow clients treated as professionals on request to waive the application of the requirements.

107. Some respondents also called for the creation of a new category of retail clients encompassing only the most experienced ones which could waive the MiFID II information requirements.

108. ESMA considers that it is indeed appropriate to allow for more flexibility when applying the MiFID II costs and charges disclosure requirements to eligible counterparties and professional clients.

Eligible counterparties

109. Respondents are of the view that eligible counterparties have the necessary knowledge and experience and therefore do not need the ex-ante costs disclosures which are currently mandatory under MiFID II for all categories of clients. In addition, they state that the application of the ex-ante costs disclosure requirements may lead to delays in the execution of transactions for participants for whom time is of essence and may, therefore, have a negative impact on best execution.

110. As a reminder, the eligible counterparty status is only available for certain investment services (in particular, this category does not apply where portfolio management and investment advice services are provided).

111. For the abovementioned reasons, ESMA is of the view that eligible counterparties should be allowed to opt-out completely of the ex-ante costs disclosure requirements, for one or more services, subject to the firms keeping records of the documented requests to opt-out.

112. The same would apply to ex-post costs disclosures as eligible counterparties should not be prescribed the format of the disclosures they receive but should be allowed to agree with their firms which costs information they need to receive.

113. ESMA is also of the view that the obligation to provide the illustration of the impact of costs on return (Article 50(10) of the MiFID II Delegated Regulation) should not apply to eligible counterparties, without the need to opt-out.

Professional clients

114. ESMA is of the view that professional clients should be allowed more flexibility. The level of such flexibility should be based on the type of service provided rather than whether the client is a professional client *per se* or a professional client on request.

115. For investment services other than portfolio management and investment advice, ESMA considers that professional clients, both *per se* and on request, should be allowed to opt-out completely of the ex-ante and/or ex-post costs disclosures, including the obligation to provide the illustration of the impact of costs on return, subject to the condition that firms shall keep records of the documented opt-out requests and that they contractually

agree with their clients, and document, what type of costs information the client will receive instead.

116. For portfolio management and investment advice services, ESMA believes that there should not be an opt-out permissible and that the default regime (also applicable to retail clients) should apply.

Experienced or sophisticated retail clients

117. MiFID II provides for the following categories: eligible counterparties (within the meaning of Article 30(2) of MiFID II), professional clients *per se* (within the meaning of Section I of Annex II of MiFID II), professional clients on request (within the meaning of Section II of Annex II of MiFID II) and retail clients. An experienced retail client may request to be treated as a professional client and waive some of the protections afforded by the MiFID II conduct of business rules if its firm finds, after an adequate individual assessment, that the conditions set out under Section II of Annex II of MiFID II are met (please see in this context also ESMA's Q&As 11.2 to 11.6 on investor protection). Therefore, MiFID II already provides a mechanism for experienced retail clients, upon their request and if they fulfil certain conditions, to transfer to a less protected category of clients.

118. Based on the current state of the discussion on this point, ESMA does not consider that the creation of a new sub-category of retail clients is required or desirable as it would further complexify the current regime. Besides, if a new category of clients were to be introduced (encompassing only the most experienced or sophisticated retail clients), MiFID II would also have to specify which of its conduct of business rules would apply or not. The most experienced or sophisticated retail clients already have the possibility to be treated as professionals in accordance with Section II of Annex II of MiFID II. If the conditions set out in Section II are not met, they should continue to be treated as retail clients and be afforded the full protection of the MiFID II conduct of business rules. Furthermore, it is worth mentioning that MiFID conduct of business rules are already calibrated on the basis of the services provided, with stronger requirements in case of portfolio management and investment advice and lighter requirements for services such as reception and transmission of orders and execution of orders on behalf of clients (which, in turn, can also be provided on an "execution only" basis, with further limitation of conduct of business requirements).

119. ESMA believe that, if the issue at stake is a general overload of information (including in relation to costs and charges) and the need to better calibrate it to different categories of clients[7], this advice already include a few proposals aimed at both facilitating provision of information in durable medium and reducing information personally addressed to clients, and at significantly reducing the information on costs and charges to be addressed to eligible counterparties and professional clients (including therefore individuals classified as professional clients on request). ESMA remains available for further work in this area; however, we are of the view that a proper consultation process

[7] See recital 63 of the Delegated Regulation 2017/565.

and careful consumer testing would be necessary in order to carry out an additional review in a meaningful manner.

Reliance on UCITS KIID or PRIIPS KID for MiFID II costs disclosures (Question K)

120. A large majority of respondents reported that firms do not rely on the PRIIPs KID or UCITS KIID, or only very partially. The reasons most frequently mentioned were:

- The PRIIPS methodology leads to misleading figures because of the reduction in yield (RYI) methodology which is not adapted to MiFID products;
- The PRIIPS methodology presents issues in relation to slippage costs;
- The MiFID II costs disclosures also include services costs so firms cannot solely rely on the PRIIPS KID or UCITS KIID;
- PRIIPS KIDs and UCITS KIIDs are not updated regularly enough to be a good basis for the MiFID II ex-ante costs disclosures;
- Inducements are treated differently under the PRIIPS KID and UCITS KIID on one hand and the MiFID II costs disclosures on the other hand;
- Some respondents do not produce PRIIPS KIDs because they do not distribute non-UCITS products to retail clients;
- MiFID II has a much wider scope than the PRIIPS Regulation and the UCITS Directive so PRIIPS and UCITS are not relevant for certain MiFID products; and
- Firms do not have and have not built the IT systems required to extract figures from the PRIIPS KID and UCITS KIID so that relying on them would require too many manual adjustments.

121. An important number of respondents said they relied instead on industry self-regulatory initiatives such as the FinDatEx EMT Template.

122. Most respondents also called for the MiFID II and PRIIPS regimes to be harmonised, mainly by amending the PRIIPS framework so that the information disclosed in PRIIPS KIDs can be used for the purpose of MiFID II disclosures, at least to a certain extent.

123. Several respondents also pointed to the success of the UCITS Ongoing Charges Figure (OCF) which they see as a clear and comparable way to disclose costs between products in a manner that drives competition. Another respondent suggested to change the PRIIPS methodology to Total Expense Ratio (TER).

124. One respondent suggested to allow firms to only provide the PRIIPS KID in circumstances where MiFID II applies and there is no service cost. One respondent went further by suggesting that, where a PRIIPS KID or UCITS KIID is available, the distributor should be able to only provide the relevant KID/KIID and nothing else under MiFID II. A still other respondent suggested to allow for MiFID II ex-ante disclosures the same exemption regarding timing of the disclosure that is available under PRIIPS (i.e., to provide information after the transaction in certain cases).

125. ESMA recognises the need to align the MiFID II costs and charges disclosure regime with the PRIIPS framework. The European Supervisory Authorities (ESAs) are currently running a consultation on proposed amendments to the existing rules underpinning the Key Information Document (KID) for PRIIPs (the "PRIIPS Review").[8]

126. As set out below (see paragraph 148), the PRIIPS Review is currently underway and may resolve some of the issues raised above. For instance, the PRIIPS Review is suggesting some amendments to the RIY methodology which may tackle some of the criticisms raised against this methodology. Amendments to Table 1 and Table 2 of the PRIIPS KID may also help align the PRIIPS framework and the MiFID II costs and charges disclosure regime. Amendments suggested to the slippage costs methodology may also help solve what some respondents see as an incompatibility between MiFID II (as Recital 79 excludes market movements from being included in the costs disclosed) and PRIIPS.

127. For these reasons, ESMA believes that any further clarification or amendments to the MiFID II costs and charges disclosure requirements in this respect should be decided after the outcome of the PRIIPS Review is known, so as to ensure the consistency of the MiFID II costs and charges disclosure regime with the PRIIPS framework (as recommended under paragraph 148 below). Moreover, the issue of discrepancies between the PRIIPS and MIFID disclosures resulting from the different treatments of inducements could be solved by adding a subtotal.

128. Regarding the UCITS OCF, ESMA is of the view that the priority is the consistency between the MiFID II costs and charges disclosure regime with the PRIIPS framework, especially given that the exemption for UCITS funds to the PRIIPS KID requirements under Article 32 of the PRIIPS Regulation should, at some point, come to an end. Therefore, ESMA considers that, as of today, the use of the OCF methodology should not be transferred as a requirement into the MiFID II costs and charges disclosure regime.

129. In relation to the suggestion to allow firms to only provide a PRIIPS KID to comply with its MiFID II costs and charges obligations when there are no service costs, ESMA considers that, for the reasons expressed above, it is too early to take a position as the outcome of the PRIIPS Review is still unknown.

[8] https://www.esma.europa.eu/press-news/esma-news/esas-consult-changes-key-information-document-priips

Cross-border application of the MiFID II costs and charges requirements (Question L)

130. Many respondents either did not respond at all or they indicated that they had no experiences with the application of the costs disclosure requirements in different jurisdictions since their activities were limited to national markets or since their international activities were a very small part of their business.

131. Out of the respondents that have indicated that they had such experiences, the majority indicated that they have experienced differences in the application of the costs disclosure requirements in different jurisdictions.

132. These differences often were a result of the existence of local rules or guidance, for example in relation to the application of growth assumptions in determining the cumulative effect of costs on return. Respondents also experienced different levels of flexibility in different jurisdictions in relation to the application of the requirements in services provided to wholesale clients (e.g., when to apply a tariff grid or how generic this grid may be).

133. Respondents also mentioned different applications of methodologies such as the PRIIPs methodology, different methodologies to determine transaction costs, considering swing pricing to qualify as a cost and national guidance on determining the fair value.

134. Some respondents indicated that as long as retail clients have no accounts in different jurisdictions the impact of these differences would be limited. Most respondents indicated that these differences are not beneficial for a pan European market and that they hinder the comparability of investment firms and investment products.

135. A small number of respondents indicated that they had not experienced any differences in the application of the costs disclosure requirements in their cross-border activities.

136. ESMA believes that the amendments suggested to the MiFID II costs and charges disclosure requirements in paragraphs 109 to 119 above and 143 to 149 below would allow for more supervisory convergence across the Union and therefore solve many of the issues raised by respondents in this respect. ESMA thus considers that, as of today, no further amendments or guidance are necessary in this respect.

Need for 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) under MiFID II (Question M)

137. Responses were split between respondents asking for more detailed rules to clarify certain requirements of the MiFID II costs and charges disclosure regime and those who called for a regulatory pause. However, among the respondents that were against more detailed rules, many still highlighted certain areas of the MiFID II regime which, in their view, warranted some clarifications.

138. Many respondents expressing their opposition to more detailed rules did so on the grounds that firms have been implementing procedures and IT systems based on the current MiFID II provisions as well as guidance provided to date. They asked for a regulatory break, as any new guidance and more detailed rules would entail changes to procedures and IT systems and therefore costs. Many emphasized that, should new rules be published, there should be a proper consultation process, including for level 3 guidance published by ESMA.

139. Others said that the flexibility allowed by the current rules should be maintained with one respondent stating that there was no one size fits all regime. One respondent also called for any new detailed rules to be limited to retail clients.

140. Other respondents, however, were in favour of more detailed rules and called for delegated regulations to harmonise the standard and presentation of costs, including in areas such as:

a) the illustration showing the impact of costs on return;

b) the interpretation of fair value; and

c) the methodology used to determine the return of the investment.

141. However, respondents generally called for a careful consultation process and the need to avoid regulatory instability prior to any introduction of more detailed rules.

142. As previously set out in paragraphs 109 to 119, ESMA believes that the MIFID II costs and charges disclosure regime should be amended to provide more flexibility for eligible counterparties and professional clients.

143. ESMA also considers that the MiFID II costs and charges disclosure regime should be further clarified to ensure maximum harmonisation and comparability.

Default MiFID II costs and charges disclosure regime

144. For retail clients or where eligible counterparties or professional clients do not opt-out of the MiFID II costs and charges disclosure requirements (please refer to paragraphs 109 to 119 above), ESMA considers the existing regime as set forth in Article 24(4)(c) of MiFID II and Article 50 of the MiFID II Delegated Regulation adequate and does not see any need for changes,.

145. In addition, ESMA is of the view that some of the ESMA Q&As relating to the MiFID II costs and charges disclosure requirements should be incorporated into the MiFID II Delegated Regulation. The purpose would be to ingrain into law some of the guidance provided by ESMA and thereby to ensure further supervisory convergence. The relevant Q&As are related to:

d) the level of aggregation for ex-ante disclosures (ESMA's Q&As 9.22 and 9.24 on investor protection);

e) the use of tariff grids (ESMA's Q&A 9.23 on investor protection); and

f) the level of aggregation for ex-post disclosures for the service of portfolio management (ESMA's Q&As 9.31 on investor protection).

146. In addition, Article 50(9) of the MiFID II Delegated Regulation should be amended to clarify that:

a) for services other than portfolio management:

i. firms should provide clients with ex-post disclosures showing both the total costs and the costs broken down on an ISIN-by-ISIN basis, in each case for each client account (or, where the client does not have an account with the firm, for each service provided);

ii. the itemised breakdown that clients may request in accordance with Article 24(4)(c) of MiFID II should be provided for each ISIN and per type of costs listed in Annex II of the MiFID II Delegated Regulation; and

b) for the service of portfolio management, the client may request a breakdown on an ISIN-by-ISIN basis and/or per type of costs listed in Annex II of the MiFID II Delegated Regulation.

147. The MiFID II Delegated Regulation should also be amended to clarify that, as firms are required to provide the actual costs incurred by the client in the ex-post costs disclosures, they should keep records of the client's portfolio on a day-to-day basis so that they are in a position to calculate and show the ex-post costs disclosures as accurately as possible.

148. ESMA is also of the view that other aspects of the ex-ante costs and charges disclosure requirements should be clarified by amendments to the MiFID II Delegated Regulation. For instance, the method of how to calculate and disclose the relevant hypothetical holding period used for the ex-ante estimation of costs should be clarified. Right now, however, it is – in ESMA's view - still too early to take any position on these topics as the outcome of the PRIIPS Review is not yet known. ESMA believes that the MiFID II costs and charges disclosure regime and the PRIIPS regime should be consistent. As some of the aspects dealt with in the PRIIPS Review may have an impact on the MiFID II Delegated Regulation, ESMA recommends holding off on any specific amendments to the MIFID II disclosure costs and charges disclosure requirements in these respects until the PRIIPS Review is completed.

149. Furthermore, ESMA recommends that any amendments to the MiFID II costs and charges disclosure requirements go through a proper consultation process before their

adoption and that market participants are given sufficient time for implementation. In addition, certain proposals (such as ISIN-by-ISIN disclosure of costs) may produce some unintended consequences for clients, such as an overload of information. Consequently, ESMA recommends that the Commission undertake consumer testing on the impact of the proposals in this advice.

Illustration of the impact of costs on return (Questions N, O and Q)

Ex-ante (Question N)

150. A little under half of the respondents to the Call for Evidence did not provide feedback in relation to this topic.

151. Many respondents indicated that the approach taken to present ex-ante costs information across firms differs significantly. Differences are, for example, reflected in different approaches on whether to display the impact of costs for only one subsequent year or over the recommended holding period. Another difference is how firms have interpreted and how they present the relationship between costs and return. There are also differences on the level (ISIN-by-ISIN versus aggregation) on which the impact of the costs is represented.

152. Most respondents stated that they do not use any methodology or assumption to determine the return of the investment (assumption of zero return on investments). Reasons were that assumptions on return may be misleading or may lead to misunderstandings by investors, while an assumption of zero return enables easy comparison with other offerings and it avoids complex simulations. Some of these respondents also indicated that, if the purpose is to inform clients of the fact that costs have an impact on return, a generic sentence explaining this effect would be more effective than an attempt to show the effect in relation to an assumed hypothetical return. Others suggested to drop the requirement to illustrate the impact of costs on the return altogether and, if anything, to replace it by the impact of costs on the amount invested, assuming a zero return on investment.

153. Some respondents indicated that they use a specific growth rate. This rate could either be a fixed percentage per year or a growth rate that is calculated based on different assumptions per asset class (e.g., in Denmark). Respondents indicated that the use of a growth rate demonstrates the compounded impact of the costs and charges over time. However, the absence of a standard projected growth rate is one of the key matters affecting the comparability of ex-ante costs and charges illustrations of different firms.

154. In general, respondents do not use the PRIIPs methodology to demonstrate returns and the effects of costs on returns. Some respondents indicated that the approach set out in PRIIPs with multiple performance scenarios is not consistent with the MiFID II costs disclosure requirements. Furthermore, there are products that fall in the scope of MiFID II, but for which no PRIIPs KID or UCITS KIID is required. Other reasons mentioned by respondents are the uncertainty of the possible changes to the PRIIPs methodology

following the PRIIPS Review, the potential misleading return figures based on the current PRIIPS methodology and the complexity of the RIY for investors.

155. Some respondents highlighted that given the broad range of products and clients, flexibility should be allowed in the approach taken. For instance, for some products such as derivatives used to hedge a position, the impact of costs on return misses the point and does not add any value.

156. Finally, some respondents explicitly questioned the use of an illustration of the impact of costs on return to professional clients and eligible counterparties. Arguments brought forward were that these kinds of clients do not need such illustrations to understand the impact of costs on return, in particularly not in case of a bespoke product where a professional client or eligible counterparty has extensively negotiated all the terms with the other side to the transaction. Furthermore, there is usually no portfolio perspective as professional clients and eligible counterparties usually trade with multiple dealers.

Ex-post (Question O)

157. On this topic, too, about half of the respondents to the Call for Evidence did not provide feedback. And, like the ex-ante illustrations of the impact of costs on return, for ex-post illustrations respondents indicated that there are different approaches used in practice.

158. Some respondents reported that they provide clients with an annual sum of the costs without specifying the exact performance. For the purpose of disclosing this information the assumption of zero return on investment is assumed. Respondents that applied this approach suggested to delete the reference to the impact of costs on return and instead to only require to provide an overview of the total costs.

159. Other respondents indicated that they provided the information in relation to the actual return of the investment or portfolio. For portfolios an average capital was assumed, and a money weighted rate of return was suggested by one banking association.

160. A couple of respondents referred to the different approaches taken in calculating the costs of products held within a portfolio. No reference was made to the calculation of the actual costs. Instead reference was made to approaches in which on a daily, but more frequently monthly, basis a portfolio was analysed in order to determine the costs incurred in that specific portfolio.

161. Whereas some respondents explicitly stated that it was important not to prescribe a methodology to determine and show ex-post returns given the differences in services, financial instruments and types of clients, other respondents were of the view that the different approaches currently used render such different results that a meaningful comparison is impossible.

Feedback on whether the illustration showing the cumulative impact of costs on return helps clients understand that overall costs and their effects on the return on investment *and what format/presentation is most appropriate to promote that understanding (Question Q)*

162. Many respondents also did not provide any feedback to this topic. Among those who did, the responses were very mixed. A vast majority of the respondents were of the view that the information, particularly for retail clients, is difficult to understand and, given the amount of information already provided, that this requirement does not add much value.

163. Some of the respondents indicated that providing a total cost information (as a percentage and the total amount) amount would be enough. Others suggested to only delete the requirement of an illustration showing the cumulative effect of costs on return set forth in Article 50(10) of the Delegated Regulation. A few respondents suggested to replace this information by providing historical returns allowing clients to compare offerings, which, however, would only allow for a comparison of performance, but not of the costs and charges.

164. A consumer representative highlighted the importance of the illustration showing the cumulative effect of costs on return and went even further by suggesting to also add the impact of inflation.

165. Whereas a couple of respondents indicated that the illustration would benefit from prescribed parameters such as holding period or growth rates, other respondents rejected the idea of prescribed assumptions. Most respondents preferred flexibility with respect to the assumptions.

166. Such flexibility was also preferred by respondents in relation to the way the information is presented. Further guidance on, for example, tables or graphs were not welcomed. In general, the replies were more favourable towards tables with numerical information than to a graphical representation.

167. One respondent suggested to conduct an EU-wide survey to analyse how the costs information could be presented in a more effective way.

168. As set out above, ESMA is of the view that the obligation to provide the illustration of the impact of costs on return should not apply to eligible counterparties, without the need to opt-out. Professional clients (both *per se* and on request) should be allowed to opt-out completely of the MiFID II costs and charges disclosure regime in relation to execution services. Eligible counterparties and professional clients have, in ESMA's view, the necessary knowledge and experience to understand that the total costs and charges have an impact on return of their investment.

169. For retail clients, however, ESMA believes that the illustration of the impact of costs on return may be useful, both on an ex-ante and ex-post basis. ESMA suggests that further details be incorporated in the level 2 requirements. Indeed, from the responses received and from our own experience, it seems that the requirement to illustrate the impact of costs on return is very differently applied across the Union. Some firms and competent

authorities have interpreted the high level requirements provided in Article 50(10) of the MiFID II Delegated Regulation in a very narrow manner (requiring only that firms include, in their ex-ante and ex-post costs disclosures, a generic sentence stating that the total costs and charges have an impact on the return of the investment). Others, on the other hand require detailed assumptions relating to the return (for ex-ante disclosures) and a graphical illustration of the impact of costs on return.

170. However, ESMA believes that it currently does not have enough data to assess which model would be the most effective to draw investors' attention to the impact of costs on return. ESMA is therefore of the view that more time should be allowed to gather further evidence as to existing or possible models and to run consumer testing before taking a decision on which exact and more detailed requirements with respect to the illustration of the impact of costs on return should be included in the MiFID II Delegated Regulation.

171. As per paragraph 147 above, the MiFID II Delegated Regulation should be amended to clarify that, as firms are required to provide the actual costs incurred by the client in the ex-post costs disclosures, they should monitor and track the client's portfolio in a manner that allows them to calculate and show the costs as accurately as possible. To that end, firms should keep records and track their client's portfolios with a view to costs incurred at least on a day-to-day basis. This would help address the issue raised by respondents regarding the calculation of actual costs on an ex-post basis, as described in paragraph 160 above.

Need for further clarification regarding the timing of the ex-ante costs disclosures in the case of telephone trading (Question P)

172. About half of the respondents to the Call for Evidence provided feedback on this topic. A few indicated that they appreciated ESMA's Q&A 9.28 on investor protection which clarified different approaches a firm could take in relation to telephone trading. However, most respondents were not satisfied with the clarification provided in this Q&A.

173. Many respondents indicated that the Q&A still does not provide enough guidance on what constitutes providing information 'in good time'. Furthermore, respondents indicated that an exception or a specific approach should be included in the level 1 or level 2 texts.

174. Some respondents understood ESMA's Q&A 9.28 to still require firms to simultaneously with their disclosure on the phone provide the information in a durable medium. Respondents said that this, in practice, was not feasible and that such requirement may result in a delay of the transaction which may, particularly in volatile markets, be detrimental to the client.

175. Many respondents called for an explicit exemption allowing the provision of the information at a later stage in line with the approach taken with respect to the suitability statement or the provision of the PRIIPs KID. Other respondents were of the view that in case of telephone trading, the recording of the conversation including the provision of

the ex-ante information should be sufficient. Still other respondents stated that it was sometimes impossible to provide the ex-ante information on the spot.

176. Some respondents suggested an ‘opt-out’ or a waiver possibility for experienced retail clients that use telephone trading. In practice, those clients do not appreciate a delay of their transaction caused by reading out the ex-ante costs information.

177. A limited number of respondents indicated that similar issues as with telephone trading occur in other electronic ways of trading in which the speed of the transaction is key, such as trading via online chats.

178. Another suggestion by some respondents was to extend the application of the grid approach to product costs which would allow for the possibility not to provide ex-ante information prior to every single trade but constitute a blanket costs disclosure for a certain period of time, e.g., until the conditions change.

179. A couple of respondents asked for further clarification in case instructions are received from a client for a specific trade (e.g., by email or fax) where no ex-ante information has been provided yet. In such instances, a delay of the transaction only to inform the client of the ex-ante costs and await confirmation of the instruction might not be in the client’s interest.

180. Finally, many respondents indicated that for eligible counterparties and professional clients the approach described in Q&A 9.28 was not appropriate. These respondents suggested fundamentally changing the ex-ante costs disclosures for these clients or to discard the ex-ante disclosure requirement for these clients in its entirety.

181. ESMA believes that, in respect of the provision of ex-ante costs disclosures in case of telephone trading, MiFID II should be aligned with the PRIIPS Regulation and Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services. As such, MiFID II should provide that, where a transaction is carried out by telephone at the request of the client and it is not possible to provide the ex-ante costs disclosure in good time before the transaction, the relevant costs disclosures may be provided immediately after the transaction is concluded.

Other aspects of the MiFID II costs disclosure requirements requiring clarifications or changes (Question R)

182. One common theme in the responses was the methodology for the calculation of costs with some respondents indicating that the cost transparency would benefit from a further alignment with PRIIPs.

183. In this respect, as MiFID II does not provide for any specific methodology to be used for purposes of the costs disclosures, ESMA does not believe that any amendments are necessary. However, ESMA agrees that MiFID II and PRIIPS should be consistent and,

as explained in paragraph 148, any amendments in this respect should only be decided after the outcome of the PRIIPS Review is known.

184. For the transaction costs methodology, the views were mixed. Whereas one consumer representative supported the inclusion of implicit transaction costs in the costs disclosures, industry associations and market participants were differing views on this topic. Some respondents indicated that implicit transaction costs should not be part of the costs disclosures under MiFID II. Others suggested to use a calculation methodology different from the slippage methodology using purchase prices. Reference was also made to the need for further clarification on the fair value determination and the costs for real assets.

185. In respect of implicit costs, it is clear for ESMA, that they should be included in the MiFID II costs disclosures as the MiFID II costs and charges disclosure regime requires the disclosure of all costs. ESMA is also of the view that not disclosing implicit transaction costs would be detrimental to clients as the disclosures would then be incomplete and hence misleading. Regarding the transaction costs methodology, ESMA proposes to await the outcome of the PRIIPS Review of this topic.

186. With respect to the ex-post disclosures, some respondents indicated that firms usually calculate the costs based on the period the client has held the financial instrument (which can be less than twelve months), the value of and the amount invested in the instrument. Firms usually use the average value of the financial instrument as a reference point, either based on daily or a monthly valuation. In these respondents' views, further clarification on the ex-post calculation would be helpful.

187. ESMA believes that further clarifications should be incorporated in the MiFID II Delegated Regulation to clarify certain aspects of the ex-post costs disclosure requirements.

188. Many respondents indicated that the implementation of MiFID II was very costly and that it is important that any changes to the current regime are made only after a good dialogue with the industry. Some respondents proposed extensive consumer testing prior to any changes to ensure that changes, if any, produce the desired results. Finally, respondents pointed out that any changes needed to be accompanied by a sufficiently long implementation period. This, incidentally, was also requested by some of the respondents asking for further clarification on the MiFID costs and charges disclosure rules by ESMA.

189. ESMA notes that an additional specific consultation has been launched by the Commission in relation to the review of the MiFID II/MiFIR framework.

190. A couple of respondents called for further cross-sectoral alignment, in particular with the Insurance Distribution Directive (IDD) in its upcoming review.

191. ESMA supports the notion that investment products with similar characteristics should be treated in a similar way and hence believes that MiFID-like products should be subject

to the same rules as MiFID II. In particular, such products should be subject to equally strict costs and charges disclosure requirements. This is called for both from a level playing field and from a transparency and comparability of products point of view.

192. Many respondents criticised in Article 3(1) of the Delegated Regulation which generally requires that information is provided to clients on paper and that only provides for another durable medium under certain circumstances. The respondents indicated that all durable mediums should be available to them for the dissemination of the information and that paper should not be the default option. Respondents recognised that this request does not only relate to the costs and charges disclosures.

193. ESMA recommends to amend Article 3 of the MiFID II Delegated Regulation so that, when information must be provided in a durable medium, the provision of such information by means of electronic communications shall become the default option and should not require an active choice of the client, provided, however, that the client has provided the firm with a valid email address. Irrespective of this, the client should retain the right to receive information on paper. Firms should also be required to provide clear information to their clients on the consequences attached to the provision of a valid email address, and the fact that in such case no information will be provided in a paper form.

194. In addition, Article 3 of the MiFID II Delegated Regulation as well as corresponding articles (Article 66(3) and Article 47(1)) should be amended so that firms are not required anymore to personally address their best execution and conflicts of interest policies to their clients; provided that such policies are freely accessible on the firm’s website.

195. Some respondents asked for further clarification that the costs disclosure requirements only relate to the purchases of financial instruments and not to the sale of financial instruments. One reason given is that the legislative text refers to the importance of costs disclosures in the investment decision. According to the respondents this shows that the legislator only had the purchase of a product in mind, because the client arguably only takes an investment decision when buying a product, not when selling a product. Furthermore, certain requirements in the MiFID II Delegated Regulation, such as the cumulative effect on return and the anticipated spikes are forward looking and do not apply when an investor is selling a financial instrument.

196. ESMA has already published guidance in this respect (please see ESMA Q&A 9.27 on investor protection) and believes that further guidance or changes to its position are not required.

Technical advice

ESMA believes that the MiFID II costs and charges disclosure regime should allow for more flexibility when applied to eligible counterparties and professional clients.

Eligible counterparties

Eligible counterparties should be allowed to opt-out of the entire costs and charges disclosure regime (ex-ante and ex-post). Firms should keep records of the requests of opt-out.

Beyond that, the obligation to provide the illustration of the impact of costs on return (Article 50(10) of the MiFID II Delegated Regulation) should never apply (i.e., with respect to this requirement, not even an opt-out should be required).

Professional clients

More flexibility should also be allowed with respect to professional clients. The level of such flexibility should be based on the type of service provided rather than on whether the client is a professional client *per se* or a professional client on request.

With respect to services other than investment advice and portfolio management, professional clients, both *per se* and on request, should be allowed to opt-out of the entire costs and charges disclosure regime (ex-ante and ex-post and including the obligation to provide the illustration of the impact of costs on return).

Firms shall keep records of the documented requests to opt-out and they should contractually agree with their clients what type of costs information the client will receive instead.

For portfolio management and investment advice services, however, there should not be an opt-out and the entire costs and charges disclosure regime should apply (as it does for retail clients).

Default MiFID II costs and charges disclosure regime

For retail clients and eligible counterparties and professional clients who do not opt-out of the MiFID II costs and charges disclosure requirements, the existing regime has proven effective and should be kept in place with the following amendments.

1. Some of the ESMA Q&As relating to the MiFID II costs and charges disclosure requirements should be incorporated into the MiFID II Delegated Regulation. This would transform some of the guidance provided by ESMA into binding requirements and thereby ensure convergence. The relevant Q&As are the ones related to:

a) the level of aggregation for ex-ante disclosures (ESMA’s Q&As 9.22 and 9.24 on investor protection);

b) the use of tariff grids (ESMA’s Q&A 9.23 on investor protection); and

c) the level of aggregation for ex-post disclosures for the service of portfolio management (ESMA’s Q&As 9.31 on investor protection).

2. Article 50(9) of the MiFID II Delegated Regulation should clarify that:

   a) for services other than portfolio management,

      i. firms should provide clients with ex-post disclosures showing both the total costs and the costs broken down on an ISIN-by-ISIN basis, in each case for each client account;

      ii. the itemised breakdown that clients may request in accordance with Article 24(4)(c) of MiFID II should be available for each ISIN and per type of costs listed in Annex II of the MiFID II Delegated Regulation; and

   b) for the service of portfolio management, the client may request a breakdown on an ISIN-by-ISIN basis and/or per type of costs listed in Annex II of the MiFID II Delegated Regulation.

3. The MiFID II Delegated Regulation should clarify that, as firms are required to show the actual costs incurred by the client in the ex-post costs disclosures, they should monitor and track the client’s portfolio on a day-to-day basis so that they are in a position to calculate and show the costs as accurately as possible.

4. Other aspects that should be clarified include the period for which the ex-ante estimation of costs should be calculated and the methodology of the costs on return calculation. However, in ESMA’s view it is too early to address these topics as there is an ongoing consultation by the European Supervisory Authorities (ESAs) on amendments to the existing rules for Key Information Documents (KIDs) for PRIIPs (the “PRIIPs Review”).[9] The outcome of this review will have a bearing on the MiFID II discussion, because the MiFID II and PRIIPS regimes should be aligned and be consistent. ESMA therefore prefers awaiting the outcome of the PRIIPS Review before suggesting any specific amendments to the MIFID II costs and charges disclosure regime in these respects.

Telephone trading

[9] https://www.esma.europa.eu/press-news/esma-news/esas-consult-changes-key-information-document-priips

With respect to the provision of ex-ante costs disclosures in case of telephone trading, MiFID II should be aligned with the PRIIPS Regulation and Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services. As such, MiFID II should provide that, where a transaction is carried out by telephone at the request of the client and it is not possible to provide the ex-ante costs disclosures in good time before the transaction, the relevant costs disclosures may be provided immediately after the transaction is concluded.

Illustration of the impact of costs on return

As set out above, the obligation to provide the illustration of the impact of costs on return should not apply where the client is an eligible counterparty.

Professional clients (both *per se* and on request) should be allowed to opt-out of the entire MiFID II costs and charges disclosure regime; provided that they receive services other than portfolio management and investment advice.

In all other situations (in particular, where the client is a retail client), the illustration of the impact of costs on return may be useful and should be shown both on an ex-ante and ex-post basis. ESMA believes that further details regarding this illustration should be incorporated in the level 2 requirements. As of the date of this Report, however, ESMA does not have enough data to assess which illustration and calculation method would be the most effective in drawing investors' attention to the impact of costs on return. Hence, further evidence as to existing or possible models and consumer testing data should be gathered by the Commission prior to the introduction of more detailed level 2 rules.

Cross-sectoral alignment

Investment products with the same characteristics should be treated the same. Hence, not only financial instruments, but also similar investment products (in particular, insurance products) should be subject to the costs and charges disclosure regime set forth by MiFID II.

Durable medium

Lastly, ESMA recommends amending Article 3 of the MiFID II Delegated regulation so that, when information must be provided in a durable medium, the provision of such information by means of electronic communications shall become the norm and default option. An active choice of the client to that end, should not be required any more. Only if the client has not given the firm a valid email address or if it explicitly requests the information in paper form, should the firm furnish the information on paper. Firms should also be required to provide clear information to their clients on the consequences attached to the provision of a valid email address, and the fact that in such case no information will be provided in a paper form, unless explicitly requested by the client.

In addition, Article 3 of the MiFID II Delegated Regulation as well as corresponding articles (Article 66(3) and Article 47(1)) should be amended so that firms are not required anymore to personally address their best execution and conflicts of interest policies to their clients; provided that such policies are freely accessible on the firm’s website.