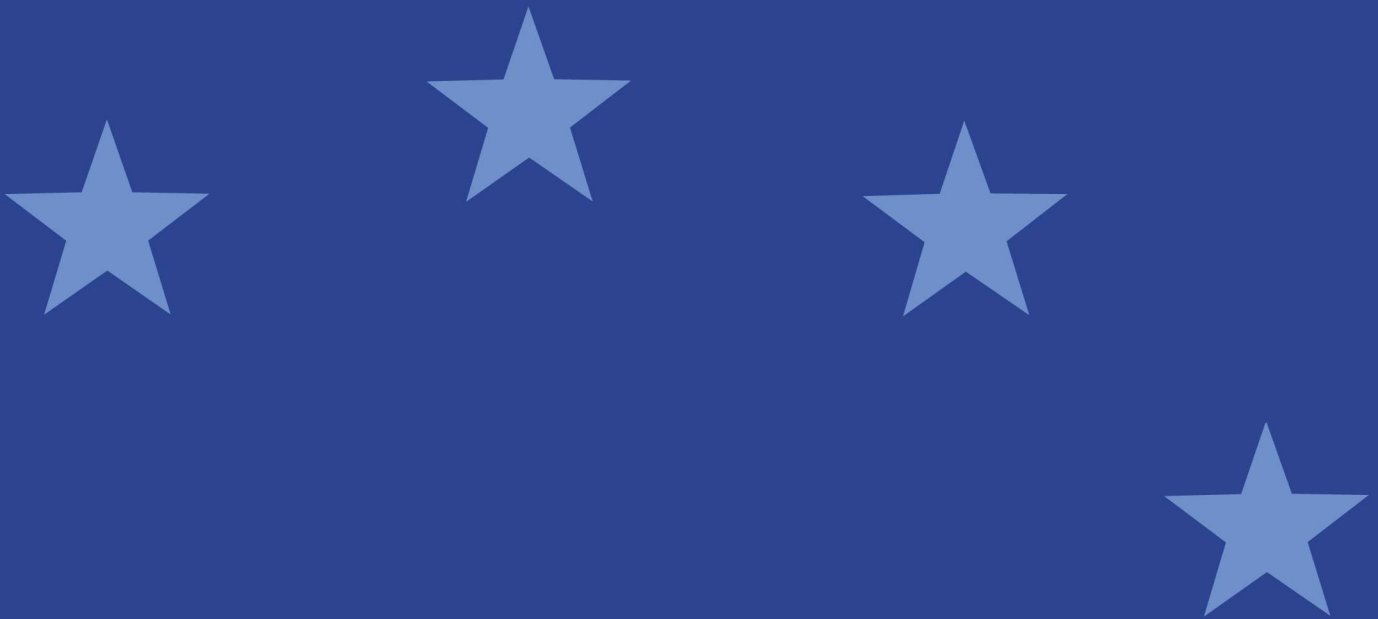




European Securities and
Markets Authority

Call for evidence

Impact of the inducements and costs and charges disclosure requirements under MiFID II



Responding to this paper

ESMA invites comments on this paper and in particular on the specific questions summarised in **Chapter 3**.

ESMA will consider all comments received by **6 September 2019**.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading [Legal Notice](#).

Who should read this paper

All interested stakeholders are invited to respond to this call for evidence.

This call for evidence is primarily of interest to (i) firms which are subject to Article 24(4) and (9) of MiFID II¹ when providing investment services and/or ancillary services and (ii) consumer groups and investors.

Item (i) of the above includes investment firms (as defined in Article 4(1)(1) of MiFID II), credit institutions when providing investment services and activities, external Alternative Investment Fund Managers (AIFMs) (as defined in Article 5(1)(a) of the AIFMD²) and UCITS management

¹ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

² Directive 2011/64/EU of the European Parliament and of the Council of 8 June 2011 on alternative investment fund managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) 1095/2010.

companies (as defined in Article 2(1)(b) of the UCITS Directive³) when providing investment services (in accordance with Article 6(4) of the AIFMD and Article 6(3) of the UCITS Directive, respectively).

³ Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast).

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

1. Under MiFID I⁴, inducements were regulated under Article 26(b) of the MiFID Implementing Directive⁵. The essential requirements for the legitimacy of inducements to be paid by/to a third person (other than payments by or on behalf of the client) were:
 - i. disclosure of the existence, the nature and amount of the fee, commission or benefit, or, where the amount cannot be ascertained the method of calculating that amount prior to providing investment or ancillary services;
 - ii. the third party payment must be designed to enhance the quality of the relevant service to the client; and
 - iii. the third party payment must not impair compliance with the firm's duty to act in the best interest of the client.
2. MiFID II aimed to strengthen the MiFID requirements for third party payments and benefits. To this end 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.
3. 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:
 - i. is designed to enhance the quality of the relevant service to the client; and
 - ii. does not impair compliance with the firm's duty to act honestly, fairly and professionally in accordance with the best interest of its clients.
4. Article 11(2) to (4) of the MiFID II Delegated Directive⁶ specifies the conditions that have to be met for the fee, commission or non-monetary benefit to enhance the quality of the service to the client.
5. 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

⁴ Directive 2004/39/EC of the European Parliament and the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC.

⁵ Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

⁶ 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.

be clearly disclosed to the client, in a manner that is comprehensive, accurate and understandable, prior to providing the relevant investment or ancillary services.

6. 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

7. 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 in relation to permitted inducements.
8. 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.
9. 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.
10. In addition, Article 11(5)(b) and (c) of the MiFID II Delegated Directive provides for the following ex-post disclosure requirements:
 - i. 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
 - ii. at least once a year, 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 payed. Minor non-monetary benefits may, however, be described in a generic way.

In implementing the above requirements, firms shall take into account the rules on costs and charges.

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

- ii. 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.

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

12. Under MiFID I, Article 19(3) already required investment firms to provide information on costs and charges to be paid by clients. Article 33 of the MiFID Implementing Directive specified such obligations for retail clients.
13. However, MiFID II clarified, strengthened and expanded the scope of the costs and charges disclosure requirements.

Costs and charges to be aggregated

14. Article 19(3) of MiFID I already required information on costs and associated charges to be provided to clients and potential clients. While such requirements remained at high level for non-retail clients, Article 33 of the MiFID Implementing Directive specified that, for retail clients such information shall include information on the total price to be paid including related fees: *“the total price to be paid by the client in connection with the financial instrument or the investment service or ancillary service, including all related fees, commissions, charges and expenses, and all taxes payable via the investment firm...”*.
15. Article 33 referred to all related fees, commissions, charges or expenses, but did not provide any further specification that could help the common understanding and application of these items. In addition, it emphasised the possibility that other costs that are not imposed by the firm but are related to transactions may arise for the clients. This could imply that costs arising from third parties may be excluded from the MiFID I costs and charges disclosures.
16. In these respects, MiFID II clarified which costs and charges shall be included in the cost disclosure (Annex II of the MiFID II Delegated Regulation⁷) and that third party payments (inducements) should be aggregated in the cost disclosure provided to clients (but be identified separately in the disclosure).

⁷ Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

17. MiFID II also bolstered the costs and charges disclosure requirements as it is now clear that the cost disclosures may not be done in a generic way and have to be specific to a transaction. 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 of ESMA's Q&As document on MiFID II and MiFIR investor protection and intermediaries topics).

Professional clients and eligible counterparties

18. Article 19(3) of MiFID I applied to all clients but Article 33 of the MiFID Implementing Directive applied to retail clients only. The extension of certain safeguards to the relationship between investment firms and non-retail clients (including eligible counterparties) has been one of the innovative elements in MiFID II. In addition, increased transparency on costs is relevant for all categories of clients, including non-retail clients.
19. As such, the MiFID II cost 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 from 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 requirements that investment firms may agree, at the request of the client concerned, not to apply.
20. MiFID II however excludes such possibility (the limited application of the cost disclosure for professional clients and eligible counterparties) in situations in which the nature of the services provided or the financial instruments concerned justifies the full application of the requirements. Thus, Article 50(1) excludes it: 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.
21. Based on initial feedback received from national competent authorities and market participants, it appears appropriate to analyse the impact of and reassess the costs and charges rules applicable to professional clients and eligible counterparties.

Scope of the ex-ante disclosure

22. 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".
23. Based on this article, The MiFID II Delegated Regulation distinguishes situations where full ex-ante cost disclosures have to be provided and when the cost disclosures only need to include the costs and charges related to the investment and/or ancillary service provided.

24. 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 cost disclosure shall disclose the aggregated costs and charges related to i) the financial instrument and ii) the investment or ancillary service provided.
25. In the remaining (residual) situations, investment firms need only 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

26. 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 to 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).
27. 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.*”
28. The MiFID II cost 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 have to be considered). Hence, investment firms could rely on the PRIIPs KID or UCITS KIID for their MiFID II cost disclosures⁸.
29. Based on feedback received from some national competent authorities and market participants, it seems that, even where the MiFID II and PRIIPs/UCITS cost disclosures overlap, investment firms do not rely on the information available in the PRIIPs KID or in the UCITS KIID for their MiFID II cost disclosures. This has created divergent interpretations and applications of the cost 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

⁸ ESMA also published some Q&As on this topic (for instance, Q&As 9.6 and 9.7 of ESMA’s Q&As document on MiFID II and MiFIR investor protection and intermediaries topics).

30. 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.
31. In practice, this raised some issues for telephone trading. ESMA already clarified 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 to either: a) delay 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) provide 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).
32. 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

33. 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.
34. The illustration is aimed at helping clients to further understand the overall costs and their effect on the return of its 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 Q&A 9.2 of ESMA’s Q&As document on MiFID II and MiFIR investor protection and intermediaries topics). However, it may be appropriate to analyse how this requirement has been applied and reassess the need to require such illustration to be provided in a more standardised format in order to support investors to compare products and to ensure that investment firms indeed show the “impact” that costs may have on the return (not just aggregated cost figures)⁹.
35. 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

⁹ For instance, one might consider clarifying whether firms shall make performance assumptions or calculations for the purpose of the illustration.

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 investment service provided.

Periodic ex-post disclosures

36. The MiFID Implementing Directive 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).
37. 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)¹⁰.
38. Similarly 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 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, especially to help comparability.

3 Impact

39. Article 90 of MiFID II provides that, before 3 March 2020, the Commission shall, after consulting ESMA, present a report to the European Parliament and the Council on, inter alia, *“the impact of the requirement to disclose any fees, commissions and non-monetary benefits in connection with the provision of an investment service or an ancillary service to the client in accordance with Article 24(9), including its impact on the proper functioning of the internal market on cross-border investment advice”*.
40. In its mandate sent to ESMA on 23 May 2019, the European Commission requested ESMA to: *“assess together with the NCAs whether firms comply with inducement and cost disclosure rules in practice, whether the application varies across Member States and, if positive, how. During this process, the Commission invites ESMA to 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”*.

¹⁰ The term “ongoing relationship” has been clarified by ESMA in Q&A 15.1 of its Q&As on MiFID II and MiFIR investor protection and intermediary topics.

41. The mandate sent to ESMA by the European Commission is thus broader than the area of MiFID II referred to in Article 90(1)(h) of the MiFID II Delegated Regulation as it also covers costs disclosures under Article 24(4) of MiFID II.
42. As part of its analysis, ESMA is therefore studying in detail the impact of:
 - i. 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
 - ii. Article 24(4)(c) of MiFID II on the provision of investment services and ancillary services.
43. ESMA will also assess whether and how the application of the above rules varies across Member States.
44. To this end, ESMA would welcome responses from all stakeholders to the questions below.
45. Firms that are subject to Article 24(9) of MiFID II may be especially well-placed to provide responses to questions A to G below. Entities providing independent investment advice may be interested to respond to Question G. Firms that are subject to the costs and charges disclosure requirements of MiFID II may be especially well-placed to provide responses to questions I to R. Questions G, H, L, O, P, Q and R below may be of interest for consumer groups and investors. Respondents may, however, respond to any of the questions below if they wish to.
46. Respondents are invited to provide any qualitative information and especially any quantitative information they may have.

4 Questions

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

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

B: Do you use the ex-ante and ex-post costs and charges disclosures as a way to also comply with the inducements disclosure requirements? At which level do you disclose inducements: instrument by instrument, investment service or another level (please specify how)?

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

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

E: How do you apply ex-ante and ex-post disclosures obligations under Article 24 (9) of MiFID II in case of investment services provided on a cross-border basis? Do you encounter any specific difficulty to comply with these requirements in a cross-border context? Please explain.

F: If you have experience of the inducement disclosure requirements across several jurisdictions, (e.g. a firm operating in different jurisdictions), do you see a difference in how the disclosure requirements under Article 24(9) of MiFID II and Article 11(5) of the MiFID II Delegated Directive are applied in different jurisdictions?

G: Would you suggest changes to the disclosure regime on inducements so that investors or potential investors, especially retail ones, are better informed about possible conflicts between their interests and those of their investment service provider due to the MiFID II disclosure requirements in relation to inducements?

H: What impact do you consider that the MiFID II disclosure requirements in relation to inducements have had on how investors choose their service provider and/or the investment or ancillary services they use (for instance, between independent investment advice and non-independent investment advice)?

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

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

J: What would you change to the cost disclosure requirements applicable to professional clients and eligible counterparties? For instance, would you allow more flexibility to disapply certain of the costs and charges requirements to such categories of clients? Would you give investment firms' clients the option to switch off the cost disclosure requirements completely or apply a different regime? Would you distinguish between per se professional clients and those treated as professional clients under Section II of Annex II of MiFID II? Would you rather align the costs and charges disclosure regime for professional clients and eligible counterparties to the one for retail? Please give detailed answers.

K: Do you rely on PRIIPS KIDs and/or UCITS KIIDs for your MiFID II costs disclosures? If not, why? Do you see more possible synergies between the MiFID II regime and the PRIIPS KID and UCITS KIID regimes? Please provide any qualitative and/or quantitative information you may have.

L: If you have experience of the MiFID II costs disclosure requirements across several jurisdictions, (e.g. a firm operating in different jurisdictions), do you see a difference in how the costs disclosure requirements are applied in different jurisdictions? In such case, do you see such differences as an obstacle to comparability between products and firms? Please explain your reasons.

M: Do you think that MiFID II should provide more detailed rules governing the timing, format and presentation of the ex-ante and ex-post disclosures (including the illustration showing the cumulative impact of costs on return)? Please explain why. What would you change?

N: For ex-ante illustrations of the impact of costs on return, which methodology are you using to simulate returns? Or are you using assumptions (if so, how are you choosing the return figures displayed in the disclosures)? Do you provide an illustration without any return figure?

O: For ex-post illustrations of the impact of costs on return, which methodology are you using to calculate returns on an ex-post basis (if you are making any calculations)? Do you use assumptions or do you provide an illustration without any return figure?

P: Do you think that the application of the MiFID II rules governing the timing of the ex-ante costs disclosure requirements should be further clarified in relation to telephone trading? What would you change?

Q: Do you think that the application of Article 50(10) of the MiFID II Delegated Regulation (illustration showing the cumulative impact of costs on return) helps clients further understand the overall costs and their effect on the return of their investment? Which format/presentation do you think the most appropriate to foster clients' understanding in this respect (graph/table, period covered by the illustration, assumed return (on an ex-ante basis), others)?

R: Are there any other aspects of the MiFID II costs disclosure requirements that you believe would need to be amended or further clarified? How? Please explain why.