BETTER FINANCE
The European Federation of Investors and Financial Services Users
Fédération Européenne des Épargnants et Usagers des Services Financiers

Ref.: *ESMA Call for Evidence Impact of the inducements and costs and charges disclosure requirements under MiFID II*

Link: https://www.esma.europa.eu/press-news/consultations/call-evidence-impact-inducements-and-costs-and-charges-disclosure

BETTER FINANCE RESPONSE

This paper represents the response of BETTER FINANCE, The European Federation of Investors and Financial Services Users. BETTER FINANCE is the public interest non-governmental organisation advocating and defending the interests of European citizens as financial services users at European level to lawmakers and the public in order to promote research, information and training on investments, savings and personal finances.

BETTER FINANCE acts as an independent financial expertise and advocacy centre to the direct benefit of European financial services users. Since the BETTER FINANCE constituency includes individual and small shareholders, fund and retail investors, savers, pension fund participants, life insurance policy holders, borrowers, and other stakeholders who are independent from the financial industry, it has the best interests of all European citizens at heart. As such its activities are supported by the European Union since 2012.

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General comment

BETTER FINANCE welcomes this timely assessment and evidence gathering on the application of the new MiFID II rules on disclosures for inducements and costs. However, we are unhappy to observe that, in a field that is eminently anchored in investor protection and designed to enhance consumers' experience and trust in financial services, the majority of questions are addressed to those who are implementing the new rules, **not end-users**.[1]

In other words, measuring the impact of extended disclosure requirements, meant to increase transparency and comprehensibility of the financial service to the consumer, should be based on consumer views in order to ascertain whether:

- they have reached their purpose; and
- there is divergent application between EU jurisdictions.

BETTER FINANCE surveys both among its Member Organisations and directly with consumers in several EU markets have revealed a very disappointing experience following the entry into force of MiFID II (1 January 2018), in particular in relation to disclosure of costs.

As such, to see that ESMA qualifies merely above a third of questions "of interest" to consumer organisations (in fact, only 28% can be normally answered) raises serious concerns on the usefulness of results ESMA may derive from this exercise.

We regret to see yet another public consultation focusing more on the subjects of a new obligation (checking if they are fine with the new obligation) then on gathering the experience and input from the potential beneficiaries of investor protection rules.

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?

The new rules on inducements disclosure introduced by MiFID II achieve their purposes in environments that use predominantly third-party distribution mechanisms ("open architecture channels"), i.e. where a legal entity selling the products is distinct (not part or affiliated) to the product manufacturer.

However, in *captive distribution*, or "closed architecture" channels (where the product manufacturer itself sells its products, either directly or through affiliated companies) the rules set out in Article 24(9) MiFID II and Articles 11 *et seq.* in the Delegated Regulation are no longer applicable. However, distinct forms of inducements (salarised networks) still exist, and a stimulus to act in the interest of the product manufacturer is inherent.

In the EU, several major markets function via captive distribution for investment funds or *bancassurance* for insurances, meaning that strengthening the rules on inducements or even banning the latter (as in the examples for the United Kingdom or the Netherlands) would not improve the situation. As a study commissioned by the European Commission in 2018 showed

[1] Article 24 is part of the MiFID II "*provisions to ensure investor protection*" section.

in relation to investment advice, "[t]*he vast majority of products offered are in-house investment funds, followed by life insurance policies*".[2]

BETTER FINANCE pointed out as early as 2014 the issue of captive models and conflicts of interests arising from variable remuneration, where we indicated that "*the economics rely mostly on in-house product sales, and where <<advisors>> are hardly distinguishable from salespeople*".[3]

Providing "in-house" investment counselling and recommendations is not subject to the disclosure rules of third-party advisors, reason for which the main "closed architecture" distribution model escaped these new rules on inducements disclosure of MiFID II and has been ever since favoured to the detriment of the small "open architecture" networks.

As such, **BETTER FINANCE proposes to mirror the disclosure rules for in-house or affiliate advisors** in order to give a full and clear image to the potential client that advice is performed by the one manufacturing the product and that the investment recommendation is confined to a limited range of in-house products, where applicable. In other words, the meaning of "inducements" must either be much broader in scope or it should find itself an analogous concept for the captive distribution models.

Retail investors must understand from the outset that in-house investment counselling does not merely mean an inherent, natural inclination to the company's products, but in fact confines the investment recommendation to a pre-determined set of products which may not best serve their interest. In addition, the suitability assessment is much more limited than with a tied agent or independent advisor since the target market assessment and product category (type and risk) will not cover all potential solutions.

In addition, as indicated in the 2014 Public Consultation of MiFID II/MiFIR, BETTER FINANCE reiterates that information on "*monetary and non-monetary inducements that are paid at AND post-point of sale to the client on an annual basis*"[4] should be disclosed as well. Currently, the disclosure rules concerning inducements and independent advice concern only the pre-contractual phase.

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)?

N/A.

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

N/A.

[2] European Commission, 'Distribution Systems of Retail Investment Products Across the European Union" (2018) 33, https://ec.europa.eu/info/sites/info/files/180425-retail-investment-products-distribution-systems_en.pdf.

[3] BETTER FINANCE response for the ESMA MiFID II/MiFIR Consultation Paper (22 May 2014) https://betterfinance.eu/fileadmin/user_upload/documents/Position_Papers/Financial_Markets_Infrastructure/en/PP-_Response_to_ESMA_Consultation_MiFID_II_22052014.pdf.

[4] Ibid, page 22.

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

N/A.

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.

N/A.

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?

N/A.

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?

The current disclosure regime is too hidden, opaque and complex for the average individual investor, therefore violating the MIFIDI and II requirement that information must be intelligible, clear, and that weaknesses of products must be displayed as clearly and as prominently as advantages.

Inducements must be:

1. Clearly explained: most EU citizens as individual investors have no clue what this term means. They must be informed that these are mostly commissions paid by the provider of the product out of his own commissions to the distributor (financial "advisor", another very misleading term for a "non-independent" one) who sells his product.
2. Is quantified impact on total annual charges and performance must be disclosed much more clearly and visibly and labeled as what it is: a selling commission. It must be disclosed alongside the management one.
3. In compliance with MIFID information rules, a prominent warning must inform the investor that such commissions generate a very high risk of conflict of interests of the distributor, who – other things being equal – will favor / promote only products that provide him with such commissions. In particular low fee products such as index ETFs are very likely not to be promoted as strongly as higher fee and selling commissions providing products.

As mentioned for many years by BETTER FINANCE, the whole disclosure regime does not address the main "non independent" retail distribution networks in continental Europe: the large retail banks' "closed architecture networks", who can claim their salaried sellers (so-called "advisors") do not get any such commissions. For those distribution networks, the very least to comply with MIFID information rules would be to have a prominent warning that this "advisor" sells only in-house products that may or may not be the most appropriate and cost-efficient products on the market.

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)?

Evidence gathered by BETTER FINANCE shows that these disclosure requirements have had very little impact if any, partly for the reasons mentioned in our reply to question G above.

Actually, we have evidence of very negative evolutions with regards to conflicts of interests in the distribution of retail investment products. In particular, the French Government just lifted its 15-year ban on inducements for personal pension products, including those which are not insurance products and are subject to MIFID ("PACTE" Law of May 2019, Article 71).

BETTER FINANCE estimates the impact of such a lift of at least a 20 billion euros loss for French personal pension savers over the life of their PPP contracts. This includes only the impact of the increase in commissions, it does not include the impact of conflicts of interests on fund selection. The declared motivation of French Public Authorities is to incentivize "advisors" to sell the new French PPP called "*Plan d'Epargne Retraite*" or PER).

In unit-linked business, the biggest French savers association recently announced an increase of 70% of its annual commissions (*Lettre AFER*, May 2019, nr. 112), most likely at least partly to increase inducements.

BETTER FINANCE had not advocated for an outright ban of commissions at the time of the design of MIFID II, because this would have done little to the often-dominant retail bank "closed architecture" networks. But today it is clear that "non-independent" advice (a wording carefully hidden to end clients) is anything but on the rise from its already very dominant market share in Continental Europe (except in the Netherlands who banned commission of course).

The EU Authorities should ask NCAs to analyze and measure the devastating direct (increase of total charges) and indirect (promotion/ selection of high fee / high inducements investment options to the detriment of more cost-efficient ones such as index ETFs) impact on the retruns of long-term retail savings. A ban on inducements today appears like the only solution.

Studies on retail distribution channels in the EU have shown that retail investors do not have a wide choice in terms of independent or non-independent advice. As pointed out to question A above, the dominant model is that of captive distribution networks that escape disclosure rules, and the open (especially independent) networks have been discriminated as such.

Therefore, in the majority of cases, the retail investor is forced to either go through salarised networks or buy without advice.

Drawing on the results in the United Kingdom and the Netherlands, where inducements and retrocessions have been fully banned regardless of whether the advice is independent or not, it has been observed that advice has either been dropped by financial institutions (and shifted to execution-only models or discretionary management) or clients have been redirected to financial advisors, part of which have minimum criteria (investment amount) in order to give advice. This shows how reliant distribution models were on commission-based investment advice, which should be a point of reflection for EU public authorities.

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.

N/A.

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

N/A.

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.

BETTER FINANCE, although in favour of the PRIIPs KID project to harmonise key pre-contractual disclosure for all retail investment products, including personal pension products (PPPs), strongly opposes the PRIIPs Costs section, in particular the summary cost indicator using a Reduction-in-Yield (RiY) that is non-transparent, difficult to understand, confusing and almost impossible to compare with other PRIIPs.

BETTER FINANCE favours the current simple and actual costs disclosure based on the UCITS KIID and suggests that all EU law must be steered in a direction that offers clarity, certainty and simplicity for the end user. As being a consumer is not a full-time job, BETTER FINANCE opposes the difficult constructs and remind that a KID/KIID **must avoid jargon**.

Last, BETTER FINANCE suggests that, whichever approach is taken, it must harmonise the three pre-contractual disclosure documents or marketing materials required by the UCITS KIID, the PRIIPs KID and the MiFID II frameworks. Even with advantages attached to each in particular, the information overload and the small distinctions between the three – rendering different cost figures – are misleading and add to the confusion.

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.

N/A.

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/A.

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?

Without delving into the entire debate on performance forecasts and PRIIPs, BETTER FINANCE wishes to shortly reiterate the last idea for Question K above, that the MiFID II and PRIIPs and, if applicable, IDD must be consistent with one another and, to the largest extent possible, ensure that the same methodology and information (format) presentation is used, in order to truly allow comparability of the products.

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 illustraton without any return figure?

N/A.

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?

N/A.

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)?

BETTER FINANCE has supported since the adoption of the MiFID II the presentation of the cumulative impact of costs on return to the retail investor and continues to do so. Moreover, BETTER FINANCE considers that not only the evolutive difference in time between gross and net returns should be presented, but most importantly, the effect of inflation should be presented for the ex-post cost presentations.

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.

N/A.