

MiFID II

**Information to clients on
costs and charges**

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Key Points

- All costs and associated charges related to investment/ancillary services and financial instruments should be disclosed to clients. This encompasses a wider range of costs than were previously required by MiFID I.
- Clients should be provided with an aggregated overview of all costs and charges of the investment, including the possibility to request an itemised breakdown.
- The information provided to the client should allow him to understand the cumulative effect of costs and charges on the return of the investment.
- Clients should be provided with the above information at point of sale as well as, where applicable, on a post-transaction basis.
- The new disclosure rules will apply in relation to professional clients and eligible counterparties, as well as retail clients. Subject to certain exceptions, firms will be able to agree a lighter disclosure regime for professional clients and eligible counterparties. However, investment advisers and portfolio managers will not be able to agree a lighter disclosure regime.

Background

Article 24(4) of the MiFID II Directive requires MiFID firms to provide appropriate information in good time to clients or potential clients with regard to (amongst other things) all costs and related charges.

MiFID firms are already subject to similar requirements under Article 19(3) of the MiFID I Directive and Article 33 of the MiFID Implementing Directive.

Much of the detail of what is required under MiFID II can be found in the MiFID II Delegated Regulation,¹ which is based on ESMA's Technical Advice.² The key requirements under MiFID II are set out below.

¹ Delegated Regulation 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 (the "**MiFID II Delegated Regulation**").

² ESMA, Final Report: Technical Advice to the Commission on MiFID II and MiFIR, 19 December 2014

Point of sale disclosure

Article 50(5) of the MiFID II Delegated Regulation says that firms will be required to provide "full point of sale disclosure" (where aggregated information must be disclosed about both the costs related to the financial instrument and the costs related to the investment service or activity) where:

- they recommend or market financial instruments to clients;³ or
- they are required to provide a Key Information Document ("**KID**") or Key Investor Information Document ("**KIID**") in relation to the relevant financial instruments under European legislation.⁴

If neither of those conditions is met, while it is recognised that the firm may not be in as strong a position to take into account all costs relating to a financial instrument, the firm must still:

- inform the client about all costs and charges relating to the investment and/or ancillary service provided;⁵ and
- comply with any other obligations to provide information on the risks of the relevant financial instrument.⁶

Clients should be informed of any costs to be paid in foreign currency, including applicable conversion rates, related charges, and any payment arrangements.

When more than one firm provides investment or ancillary services to the client, each firm should provide information about the costs of the services it provides.

A firm that recommends or markets to its clients the services provided by another firm should aggregate the cost of its services together

(ESMA/2014/1569) (the "**Technical Advice**"), chapter 2.14.

³ Recital 75 of the MiFID II Delegated Regulation guides that this includes providing investment advice or portfolio management services, providing general recommendations concerning financial instruments, or promoting financial instruments when providing investment and ancillary services to clients. This includes firms entering into distribution agreements. The rationale for this condition is the firm's obligation to act in the best interest of clients.

⁴ Firms would be required to produce a KID under the Packaged Retail and Insurance-Based Investment Products ("PRIIPs") Regulations or a KIID under the UCITS Directive. The rationale for this condition is the firm's obligation to provide clients with information on costs in accordance with existing European law.

⁵ Article 50(6), MiFID II Delegated Regulation.

⁶ Recital 77, MiFID II Delegated Regulation.

with the cost of the services provided by the other firm. Costs for investment or ancillary services provided by other firms, where the firm has directed the client to them, should also be taken into account. These requirements may present practical problems for many firms.

Post-sale periodic disclosure

When firms fall within the full point of sale disclosure conditions they will be also obliged to provide annual post-sale information to the client about all the costs and charges related to both the financial instrument(s) and investment and ancillary service(s) if they have, or have had, an ongoing client relationship during the year. This aggregated information can be included within any existing periodic reports from the firm to the client.⁷

If the point of sale disclosure conditions are not met, firms are still expected to include cost elements when providing clients with periodic communications on the services provided to them.⁸

Where post-sale disclosure is given during the life of the investment, it should be based on costs incurred and provided to the client on a personalised basis.

ESMA Technical Advice declined to provide a standard format for annual disclosures, since that is a matter of discretion for Member States. Nevertheless, ESMA did cite a suggested format from the Securities and Markets Stakeholder Group ("SMSG"), and it is possible that Member States may follow that format.

Identified costs that should form part of the costs to be disclosed to clients

Annex 2 to the MiFID II Delegated Regulation sets out tables of the costs that should be disclosed. There are separate tables for costs associated with the service and costs associated with the financial instrument.

The table for costs associated with the service contains the following:

| Cost items to be disclosed | Examples |
|----------------------------|---|
| One-off charges | All costs and charges paid Deposit fees, termination |

⁷ Article 50(9), MiFID II Delegated Regulation.

⁸ For more information on this obligation, see Article 25(6) of the MiFID II Directive.

| Cost items to be disclosed | Examples |
|--|--|
| related to the provision of an investment service | to the firm at the beginning or at the end of the provided investment service(s). fees and switching costs. ⁹ |
| On-going related to the provision of an investment service charges | All on-going costs and charges paid to firms for their services provided to the client. Management fees, advisory fees, custodian fees. |
| All costs related to transactions initiated in the course of the provision of an investment service | All costs and charges that are related to transactions performed by the firm or other parties. Broker commissions, ¹⁰ entry and exit charges paid to the fund manager, platform fees, mark ups (embedded in the transaction price), stamp duty, transactions tax and foreign exchange costs. |
| Any charges that are related to ancillary services | Any costs and charges that are related to ancillary services that are not included in the costs mentioned above. Research costs. Custody costs. |
| Incidental costs | Performance fees |

The table for costs associated with the financial instrument contains the following:

| Cost items to be disclosed | Examples |
|----------------------------|--|
| One-off charges | All costs and charges Front-loaded management |

⁹ Guidance in Annex II confirms that switching costs are costs incurred by investors when switching from one firm to another.

¹⁰ Guidance in Annex II confirms that broker commissions are charges for the execution of orders.

| Cost items to be disclosed | Examples |
|---|---|
| (included in the price or in addition to the price of the financial instrument) paid to product suppliers at the beginning or at the end of the investment in the financial instrument. | fee, structuring fee, ¹¹ distribution fee. |
| On-going charges | All on-going costs and charges related to the management of the financial product that are deducted from the value of the financial instrument during the investment in the financial instrument. |
| All costs related to the transactions | All costs and charges that incurred as a result of the acquisition and disposal of investments. |
| Incidental costs | Broker commissions, entry and exit charges paid by the fund, marks up embedded in the transaction price, stamp duty, transactions tax and foreign exchange costs. |
| | Performance fees |

In the discussion accompanying the ESMA Technical Advice, ESMA acknowledged some of the practical difficulties that are likely to arise in

quantifying the charges. In particular, ESMA noted that:

- in some markets (e.g. for bonds, derivatives and foreign exchange), the transaction costs are embedded in the bid-ask spread of the financial instrument and are difficult to quantify. Nevertheless, firms are still required to make the disclosure;
- practices where there is "netting" of costs are not excluded from the obligation to disclose; and
- even where costs are based on a percentage of assets under management ("AUM"), which means that costs will increase where the value of the AUM increases, firms will still be expected to make estimates of their costs.

Costs and charges to be aggregated

When providing either point of sale or post-sale disclosure to clients under MiFID II, Article 50(2) of the MiFID II Delegated Regulation states that firms will be required to aggregate:

- all costs and associated charges for both investment and ancillary services charged by the firm (or other parties where the client has been directed to such other parties); and
- all costs and associated charges associated with the manufacturing and managing of the financial instruments.

Third party payments received by firms in connection with the investment service shall be regarded as part of the cost of the service and identified separately (i.e. it should be clear to the client what part of the costs paid are rebated to the firm providing the investment service).

The aggregated costs and charges should be totalled and expressed both as a cash amount and as a percentage. Where the actual costs are not known, the firm should make a reasonable estimate. Any estimates should be reviewed post-sale and adjusted accordingly.¹²

Separate figures may be given for initial costs and charges, ongoing costs and charges and exit costs.

In relation to UCITS, Article 50(4) of the MiFID II Delegated Regulation states that firms are required to calculate and disclose product costs

¹¹ Guidance in Annex II confirms that structuring fees are those charged by manufacturers of structured investment products.

¹² Article 50(8), MiFID II Delegated Regulation.

and charges that are not included in the UCITS KIID (e.g. transaction costs). In line with Recital 78 of the MiFID II Directive, where transaction costs have not been provided by a UCITS management company, the firms should calculate and disclose those costs (for example, by liaising with the UCITS management companies to obtain the relevant information).

Cumulative effect of costs on return

Article 50(10) of the MiFID II Delegated Regulation confirms that firms will be obliged to provide their clients with an illustration at the point of sale, and as part of post-sale disclosure obligations, showing the cumulative effect of costs on return when providing investment services. The illustration should:

- show the effect of the overall costs and charges on the return of the investment;
- show any anticipated spikes or fluctuations in the costs (such as high costs in the first year of the investment (upfront fees), lower costs in the subsequent years (on-going fees) and higher costs at the end of the investment (exit fees); and
- the illustration is accompanied by a description of what the illustration shows.

Disclosure on a generic basis

The costs and charges disclosure may be provided on a generic basis as long as the firm ensures the costs and charges are representative of the costs the client would actually incur based on an assumed investment amount.

Recital 78 of the MiFID II Delegated Regulation, and earlier ESMA Technical Advice, has clarified the following:

- to calculate the costs in monetary terms, firms will be able to assume an investment amount, rather than the amount that the client is actually investing. However, they should accurately assess the true costs and charges that the client will pay: for example, if the client can choose from different services, the disclosure should relate to the service that the client has chosen;
- the only information that can be provided on a generic basis is the assumed investment amount. All other information should reflect the true costs and charges the client will pay; and

- any post-sale disclosures should reflect the client's actual investment amount.

Itemised breakdowns

Under Article 24(4) of the MiFID II Directive, the client must be given an itemised breakdown of the costs and charges on request. This goes further than the existing MiFID rules, where itemisation was only required in relation to commissions.

Application to professional clients and eligible counterparties

Under the current MiFID rules, many of the detailed disclosure requirements around costs and charges apply only in relation to services provided to retail clients. Under MiFID II, the detailed information on costs must be made available to professional clients and eligible counterparties, as well as to retail clients.

Article 50(1) of the MiFID II Delegated Regulation says that firms may agree with the client a limited application of these detailed requirements when providing services to professional clients and eligible counterparties, except where:

- the services of investment advice or portfolio management are provided (although this does not apply where the client is an eligible counterparty); or
- irrespective of the investment service provided, the financial instruments embed a derivative (and, where the client is an eligible counterparty, they intend to offer them to their clients).

Investment advisers and portfolio managers are likely to find themselves subject to significantly greater burdens than they were previously subject to.

Timescales for implementation

The MiFID II Directive and the Markets in Financial Instruments Regulation ("**MiFIR**") came into force on 3 July 2014, and most of their provisions will come into effect in member states from 3 January 2018. Member states have until 3 July 2017 to transpose the MiFID II Directive into national law.

The relevant sections in the MiFID Implementing Directive will be replaced by provisions in the MiFID II Delegated Regulation which will become effective by 3 January 2018.

The MiFID II Delegated Regulation will have direct effect and the member states will not need to implement these changes into national law.

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