MiFID II

Information to clients on costs and charges

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 ESMA Technical Advice. The key requirements under MiFID II are set out below.

Point of sale disclosure

The ESMA Technical Advice 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; 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.

If neither of those conditions is met, the firm still has to inform the client about all costs and charges relating to the investment and/or ancillary service provided. This appears to mean something less than the "full point of sale disclosure", although this is not clear from the guidance.

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 with the cost of the services provided by the other firm. This may present practical problems for many firms.

Post-sale periodic disclosure

The ESMA Technical Advice says that firms who are caught by the point of sale disclosure requirements will be also obliged to provide annual post-sale information 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.

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

ESMA declined to provide a standard format for annual disclosures, since that it 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 2.14.1 of the ESMA Technical Advice 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:

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

<table>
<thead>
<tr>
<th>Cost items to be disclosed</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>One-off charges related to the provision of an investment service</td>
<td>All costs and charges paid to the firm at the beginning or at the end of the provided investment service(s).</td>
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<tr>
<td>On-going charges related to the provision of an investment service</td>
<td>All on-going costs and charges paid to firms for their services provided to the client.</td>
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<tr>
<td>All costs related to transactions initiated in the course of the provision of an investment service</td>
<td>All costs and charges that are related to transactions performed by the firm or other parties.</td>
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<tr>
<td>Any charges that are related to ancillary services</td>
<td>Any costs and charges that are related to ancillary services that are not included in the costs mentioned above.</td>
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<tr>
<td>Incidental costs</td>
<td>Performance fees</td>
</tr>
<tr>
<td>All costs related to the transactions</td>
<td>All costs and charges that incurred as a result of the acquisition and disposal of investments.</td>
</tr>
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</table>

### Examples

- **Deposit fees, termination fees and switching costs.**
- **Management fees, advisory fees, custodian fees.**
- **Front-loaded management fee, structuring fee, distribution fee.**
- **Management fees, service costs, swap fees, securities lending costs and taxes, financing costs.**
- **Research costs. Custody costs.**
- **Broker commissions, 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.**
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, firms will be required to aggregate:

- all costs and associated charges 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.

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

In relation to UCITS, the ESMA Technical Advice suggests that the Commission should consider the possibility of requiring firms to disclose costs 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**

Firms will be obliged to provide their clients with an illustration at point of sale 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 an explanation 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.

The 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.

## 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.

The ESMA Technical Advice says that firms may agree (presumably 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.

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 2017. Member states have until July 2016 to transpose the MiFID II Directive into national law.

The changes to the MiFID Implementing Directive will be made by the Commission as delegated acts that will become effective by 3 January 2017. The member states will need to implement these changes into national law.
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