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Public Statement

ESMA presents the results of the 2022 Common Supervisory Action (CSA) and Mystery shopping exercise on MiFID II requirements on information on costs and charges

Background

In February 2022, ESMA announced on its website[1] the launch of a common supervisory action (CSA) with national competent authorities (NCAs) on the application of MiFID II costs and charges disclosure rules across the European Economic Area (EEA).

In its public announcement, ESMA noted that the 2022 CSA would focus on ex-post information provided to retail clients and that NCAs would review how firms ensure that these disclosures:

- are provided to clients in a timely manner;
- are fair, clear and not misleading;
- are based on accurate data reflecting all explicit and implicit costs and charges; and
- adequately show inducements.

ESMA also noted that the initiative, and the related sharing of practices across NCAs, would help ensure consistent implementation and application of EU rules and enhance the protection of investors as well as the improvement of NCAs' understanding of supervisory approaches in line with ESMA's objectives.

As part of its new tasks related to investor protection[2], ESMA also decided to complement the CSA with a first ESMA-coordinated mystery shopping exercise on the ex-ante cost and charges information provided to retail clients. Mystery shopping exercises allow ESMA and NCAs to monitor firms' practices, help identify at an early stage new risks and issues (including possible areas where mis-selling can occur) and allow to get more information on how firms applied the requirements in practice.

[1] ESMA launches a Common Supervisory Action with NCAs on MiFID II costs and charges (europa.eu)
[2] The revised ESMA Regulation (ESA Review) supplemented Article 9 on ESMA's tasks related to consumer protection as follows: "The Authority shall take a leading role in promoting transparency, simplicity and fairness in the market for consumer financial products or services across the internal market, including by: […] f) coordinating mystery shopping activities of competent authorities, if applicable."

Both the CSA and the mystery shopping exercise were performed based on a common approach and high-level methodology developed by ESMA. The framework of the two exercises, including scope, expectations, and timeline is the result of a joint effort to carry out these actions in a convergent manner.

ESMA has published 33 Q&As[3] on MiFID II requirements on costs and charges and has delivered technical advice to the Commission that was partly incorporated in the MiFID II "recovery package"[4]. Ensuring greater convergence in the supervision of information on costs and charges is an integral part of ESMA's broader efforts on the cost of retail investment products, making this topic a natural choice for the 2022 CSA and mystery shopping exercise.

CSAs and mystery shopping exercises contribute to fulfilling ESMA's mandate on building a common supervisory culture among NCAs to promote sound, efficient and consistent supervision throughout the EU and to improve the consistency and effectiveness of investor protection. ESMA's promotion of supervisory convergence and investor protection is done in close cooperation with NCAs.

Overview of the execution of the two exercises by NCAs

CSA exercise

Overall, 27 EEA NCAs participated in this CSA and shared knowledge and experiences at the level of ESMA throughout 2022, to foster supervisory convergence in the way they supervise the MiFID II rules on costs and charges disclosure and ultimately enhance the protection of investors across EEA Member States.

A total of 194 firms were included in the CSA sample, 118 of which credit institutions (CIs), and 76 investment firms (IFs). NCAs used different criteria to select a representative sample for their market. Criteria used included total number of clients, market share (in terms of investment services) and overall size of the firm.

NCAs used different supervisory approaches and carried out a total of 209 supervisory actions[5], 46 of which were on-site visits to firms. NCAs did not limit themselves to purely desk-based approaches, but also made use of various tools (such as video/audio conferencing tools) to perform inspections and to test the overall effectiveness of firms' policies and procedures.

Mystery shopping exercise

[3] ESMA35-43-349.
[4] ESMA35-43-2126.
[5] The number is higher than that of the number of firms in the samples as some firms were the subject oft both desk-based reviews and on-site visits

Ten NCAs[6] participated in ESMA's first coordinated mystery shopping exercise. The ESMA methodology for the mystery shopping exercise included two scenarios:

- One with onsite visits to physical branches where a retail investor was looking for investment advice.
- One with remote visits (online distribution of services) where a retail investor was looking to trade on investment products without advice and on his/her own initiative.

NCAs, who participated on a voluntary basis, could choose whether to cover both scenarios or one of the two. Overall, 57 firms were visited as part of the "onsite" scenario and 82 for the remote "online" visits.

Main findings

The CSA related to the ex-post costs and charges information provided to retail clients and focused on firms' compliance with the applicable requirements.[7]

The mystery shopping exercise, on the other hand, related to ex-ante costs and charges information given to retail clients. Here, the focus was on what the mystery shopper was actually provided with and whether s/he found the information understandable and useful. The goal of this exercise was to get a better picture of how the ex-ante MiFID II requirements are perceived by the investor and to a lesser extent to assess whether firms comply with the applicable requirements.

The main findings of the two exercises are presented below.

<u>CSA exercise</u>

The 2022 CSA exercise has shown an adequate level of compliance with most elements of the ex-post costs and charges requirements under MiFID II, although with varying degrees across Member States. Generally, firms provide the ex-post costs and charges information to clients and have relevant controls in place. In most instances, if requested, firms also provide itemised breakdowns of the costs and charges to clients.

However, the CSA exercise also revealed certain shortcomings and/or areas where there is a lack of convergence:

Costs not always shown as a percentage

Firms must show costs and charges both as a nominal amount and as a percentage. The CSA showed that some firms only provide disclosure documents showing the nominal amounts, not the corresponding percentages. Moreover, where firms did provide the percentage information, they did not always explain to clients how this percentage was calculated. Methodologies to

[6] BE-FSMA, CY-CySEC, DE-BaFin, ES-CNMV, FR-AMF, HU-MNB, LV-FKTK, MT-FSA, NL-AFM and PT-CMVM.
[7] Any clarifications on MiFID II costs and charges obligations that may have been additionally provided on the topic at national level (e.g., in the form of recommendations or Q&As) were also taken into account by the relevant NCAs.

calculate percentages differ among firms, which can be confusing for clients and hampers comparability.

Cost allocation between service and product costs varies

When providing information on all costs and charges to clients, next to showing the overall costs, firms are required to distinguish between all costs and charges related to the service(s) and to the product(s). The relevant cost items are further specified in Annex II of the MiFID II Delegated Regulation. The CSA revealed that, on occasion, the allocation by firms of certain costs and charges items to one or the other category varies, leading to differences in the disclosures provided to clients and hampering their comparability.

Inducements: differing practices and sometimes lack of disclosure

Firms must also show third-party payments received in the ex-post disclosures. The CSA revealed that inducements are not always shown in a consistent manner by firms across the EEA. Some firms, for example, show such costs only in the aggregated figures whereas others also show them in the itemised breakdown, on an instrument-by-instrument basis. Some firms did not disclose inducements at all to clients.

Implicit costs: not always shown

Firms are required to disclose all costs and charges related to the service and the product to clients, both explicit (e.g., advice fees or commissions) and implicit (e.g., transaction costs included in spreads or structuring costs embedded in the client price). The CSA showed that implicit costs are sometimes not disclosed to clients. Moreover, firms that do disclose such costs often apply different methodologies to calculate them, sometimes involving guesswork leading to incomplete and/or incorrect results. Moreover, firms tend to rely heavily on third-party data without being able to check the validity of such data.

Illustration showing cumulative effect of costs on return: differing and not always compliant practices

Firms are required to provide clients with an illustration showing the cumulative impact of the costs and charges on the return of the investment. MiFID II allows for different ways of illustrating this and the CSA showed that firms make use of graphs, tables or narratives for this purpose. The firms that make use of narratives, however, sometimes just included a generic statement that the costs had a negative effect on the client's return, without specifying the actual cumulative effect on the client's return.

Format and content of ex-post disclosures differ widely

The CSA revealed that the disclosure of ex-post costs and charges (both in terms of the aggregated information and the itemised breakdown) differs widely from Member State to Member State and sometimes even from firm to firm within the same Member State. This relates both to the layout and the detail of information provided as well as to the terminology used. For example, firms do not always adequately explain all cost items and the terminology used to refer to the different cost items is not always aligned with that used in MiFID II (for

example “ongoing” and “recurring” costs), which can be confusing for clients and hampers comparability. Moreover, where the ex-post information was provided through a document of wider content, the cost information was not always presented with the necessary prominence to allow clients to find it easily (for example, because it was placed at the end of the document).

In this context, NCAs stressed again the need for having a standardised format for the disclosure of costs and charges information. This would ensure more convergence in the way the information is presented to clients and would help ensure that the information is complete and comparable.

Mystery shopping exercise

As a preliminary remark, it should be noted that there are some reservations on the results obtained from this first coordinated mystery shopping exercise, given factors that may have conditioned the interpretation of responses submitted by mystery shoppers (for example, limited use of real accounts/transactions, technicality of some aspects related to costs and charges disclosure, difficulty to compare results from different outsourced providers).

As to the results, in most cases, mystery shoppers were provided with some information about costs and charges prior the provision of the investment service. However, only in approximately half of the cases, proper MiFID II ex-ante information about costs and charges was provided, in a durable medium. In the other cases, the information was incomplete (e.g. only a KIID/KID was provided, or only marketing material containing some cost information) or provided just orally. Moreover, ex-ante costs and charges were at times only disclosed late in the client’s decision process, impairing the client’s ability to make an informed investment decision based on this information.

Furthermore, when providing investment advice, firms did not always disclose in an adequate manner whether their investment advice was independent or not. Firms were also not always forthcoming with respect to the disclosure of inducements; in some cases, such information was not provided at all, while in cases in which the information was provided, sometimes only late in the process. Such a practice would not amount to providing the information in good time before providing the service and may result in inducements only being disclosed at a time when the client has already decided on a specific product.

Next steps

Based on the results of the CSA and the mystery shopping, ESMA will focus its convergence efforts on the following:

- Development of a limited number of new Q&As, or review existing ones, to address some issues identified in the two exercises that are relatively simple and straightforward to solve;
- Preparatory work on a possible standardised EU format for the provision of information about costs and charges to clients.

NCAs will undertake follow-up actions on individual cases, where needed, to ensure that regulatory breaches as well as other shortcomings or weaknesses identified are remedied.

ESMA reminds market participants that they should ensure compliance with all relevant MiFID II regulatory requirements at all times.