Fund Managers Face MiFID II Costs and Charges

MiFID II's new costs and charges regime promises greater transparency and clarity for investors, but also leaves an operational burden for fund managers to meet stricter disclosure requirements.

For several years now, costs and charges have been high on the reform agenda for the investment management industry and the implementation of MiFID II on January 3, 2018, is set to usher in fundamental changes in the way these fees are disclosed to investors. The new regime will require fund managers to be diligent with their accounting and establish clear communication lines with distributors.

MiFID II puts cost under the microscope

MiFID II seeks to clarify existing provisions relating to costs and charges disclosures outlined in MiFID I while introducing additional requirements as part of the reform's enhanced investor protection. The stricter disclosure regime is aimed at boosting transparency for investors, allowing them to better understand total costs and more easily compare different services and financial instruments. It is also intended to foster greater competition and potentially reduce fees for investors.[1]

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Ex-ante and ex-post disclosures

All financial intermediaries are concerned with the new rules and require the aggregation of all types of costs (i.e., for investments and for all ancillary services including custody, investment research and foreign exchange services). Firms will be required to disclose costs both on a point of sale (ex-ante) and post-sale (ex-post) basis, and present them as a percentage of net asset value and as a given value.[2]

Ex-ante disclosure will require a number of costs and charges to be estimated, either via incurred costs as a proxy or through "reasonable estimations" made by the firm, which can adjust its assumptions according to actual experience.[3] Ex-post disclosure will require firms to provide an annual breakdown of costs and charges to clients throughout an entire year. The latter is seen as a bigger challenge, as firms will have to potentially unbundle their charges and, if requested, provide clients with a daily calculation of all charges related to their investment fees.[4] Both ex-ante and ex-post disclosures will compel firms to provide an illustration of the cumulative effect of costs on returns which take into account anticipated spikes or fluctuations from upfront fees, exit costs or other charges.[5]

KEY INSIGHTS

- Investment firms must illustrate cumulative effect of costs on returns for clients
- The lack of a standardized approach in calculating certain costs could cause inconsistencies in methodologies used by individual firms
- The new EFAMA template for data exchange between manufacturers and distributors will support them in meeting their regulatory requirements

Counting the cost of compliance

Meeting the disclosure requirements will require asset managers to collate significant data from different systems and departments in each investment firm and make arrangements to receive necessary data from other firms in the chain of intermediaries or third party-service providers. According to Bovill, a global financial services regulatory consultancy, achieving compliance for the aggregation of costs and charges is expected to take more work-hours to implement than any other element of the reforms.[6] Asset managers will also have to establish processes to report costs clearly and effectively so clients can understand them. They will also need to deploy resources to provide itemized costs on request and answer client queries that are expected to arise from the increased transparency of charges.

The added operational burden has also been compounded by a lack of a standardized industry approach to calculating certain costs and charges, which could give rise to inconsistency in the assumptions and methodologies used by individual firms.[7] For example, the methodology used in calculating underlying transaction costs is seen as contentious. In markets for bonds, derivatives and foreign exchange, transactions costs are embedded in the bid-ask spread and are hard to quantify. Such costs can vary widely depending on liquidity and asset class.[8]

The European Securities and Markets Authority (ESMA) has attempted to provide some clarity over the methodology for calculating costs and charges in a recent update to its MiFID II 'Investor Protection' Q&A.[9] The update provided information about how the calculation methodology used in the separate Packaged Retail and Insurance-based Investment Regulation (PRIIPs) can also be applied to some of the costs that need to be disclosed under MiFID II. However, PRIIPs' scope is limited to funds and products marketed to retail investors and is primarily concerned with the production of generic pre-sale documents, whereas MiFID II places an ongoing responsibility on advisors and distributors to update client-specific costs and charges.[10] Until regulatory authorities provide further guidance, firms will need to develop pragmatic solutions that at least demonstrate reasonable endeavours to meet the spirit of the requirements by the January deadline.[11]

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Deadline looms for standardized data exchange

Ensuring the accurate and timely exchange of costs and charges information between manufacturers and distributors to service clients is another core concern for investment firms. ESMA's Q&A update did not clarify how frequently asset managers should transmit information to distributors for ex-post costs disclosure in order to deliver the personalized disclosure to clients.[12] In order to share key sets of data throughout their distribution network, asset managers will have to work in concert, using standardized information. In this regard, the European Fund and Asset Management Association (EFAMA) recently endorsed and published the European MiFID II Template (EMT) which “provides a functional description of the minimum set of data” for product manufacturers to distributors to help meet their regulatory requirements.[13]

1. KPMG (June 2017) Evolving Investment Management Regulation 2. PwC (November 2016) Cost disclosure under MiFID 3.KPMG (June 2016) Disclosure of costs and charges 4. Ibid. 5. FE Ltd (March 21, 2017) Cost disclosure under MiFID II explained 6. Bovill (2017) Costs and Charges 7. Ibid. 8. Investment Solutions Consultants (2017) MiFID II, Costs and Charges 9. ESMA (October 3, 2017) Questions and Answers on MiFID II and MiFIR investor protection and intermediaries topics 10. Law360 (June 6, 2017) ESMA Provides Clarity On MiFID II Investor Protection Rules 11. Ibid. Bovill 12. BNP Paribas (2017) A Guide to Product Disclosure Requirements 13. EFAMA (August 7, 2017) MiFID Template

11/17 17-209A