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Client Alert
News Flash

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MiFID II Costs and Charges — Room For Improvement

The FCA has issued feedback from its review of firms' costs and charges disclosures under MiFID II.

Key Points:

- The FCA found that, despite firms being aware of the rules and taking compliance seriously, firms are not interpreting the rules consistently.
- Firms should review the areas for improvement highlighted by the FCA, and ensure that their disclosures meet regulatory expectations.

The FCA has issued its first formal piece of feedback on MiFID II implementation, in the form of a webpage setting out findings from its review of firms' costs and charges disclosures. Although the review itself focused on retail investment firms, all firms subject to the MiFID II requirements on costs and charges should review their practices against the FCA's findings.

It is fair to say that firms have struggled with the new requirements, and this is supported by the FCA's findings. While it seems that no enforcement action is on the cards at present, the FCA expects all firms to review their compliance with the requirements, and notes that it will consider whether further action is required if it does not see improvements. This is a notoriously tricky area, and so firms will welcome having at least some further clarity around regulatory expectations.

Positive Findings

Overall, the FCA found that firms were aware of the rules and their obligations, and most were at least making a serious attempt to comply with them. The FCA sets out some specific examples of how certain firms have gone beyond the strict requirements, citing these as illustrations of good practice that other firms may wish to emulate:

✓ Training: some firms have provided specific training for relevant staff on costs and charges disclosures, including an assessment component to check understanding.

✓ Technological innovation: some firms have been developing technological solutions to help present costs and charges in more novel and interactive ways, and to help with data-gathering exercises.

- ✓ Non-MiFID business: firms offering both MiFID and non-MIFID products often applied the MiFID II standards to all products, to give customers a consistent illustration of costs (although the FCA acknowledges there are difficulties for these firms in terms of gathering data from manufacturers of non-MiFID products).

Room for Improvement

Despite finding that many firms were trying their best to comply, the FCA observes that firms are not interpreting the rules consistently. Although firms often do well at disclosing their own data, they struggle more with disclosing relevant third-party costs and charges, with many stating that they find it difficult to gather all of the relevant data from third parties. The FCA notes that levels of compliance have increased significantly since January 2018, but there remains a good deal of room for improvement.

Unsurprisingly, the FCA's list of areas for improvement far outnumbers the examples of good practice. These include:

- × Transaction and incidental costs: many firms are disclosing their own transaction costs, but not the costs of buying and selling underlying assets in an investment product, meaning that their aggregated figures are wrong. Some firms are also leaving out transaction and incidental costs because they cannot get the data. The FCA reminds firms that in such cases they cannot simply estimate the costs as zero, and instead must use reasonable estimates. Firms should also review any pre-sale estimates based on post-sale experience and use this to adjust estimates where necessary.

- × Inconsistencies: some firms are prominently advertising low costs while disclosing higher aggregated costs on less prominent parts of their websites. Others are inconsistent in their cost disclosures throughout the customer journey, with generic pre-sale figures differing substantially from tailored point-of-sale disclosures.

- × Itemised breakdowns: the FCA highlights that firms should take reasonable steps to minimise the effort required for a client to request an itemised breakdown, and that best practice for online disclosures is to allow clients to get the information via hyperlinks.

- × Cash equivalents: some firms still do not consistently include charges as both percentages and cash equivalents, as required by the rules.

- × Use of sample figures: firms using sample investment amounts and timescales to illustrate the impact of percentage charges over the lifecycle of an investment should choose examples that reflect general customer experience, not just selecting numbers that make the calculations simple.

- × Comparisons: the FCA reminds firms that if they wish to compare their own costs with those of competitors, they must use up-to-date costs that are subject to the same disclosure rules. The FCA found that some firms are using out of date figures that therefore make the comparisons potentially misleading for customers.

- × Third-party costs: firms are not disclosing costs for third-party products and services to the same standard as their own costs. The FCA reminds manufacturers that they need to ensure that they make the data available to all firms that distribute their products.

Key Action Points for Firms

Firms should:

- Review their ex-ante costs and charges disclosures against the MiFID II requirements, and against the areas for improvement highlighted by the FCA.
- Consider in particular whether they are accurately disclosing all transaction and incidental costs and charges (as the FCA highlights this as a particular issue).
- Review the examples of good practice and consider whether they ought to adopt some or all of these.
- Consider whether their costs and charges disclosures meet the overarching obligation for communications to customers to be clear, fair and not misleading.

One observation from the FCA's review is that it does not touch at all upon firms' ex-post disclosures. This could mean that the FCA is comfortable with how firms have dealt with difficult points such as how to reflect the spread and mark-up in their disclosures, or which costs are included in the annual costs and charges disclosure. However, it could simply be indicative of the fact that the FCA has not had the opportunity to review enough ex-post disclosures yet, or has not had the supervisory resource to focus on this aspect and has seen ex-ante disclosures as a greater priority.

Andrew Bailey signalled during a Treasury Committee evidence session in January 2019 that costs and charges was one of three initial supervisory focus areas for the FCA in relation to MiFID II implementation. The FCA is also conducting supervisory work this year in relation to the product governance regime and research unbundling, so firms should expect more to come on those topics. It appears from Mr Bailey's remarks that the FCA is focusing on supervisory, rather than enforcement, work at this stage, so the FCA's output on these topics is expected to be in the form of further supervisory guidance rather than enforcement cases.

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