MANAGED FUNDS ASSOCIATION

AIMA

European Securities and Markets Authority
103 Rue de Grenelle
75007 Paris

By online submission - www.esma.europa.eu

5 September 2019

Call for evidence on the impact of the inducements and costs and charges disclosure requirements under MiFID II – AIMA and MFA response

Dear Sir or Madam,

The Alternative Investment Management Association[1] ("AIMA") and Managed Funds Association[2] ("MFA"; collectively, the "Associations") welcome the opportunity to respond to the European Securities and Markets Authority ("ESMA") regarding its Consultation Paper[3] "Call for evidence: Impact of the inducements and costs and charges disclosure requirements under MiFID II" ("the CP").

Our detailed responses to the CP questions are provided in Annex 1. In particular, we highlight the fact that differences between the PRIIPS KID, UCITS KIIDs and MiFID II rules as to costs disclosure are such that the output under the disclosures for the different regimes is not necessarily substitutable.

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[1] AIMA is the global representative of the alternative investment industry, with more than 1,900 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programs and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council ("ACC") to help firms focused in the private credit and direct lending space. The ACC currently represents over 100 members that manage $350 billion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialized educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors).

[2] Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has cultivated a global membership and actively engages with regulators and policymakers in Asia, Europe, the Americas, Australia and all other regions where MFA members are market participants.

[3] ESMA35-43-1905. Online at:
https://www.esma.europa.eu/sites/default/files/library/call_for_evidence_impact_of_the_inducements_and_costs_and_charges_disclosure_requirements_under_mifid_ii__0.pdf.

We believe that there is an opportunity to create synergies across the regulatory regimes and that the provision of product fees and costs should be standardised across PRIIPs and UCITS, with information provided by the product manufacturer in relevant disclosure documents, e.g. UCITS KIID and PRIIPs KID. We also highlight our view that slippage costs should not be included in costs and charges disclosures and raise the question as to the relevance of certain disclosures, particularly for professional clients and clients based outside of the EU.

If you would like to discuss any aspect of this submission further, please contact Adam Jacobs-Dean (ajacobs-dean@aima.org) and Matthew Newell (mnewell@managedfunds.org).

Yours truly,

/s/ Adam Jacobs-Dean	/s/ Matthew Newell
Adam Jacobs-Dean Head of Markets, Governance and Innovation Alternative Investment Management Association	Matthew Newell Associate General Counsel Managed Funds Association

<u>Annex 1</u>

I: What are the issues that you are encountering when applying the MiFID II costs disclosure requirements to professional clients and eligible counterparties, if any? Please explain why. Please describe and explain any one-off or ongoing costs or benefits.

AIMA and MFA's members consider that there are a number of issues for consideration with respect to MiFID II costs disclosure requirements as they apply to fund managers.

<u>Relevance</u>

For *ex-ante* disclosures, which have the potential to be useful as a means of comparing one manager with another, the lack of a standard template means that, in practice, the comparability across managers is limited. Furthermore, we consider that the sophistication of many professional clients is such that they do not need the MiFID II information as they already have an understanding of the costs involved. As a result, in our view the costs disclosure requirements provide professional clients with limited, if any, additional value in assessing costs.

In addition, on an *ex-post* basis, many professional clients may already have the ability to access information on costs and charges separately and so the MiFID II disclosures may be unnecessary. Where a MiFID portfolio management firm is a sub-advisor to a parent investment manager client, for example a US manager with an EU sub-advisor, the parent investment manager will have direct access to all costs and charges information it needs from the MiFID sub-advisor and will often hold more information on costs and charges than the MiFID sub-advisor firm itself. As a result, the disclosure requirements provide no additional information to the client in these circumstances, and instead add cost burdens for the firm to provide this information without any corresponding benefit. Also, where a firm has non-EU based clients it is our members' experience that such clients are often unclear why they need to receive the information at all, which can lead to unnecessary uncertainty and confusion for clients.

Accordingly, we recommend either removing the disclosure requirement altogether for professional clients or change the disclosure to be provided only on request. This would be particularly useful for EU sub-advisor firms whose sole clients are their respective parent investment management firms.

<u>Slippage Costs</u>

We consider that slippage costs are difficult to interpret as an investment "cost" alongside explicit fees and charges, particularly so in the case of a retail client audience. On the basis that the intention of the costs disclosure rules is to provide clients with costs that are comparable and transparent, we do not believe that slippage is easily standardised in terms of a 'one size fits all' calculation methodology given the range of investment strategies, asset classes and trading techniques used by firm subject to the rules; including slippage in a single number obfuscates the attribution of true fixed costs.

Accordingly, we respectfully disagree with the expectation that firms' costs and charges disclosures should include slippage costs, which we consider is a more appropriate metric in the context of best execution.

Paying slippage is not necessarily negative from an investor's perspective and this can be simply illustrated by comparing order types and how they would be evaluated on the basis of an arrival price slippage. In a rising market, a trader placing a buy market order and therefore crossing a spread would have a profitable position but incurred slippage whereas a trader who placed a limit order will have zero (or negative) slippage but may not get filled.

MiFID II itself does not prescribe slippage costs for inclusion in the costs and charges disclosure requirements, and nor does MiFID II cite slippage costs as an example under the transaction costs category[4]. Rather, the requirement stems from an ESMA Q&A (see below) which states that the inclusion of slippage costs is "expected", with the result that firms therefore need to read across to the requirements in an RTS applicable to PRIIPs and not MIFID II.

> ***ESMA Q&A (Investor Protection) - Should the PRIIPs methodology also be applied when calculating costs and charges of financial instruments that do not fall within the scope of PRIIPs?***
>
> *" …For financial instruments in category (2) above, the methodology described in Annex VI of the PRIIPs RTS appears relevant and investment firms would be expected to use it to calculate the financial instrument's costs"*

Product regulation harmonisation

For our members that are authorised under the Alternative Investment Fund Managers Directive, they may only have a limited number of direct MiFID clients (such as managed accounts) and so the main administrative burden and cost for firms will be responding to the requirement to provide information to MiFID firms (e.g. EU distributors/investors) via the European MiFID Template. This issue is caused by a lack of harmonisation across the "product" regulation (i.e. UCITS and PRIIPs) and MiFID II. This is discussed further in response to question (k).

J: What would you change to the cost disclosure requirements applicable to professional clients and eligible counterparties? For instance, would you allow more flexibility to disapply certain of the costs and charges requirements to such categories of clients? Would you give investment firms' clients the option to switch off the cost disclosure requirements completely or apply a different regime? Would you distinguish between per se professional clients and those treated as professional clients under Section II of Annex II of MiFID II? Would you rather align the costs and charges disclosure regime for professional clients and eligible counterparties to the one for retails? Please give detailed answers.

As noted above, we would seek clarification that slippage costs were not expected to be included in the calculation of transaction costs and update the ESMA investor protection Q&A to that effect. We believe this change should be applied consistently across client types as we would not expect retail clients to be in a position to track the nuances involved with slippage costs in a way that they can meaningfully compare the "costs" across firms.

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[4] Commission Delegated Regulation 2015/565 annex II states: "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 addition, we believe that *per se* professional clients understand and receive appropriate information on the fees and costs associated with their mandates. We believe it would be proportionate to either remove the disclosure requirement altogether for professional clients or change the disclosure to be provided only on request. This would be particularly useful for EU sub-advisor firms whose sole clients are their respective parent investment management firms – as described in the response to question I, above.

We submit that any proposal to align the costs and charges regime for professional clients and eligible counterparties with that for retail clients would be unwarranted and disproportionate. As set out above, we believe that the requirements under the MiFID II costs and charges disclosure regime for professional clients as they stand already exceed what such clients require, therefore expanding the format and requirements to match that provided to retail clients would be of limited value and unnecessarily burdensome for firms.

K: Do you rely on PRIIPS KIDs and/or UCITS KIIDs for your MiFID II costs disclosures? If not, why? Do you see more possible synergies between the MiFID II regime and the PRIIPS KID and UCITS KIID regimes? Please provide any qualitative and/or quantitative information you may have.

We understand that members would not generally rely on PRIIPs KIDS or UCITS KIIDs for MiFID II costs disclosures. This is because many members will not produce PRIIPs KIDs because their non-UCITS are not made available to retail clients and we are not aware of examples of firms amending UCITS KIIDs to include additional information required under MiFID II. Given the differences between the PRIIPS KID, UCITS KIIDs and MiFID II rules as to costs disclosure, the output under the disclosures for the different regimes is not necessarily substitutable and so potentially could be non-compliant.

We believe that there is an opportunity to create synergies across the regulatory regimes. We believe the provision of product fees and costs should be standardised across PRIIPs and UCITS, with information provided by the product manufacturer in relevant disclosure documents e.g. UCITS KIID and PRIIPs KID.

Our members would highlight the success of the UCITS Ongoing Charges Figure (OCF) in bringing about clear and comparable costs disclosures between products in a manner that drives competition. We believe the UCITS OCF should be used as a benchmark to create synergies across 'product' regimes. To the extent it is deemed necessary to add transaction costs, this should be kept to explicit costs. We believe variable items, such as slippage, that may have underlying complex methodologies and/or assumptions must be avoided otherwise the value in the OCF as a comparable figure becomes diminished.

Performance fees should not be included in an OCF because their variable nature would make cost comparisons difficult and may be confusing for retail clients that may see the higher cost as negative despite it arising due to outperformance. We believe performance fees should be disclosed separately in UCITS and PRIIPS disclosure documents showing i) the fact that they are charged ii) the applicable fee and iii) their methodology. We understand that in a "service" relationship, applicable under MiFID, firms will be required to report on actual incurred costs and show example costs for a portfolio of products that may charge performance fees. As such, we believe MiFID costs and charges disclosure will need to deviate from product regulation to show actual performance fees over 12 months (ex-post) and historical averages (ex-ante) and fund managers will need to make this information available to distributors up the chain.

We believe that AIFMD should be treated separately. If an AIF is marketed to retail investors, PRIIPS will apply so there is no need to apply the requirements to all AIFMs to capture the retail market. We believe Professional clients will request additional transparency on costs and charges as applicable.

M: do you think that MiFID II should provide more detailed rules governing the timing, format and presentation of the ex-ante and ex-post disclosures (including the illustration showing the cumulative impact of costs on return)? Please explain why. What would you change?

For the reasons described above, we would not support further rule making in this area. We believe that there is sufficient detail in the current rules such that firms are able to take a range of approaches in meeting their compliance obligations for different types of clients.
