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Norwegian Securities Dealers Association (NSDA)
Swedish Securities Dealers Association (SSDA)

**RESPONSE TO CESR CONSULTATION ON
BEST EXECUTION UNDER MiFID (07-050b)**

Explanatory note: CESR's proposals and questions are in italics. Our comments on CESR's proposals and our answers to CESR's questions are in ordinary type.

GENERAL

The Associations welcome this opportunity to respond to CESR's Consultation Paper (CP) on best execution under MiFID. In our response, we comment on CESR's specific proposals and answer CESR's questions. We also have seven general comments on the CP.

First, in general, we welcome the approach taken by CESR in the CP, and believe that CESR's comments in some areas (identified in our response) would provide useful guidance to firms and national regulators on the implementation of MiFID's best execution provisions.

Second, any guidance provided by CESR should emphasise the "reasonableness" concept which lies at the heart of the process-based approach adopted by Article 21 of MiFID.

Third, the CP appears to have been written primarily from the perspective of exchange-traded instruments in equity markets. A different perspective is needed for non-exchange traded cash instruments and derivatives in dealer markets.

Fourth, we are concerned that CESR should not provide an interpretation which goes beyond MiFID. In general, we do not think that CESR should issue guidance on best execution where the effect of such guidance would be to restrict the discretion available to firms under MiFID. If CESR publishes any guidance (or a Q&A) on best execution, CESR should therefore make it clear that this is not designed to restrict the discretion available to firms under MiFID, nor to override industry guidelines (for example, in the UK, MiFID Connect guidelines), provided that they are consistent with MiFID and confirmed by a national regulator.

For example, there is no requirement under Article 21 of MiFID (or Article 46 of the Implementing Directive) to list execution venues by name. Such a requirement could have anti-competitive effects at odds with the pro-competition objectives of MiFID (see our response to Q1 below).

A requirement to list execution venues by name would also go beyond the requirements of MiFID, which require only that firms which have *retail* clients list those venues on which they place “*significant reliance*” (Article 46(2)(b) of the Implementing Directive). Any further requirement would be super-equivalent and should properly be the subject of an Article 4 notification by a Member State. The need for such an Article 4 notification was noted by the Commission in the 6th informal transposition meeting of 16 November 2006.¹

The manner in which firms choose to meet the Article 21 requirements should not therefore be prescribed in terms of a requirement to list execution venues by name. Similarly, it would be unhelpful for regulators to suggest that trading in a particular manner, for example by directing orders to organised markets, will automatically meet the best execution requirements. Even where a particular execution venue was considered likely to deliver the best possible result on a consistent basis, the investment firm could legitimately match the result offered by that venue and deal with the client order as principal.

Fifth, we are concerned that CESR should apply client consent to firms’ order execution policies in an appropriate manner. In addition to providing that “prior express consent” may be given by signature (in writing or electronic), by web page click-through, or orally, CESR should also provide that such consent may be given by a client’s continuing to deal on the basis of a one-way notification of appropriate information concerning the firm’s order execution policy.

Sixth, we are also concerned that CESR has added two calls for evidence which are not critical to the implementation of MiFID on 1 November 2007. In our view, CESR should wait until MiFID has been implemented and its impact can be assessed before conducting further studies into MiFID which are not required at this stage. It is particularly important not to distract firms’ attention from the priority of preparing for the implementation of MiFID. This approach would be consistent with Article 44(5)

¹ “The question was raised as to whether Member States can require firms to provide certain information to professional clients in a way similar to the requirement set in Article 46(3) for retail clients. It was explained that Member States are not allowed to oblige firms to provide professional clients with the same information as the one required for retail clients. The inclusion of such an obligation in national legislation would require notification under Article 4 of the Level 2 and would need to meet all the conditions set in this article.” (Commission minutes of 17 January 2007, page 6.)

of the Implementing Directive, under which the Commission does not need to present a report on the availability, comparability and consolidation of information concerning the quality of execution of various execution venues until 1 November 2008.

Finally, CESR states (#12) that it “will consult market participants [on scope] and related aspects after having received the response from the Commission”. We understand that the Commission will shortly respond to CESR’s questions on the scope of the best execution obligation, and that CESR will consult on the practical application of the Commission’s response through an addendum to the current CP. If so, we would be grateful for the opportunity to comment on CESR’s addendum. But we hope that CESR will provide any guidance or recommendations on best execution as soon as possible, given the short time left for firms to prepare for the implementation of MiFID on 1 November 2007.

EXECUTION POLICIES AND ARRANGEMENTS

Contents of an execution policy

CESR considers (#20) that execution arrangements are the means that an investment firm employs to obtain the best possible results, including its strategy, practices and procedures, while the execution policy may be understood as a statement of the most important and/or relevant aspects of those execution arrangements.

We agree with this clarification.

CESR notes (#21) that, as the Article 45 “policy” (implying procedures for implementation) is analogous to the Article 21 “execution arrangements” and the Article 21 “execution policy” is both an aspect and a summary of the firm’s overall “execution arrangements”, we would expect the Article 45 “policy” of a portfolio manager or RTO to include similar elements to those contained in the Article 21 “execution policy” discussed below.

We agree that this helps to clarify the different terminology used in Articles 21 and 45.

CESR says (#22) that the execution policy must:

- *describe the investment firm’s execution approach for carrying out orders for execution from the time that an order originates to the time that it is executed or settled, as the case may be;*
- *set out the execution venues or entities the firm uses and the role of execution quality and any other factors in selecting them;*
- *explain how different factors influence the firm’s execution approach for carrying out client orders;*
- *explain why the firm’s execution approach for carrying out client orders will deliver the best possible result for the execution of those client orders.*

Question 1: Do respondents agree with CESR's views on:

- *the main issues to be addressed in an (execution) policy? Are there any other major aspects or issues that should ordinarily be included in an (execution) policy?*
- *the execution policy being a distinct part of a firm's execution arrangements for firms covered by Article 21?*
- *the execution policy under Article 21 being a statement of the most important and/or relevant aspects of a firm's detailed execution arrangements?*

First bullet, first question: We have five comments on CESR's interpretation of the main issues to be addressed in an execution policy.

The first is that CESR needs to make it clear that a firm's execution policy is expected to reflect the process and arrangements that firms should put in place to achieve the best possible result on a consistent basis, and not in every case. It is also important to decouple the content of an execution policy from the question of disclosure of appropriate information to clients, as MiFID does, but the CP fails to do.

Second, the obligation on a firm is to take "all reasonable steps" to obtain the best possible result. The use of the word "reasonable" qualifies the obligation. This should be recognised by CESR.

Third, having stated (#20) that an "execution policy may be understood as the most important and/or relevant aspects of those execution arrangements", it should be left to firms to decide what these are. They should not be prescribed by CESR.

Fourth, CESR does not make it clear how the concept of "execution approach" (#22) relates to "execution policy" and "execution arrangements". #22 (c) and (d) do not clearly relate to the requirements set out in Article 21 of MiFID or Articles 44-46 of the Implementing Directive.

Finally, there is no general requirement under Article 21 of MiFID (or Article 46 of the Implementing Directive) for firms to list execution venues by name. Such an approach would also be inconsistent with CESR's statement that a firm's execution policy may be understood as a summary of the most important and/or relevant aspects of the firm's execution arrangements, and there are good reasons why such an approach should not be prescribed by CESR.

The most that MiFID requires is for firms that have *retail* clients to list, in their execution policy for retail clients, those venues on which they place "*significant reliance*" (Article 46(2)(b) Implementing Directive). Any further requirement would be super-equivalent and should therefore properly be the subject of an Article 4 notification by a Member State.

Further, such a requirement could have serious anti-competitive effects, since a new execution venue seeking to establish itself will need to ensure that it is listed in the

order execution policies of a significant proportion of the market to be viable. It would better enhance the prospects for competition – and the emergence of new execution venues – not to prescribe any such requirement, leaving it to firms properly to consider the emergence of such new execution venues as part of the regular review of their execution arrangements.

Such a requirement would also be impracticable for firms to implement, particularly in the post-MiFID environment in which increased competition may lead to a proliferation of execution venues and where execution practices may evolve rapidly. Firms could provide information on the individual execution venues they use if so requested by their clients, but requiring this to be part of their execution policy could lead to a substantial administrative burden and would be unworkable in practice. For example, would firms be required to amend their execution policies each time they chose to add or remove an execution venue from their execution arrangements, and would they have to notify clients of a “material change” to their execution policy on each such occasion? Further, listing execution venues would not work in fixed income markets and other markets where liquidity is provided predominantly by dealers.

Rather than a list of names which may be rendered obsolete by the emergence of alternative venues or new execution practices, what would be of more relevance and value to clients in assessing firms’ execution arrangements would be information on the principles by which firms select and direct orders to execution venues.

For the reasons set out above, we do not consider that #22 should be incorporated in CESR guidance in its current form. And in particular, we do not think that CESR should expect firms to go beyond what MiFID itself requires.

First bullet, second question: No.

Second bullet: We agree with the statement that a firm’s execution policy may be understood as a summary of the most important and/or relevant aspects of the firm’s overall execution arrangements.

Third bullet: Yes.

Factors and criteria

CESR lists (#23) the factors referred to in Article 21(1) of Level 1: price; costs; speed of execution; likelihood of execution; speed of settlement; likelihood of settlement; size of the order; nature of the order; any other consideration relating to the execution of the order.”

In our view, “speed” should be interpreted as referring only to “speed of execution”. We do not accept that it refers also to “speed of settlement”. We do not consider that such an interpretation is justified.

CESR quotes (#27) Recital 67 of Level 2 in providing that speed, likelihood of execution and settlement, the size and nature of the order, market impact and any other implicit transaction costs may be given precedence over the immediate price

and cost factors “only insofar as they are instrumental in delivering the best possible result in terms of the total consideration to the retail client.” CESR thinks this may be justifiable for a particularly large order in a relatively illiquid share, for example. However, implicit costs are unlikely to be a consideration for most retail orders as the majority of these are likely to be average sized orders in liquid instruments.

Question 2: For routine orders from retail clients, Article 44(3) requires that the best possible result be determined in terms of the “total consideration” and Recital 67 reduces the importance of the Level 1 Article 21(1) factors accordingly. In what specific circumstances do respondents consider that implicit costs are likely to be relevant for retail clients and how should those implicit costs be measured?

We agree that implicit costs are unlikely to be a consideration for most retail orders as the majority of these are likely to be average sized orders in liquid instruments. But in some situations (eg some orders from high net worth individuals or small companies categorised as “retail”), market impact and other factors could be equally or more important. It is also important to note that, in bond (and other OTC) markets, retail dealing sizes are much smaller (eg tens of thousands) than standard trading sizes (eg one to five million); and that in derivatives markets, other factors like credit risk spreads need to be taken into account when executing transactions. All of these factors – and the risks arising from them – are important for firms.

We do not consider that it would be helpful for CESR to set out a prescriptive set of circumstances in which implicit costs are likely to be relevant. This is ultimately a matter for each firm to determine, based on its trading experience and expertise and taking into account the characteristics of the client and the order (etc) as required by Article 44 of the Implementing Directive. MiFID itself says enough to guide firms’ actions.

Professional clients

While MiFID only directly addresses the concept of “total consideration” in the context of retail clients, CESR considers (#29) that the concept is relevant for the assessment of best execution for professional client orders too, because in practice it would be difficult to disregard the importance of the net cost of a purchase or the net proceeds of a sale in any evaluation of best execution.

This proposal clearly goes beyond MiFID. We do not agree that the concept of “total consideration” is always relevant to professional clients, and we do not consider that it would work across all financial instruments. Whether the concept of “total consideration” is used should be left to the assessment of the parties to the transaction and competition in financial markets, and should not be proposed in CESR guidance. Under certain circumstances, when large orders have to be worked over time, market impact could be the largest cost for the professional client, and this could far exceed “total consideration”. This is why MiFID makes the distinction between retail and professional clients in this context. CESR should not (and legally cannot) pre-empt the text of the Directive.

CESR also considers (#29) that in most circumstances price and cost will merit a high relative importance in obtaining the best possible result for professional clients, although there will be circumstances where other factors will be more important.

Ordinarily, we would expect that price will merit a high relative importance in obtaining the best possible result for professional clients, though a firm's execution policy may appropriately determine that other execution factors are more important. We do not agree that cost will in most circumstances merit a high relative importance.

CESR considers (#30) that investment firms should weight the factors in a manner that is appropriate to a particular type of client, size of order or type of instrument.

CESR's approach should not be prescriptive. It would not be appropriate for CESR to limit or inhibit the way in which firms respond to MiFID requirements. Firms should have flexibility in applying the factors, as the discussion in #30 would suggest.

There is a risk that CESR's approach goes beyond what MiFID requires for professional clients. Unlike retail clients, whose orders are relatively homogeneous, professional clients have a wide variety of orders and strategies which frequently have to be executed in a bespoke manner. As there are a large number of variables, the permutations of the weight that may attach to them in different possible transactions will also be numerous. Weights and priorities are assigned in specific transactions which are negotiated between investment firms and their professional clients.

Inclusion of the firm's fees and commissions when deciding between execution venues

CESR considers (#34) that a firm's execution policy should include those venues likely to provide the best prices on a consistent basis. However, best execution requirements should also ensure the best possible net result for clients, which means that varying costs to be borne by the client according to the competing venue chosen, where they exist, should be taken into account so that the client pays the lowest possible net cost (or receives the highest possible net proceeds). This is followed by a footnote which says: "This discussion relates to price and costs only and is without prejudice to other factors that may contribute to the best possible result for the execution of client orders."

We do not agree with CESR's proposals in the case of professional clients, where CESR's proposals for the addition of "net" go beyond MiFID. In addition, CESR's proposals for the addition of "net" look only at the trade and take no account of market impact effects, which may be equally or more important to professional investors. Even in the case of retail clients, Recital 71 of the Implementing Directive suggests that CESR's approach may be too simplistic. In our view, the footnote (7) at the end of #34 is important, and should be in the main text.

CESR considers (#37) that firms are free to set their fees or commissions at whatever level they choose, provided that commissions are not used unfairly to discriminate against particular venues.

CESR should make it clear that this analysis applies only to commission-based markets. In certain transactions, including those in fixed income and OTC derivatives markets, dealing is invariably conducted without payment of exchange fees or similar costs.

Possibility of a single execution venue or entity

CESR considers (#38) that it is in the MiFID spirit as reflected in Article 21 that, whenever there is more than one trading venue that offers execution relevant services, investment firms should consider their inclusion in its execution policy.

We agree that an investment firm may want to consider potential venues from time to time, or when a new venue arrives, as part of its regular review of its execution arrangements. However, the decision about whether to add or reject a venue to a firm's execution arrangements should be left to the firm's judgment and such provision should not be interpreted to mean that, whenever there is more than one trading venue, an investment firm should include the venue in its execution arrangements. For the reasons noted in our general comments on page 2 and in our response to Q1 above, we do not agree there is any requirement for firms to list execution venues in their order execution policy.

CESR considers (#39) that it is conceivable that there may be circumstances in which only one particular execution venue or entity will deliver the best possible result on a consistent basis for some instruments and orders.

Yes, this is highly likely.

CESR considers (#39) that it may be reasonable in some circumstances to decide against connecting to potential execution venues that offer a price improvement, because of the costs of access, but in such cases the investment firm should consider the advantages of indirect access (that is, transmitting its client orders to another execution intermediary rather than executing those orders itself).

An alternative, if the venue was considered likely to deliver the best possible result on a consistent basis, would be for the investment firm to match the price and deal with the client order as principal.

Question 3: Do respondents agree with CESR's views on the use of a single execution venue?

Yes, it should be possible for a firm's policy to include only one execution venue in respect of a particular product.

Differentiation of the policy

CESR considers (#44) that a firm's execution policy will at least need to address the different classes of instruments for which it handles orders. Examples of such classes are equities, debt instruments and derivatives (which would need to be further distinguished between exchange-traded derivatives and OTC products, if appropriate.) In addition to differentiation by class of instrument (#45), CESR

considers that an investment firm may wish to distinguish its policy by client or order type.

CESR considers (#46) that the level of differentiation in a firm's execution policy should be sufficient to enable the client to make a properly informed decision about whether to utilise the execution services offered by the firm. In order to do this, the execution policy will need to provide a sufficiently detailed description of the execution approach that the firm takes in order to obtain the best possible result for the relevant categories of instruments, orders, clients and markets that it deals with.

Question 4: Do respondents agree with CESR's views on the degree of differentiation of the (execution) policy?

We are concerned that CESR should differentiate between the execution policy itself and the information that firms are required to provide to clients about it. Under MiFID, firms are required to provide appropriate information on their execution policy to enable their clients to make a properly informed decision about whether to utilise the execution services provided by the firm. However, firms should have the flexibility to determine their own approach. The scope for flexibility should not be reduced by minimising firms' discretion through CESR guidance. Some firms may adopt an approach based on instrument, client and order type, and others may adopt a different approach. In the last sentence of #46, the execution policy provided to clients should be "fair, clear and not misleading" rather than providing a "sufficiently detailed description" of its execution approach.

DISCLOSURE TO CLIENTS

CESR states (#58) that, while Article 46(2) of Level 2 specifies the disclosure requirements for retail clients, there is no equivalent provision relating to what "appropriate information" must be provided to professional clients; and quotes Recital 44 of Level 2: "Professional clients should, subject to limited exceptions, be able to identify for themselves the information that is necessary for them to make an informed decision, and to ask the investment firm to provide that information." CESR concludes that it is up to firms to determine what level of information disclosure is appropriate for professional clients, through appropriate consultation with such clients if necessary.

Question 5: Do respondents agree that the "appropriate" level of information disclosure for professional clients is at the discretion of investment firms, subject to the duty on firms to respond to reasonable and proportionate requests? On the basis of this duty, should firms be required to provide more information to clients, in particular professional clients, than is required to be provided under Article 46(2) of Level 2?

First question: Yes, we agree that it is up to firms to determine what level of information disclosure is appropriate for professional clients, through appropriate consultation with such clients if necessary. There is no need for CESR guidance in this area.

The level and type of information that a firm must provide to a client about its policy will vary depending on the firm, product and client type. The way in which this requirement is met is at the discretion of the firm, and firms may therefore choose to include the additional information required for retail clients in their policies.

Second question: No, firms should not be required to provide more information to clients, in particular professional clients, than is required to be provided under Article 46(2) of Level 2, though they may decide to do so on a commercial basis. Such a requirement would be super-equivalent under MiFID, and super-equivalence in this area would not be justified.

PRIOR CONSENT AND EXPRESS CONSENT

CESR quotes (#59) Article 21(3), which requires investment firms to “obtain the prior consent of their clients to their execution policy” and Article 21(4), which requires them to “obtain the prior express consent of their clients before proceeding to execute their orders outside a regulated market or an MTF.”

CESR understands (#60) that “prior consent” may, at least in some jurisdictions, be tacit and result from the behaviour of the client such as the sending of an order to the firm after having received information on the firm’s execution policy, whereas “prior express consent” must be actually expressed by the client.

CESR considers (#62) that, where prior express consent is required, it may be provided by signature in writing or an equivalent means (electronic signature), by a click on a web page or orally by telephone or in person (with appropriate record keeping in each case).

Question 6: Do respondents agree with CESR on how “prior express consent” should be expressed? If not, how should this consent be manifested? How do firms plan to evidence such consent?

We consider that prior express consent can be given by any active demonstration: in writing, orally, or by actions, including continuing to deal on the basis of a one-way notification. In addition to providing that “prior express consent” may be given by signature (in writing or electronic), by web page click-through, or orally, CESR should therefore also provide that such consent may be given by a client’s continuing to deal on the basis of a one-way notification of appropriate information concerning the firm’s order execution policy. From a pragmatic perspective, given the number of intermediaries with which professional clients are likely to have trading relationships, and thus the number of notifications on order execution policies each such client is likely to receive from each of those intermediaries, such a pragmatic interpretation is particularly important to allow the continued smooth functioning of professional markets post-MiFID.

Firms should be able to rely on their professional clients’ requisite knowledge and experience by agreeing in advance with their professional clients that such clients’ agreement to deal on this basis will constitute prior express consent. This would be consistent with Article 21(3), which says that such consent can be evidenced by a “general agreement” as well as being trade specific.

RELATIONSHIPS BETWEEN FIRMS IN CHAINS OF EXECUTION

CESR says (#63) that, in a “chain of execution”, some aspects of the execution are performed at different points in the chain; and (#65) that, in a chain of execution, different investment firms have different functions. An eligible counterparty must ensure that any entities with which orders are placed or transmitted for execution have execution arrangements that enable the investment firm to comply with Article 45.

CESR considers (#71) that the requirements with which a firm must comply depend on whether the services it is providing is to be characterised as execution of client orders (in which case base execution applies under Article 21), or as portfolio management (without execution) or reception and transmission of orders (in which case the Article 45 provisions apply).

CESR states (#74) that MiFID portfolio managers, RTOs and investment firms who execute orders, are not prohibited from using third country intermediaries or venues that are not subject to MiFID’s best execution requirements. But if the portfolio manager or RTO cannot satisfy itself that those intermediaries or venues have execution arrangements or standards of execution quality that will allow it to comply with Article 45 (or, in the case of an executing firm, Article 21), the portfolio manager or RTO cannot discharge its Article 45 obligations and therefore cannot use such intermediaries or venues.

CESR concludes (#75) that, where best execution responsibilities overlap, an investment firm will have to determine whether its best execution obligations are owed under Article 45 or Article 21 and how far the best execution standard delivered by an intermediary at the following point in the chain goes in satisfying the best execution requirements that apply to itself.

CESR also concludes (#76) that, in assessing compliance with the best execution requirements, competent authorities should consider the function of the relevant investment firm in the chain of execution, paying due regard to the respective responsibilities of each firm. Portfolio managers and RTOs that transmit orders to an intermediary may rely on the latter to provide best execution to the extent this is warranted but remain subject to the requirements under Article 45 of Level 2.

Question 7: Do respondents agree with CESR’s analysis of the responsibilities of investment firms involved in a chain of execution?

CESR’s analysis of the responsibilities of investment firms involved in a chain of execution is not completely clear. CESR should make it clear that execution intermediaries do not have any obligation to look through to their own clients’ clients. When an investment firm transmits an order for which it owes its client best execution to an intermediary for execution, the responsibility for best execution remains with the originating firm. The intermediary does not inherit the responsibility, except by agreement.

In addition, in #74, it is not clear whether CESR is arguing that, if a firm uses a third country intermediary, the firm should still be mindful of meeting its own obligations under Article 45, or whether CESR is arguing that third country intermediaries are inferior to EEA intermediaries, and that there should be restrictions on the use of third country intermediaries by portfolio managers and RTOs. We do not agree that the latter approach would be acceptable.

As a final point of clarification, it would also be helpful if CESR guidance were to note expressly that, under Article 24 of MiFID, best execution obligations are not owed in relation to transactions carried out with eligible counterparties.

REVIEW AND MONITORING

CESR understands (#79) that the reference to the “execution quality” of the execution intermediary in Article 45(5) of Level 2 refers to the quality of the results that the intermediary has delivered in comparison to the results that were possible.

It is not clear from this statement who decides whether “execution quality” has been obtained. In competitive markets, this is a matter for the client. Under MiFID, no retrospective judgment is required by any other party.

It is also not clear what “results that were possible” means. Best execution requires order routing to venues which consistently deliver the best result. There may be another quote on a venue which may hypothetically be better, but which does not consistently deliver the best result. Should the venue turns out not to be credible, a worse result will be obtained if the price at the main venue has changed in the meantime.

Requirement to review

CESR considers (#83-#84) that reviews which have to be carried out at least annually necessarily look beyond a firm’s current execution approach; and that, in the case of the requirement to review their execution approach whenever a material change occurs, what is material will depend to a large extent on the nature and scope of any change.

In general, we agree with this approach, which is broadly consistent with common practice in competitive markets. However, we are concerned that some of the provisions in #83, in so far as they relate to professional clients, go beyond the provisions in MiFID Article 21(4) and Article 46(1). And the term “execution approach” is unclear and unhelpful (see our comments on #22 above). The reference here should be to “execution arrangements”.

Requirement to monitor

CESR considers (#86) that the monitoring methodology is at the discretion of firms. It is not necessary for these purposes that a firm review every transaction and that other approaches, such as sampling, could suffice. Sampling must however reflect the size and nature of the transactions performed and the firm must appropriately assess and compare the relevant available data.

We agree that the methodology of monitoring should be at the discretion of firms. We do not agree that CESR should prescribe sampling, as appears to be proposed in #86, as this is not prescribed in MiFID, and if it were to be prescribed by CESR, this would restrict innovation. Firms should have discretion about whether or not to use sampling. In the first half of the last sentence of #86, “Sampling must however reflect ...” should therefore be replaced by: “If sampling is used, it should however reflect ...”

It is not clear what the last half of the last sentence of #86 means.

Differing contexts for monitoring and review

CESR considers (#87) that firms that sit at different points in the chain of execution may need to take different approaches to their review and monitoring obligations. So, where best execution obligations apply:

- *Firms executing client orders need to review whether the venues they use are delivering the best possible result for execution of their client orders, and decide whether to connect to execution venues excluded from the current execution policy; and they should monitor the execution quality being delivered by the venues currently included in the execution policy.*
- *Firms dealing on own account with clients need to review their own execution quality relative to other execution venues they (or their clients) could potentially access.*

In addition, all firms must monitor the impact of their own actions on the execution quality they achieve.

There is a presumption, in the first bullet of #87 (and elsewhere), that two different venues can show two different prices in a security for the same size. On exchanges, experience shows that any such differences are arbitrated quickly so that, after a short while, prices become the same.

In the second bullet of #87, the statement that firms dealing on own account should “review their own execution quality relative to other execution venues they (or their clients) could potentially access” is clearly linked to the question of the scope of the obligation in dealer in markets, which CESR has stated that this consultation will not address. In any event, firms in dealer markets cannot compare their execution quality to other execution venues (let alone access them). CESR’s proposal goes beyond MiFID.

Nor is it clear what the final sentence of #87 – “all firms must monitor the impact of their own actions on the execution quality they achieve” – means. If it means “assessing traders’ performance”, this already happens. If it means anything else, it goes beyond MiFID and should not be prescribed.

EXECUTION QUALITY DATA

CESR suggests (#91) that there may be some core information that any firm would find useful regardless of the particularities of its execution approach. Recital 76 to the Level 2 Directive suggests that this information could include “aspects such as speed and likelihood of execution (fill rate) and the availability and incidence of price improvement.”

Question 8: What core information and/or other variables do respondents consider would be relevant to evaluating execution quality for the purposes of best execution?

CESR states (in #38) that “MiFID establishes a competitive regime for the execution of client orders”. As firms operate in a competitive market, clients already have the opportunity to evaluate execution quality. The reputation of firms depends on providing a good service to clients. If clients are not satisfied, they have the opportunity to complain or move their business to another firm.

CESR refers (#93) to the US position as a possible approach for the EU: “SEC Rule 11Ac1-5 requires firms to report how often their prices fall outside of the US national best bid and offer. The SEC also requires firms to report their speed of execution. While the SEC recognises that other factors are relevant, they have made a conscious choice to highlight speed and price quality.” We note that Rule 11Ac1-5, which was replaced by Rule 605 of Reg. NMS, covers common stock and exchange-traded stock options that fall under the SEC Rule 3a-11 definition of equity securities, but it does not cover bonds and derivatives.

Call for evidence on execution quality data

#94: Respondents are asked to describe the execution quality information that is available commercially and what additional information may be needed. Respondents are also asked to comment on what key information competent authorities should expect firms to be considering when evaluating their own execution performance as well as the execution quality of the venues and entities to which they have recourse.

We are concerned that CESR’s call for evidence on execution quality data is premature. Under Article 44(5) of the Implementing Directive, the Commission does not need to present a report on the availability, comparability and consolidation of information concerning the quality of execution of various execution venues until 1 November 2008.

We think that the appropriate juncture for CESR’s consultation should be after the implementation of MiFID. We also think it is important that CESR should allow sufficient time for such a consultation to be carried out properly. Firms do not have time at present, as they are fully engaged in preparing for the implementation of MiFID on 1 November 2007.

When CESR does so, it needs to be clear how quantitative data can help measure execution quality. In competitive markets, execution quality is for clients to judge. If they are not satisfied with execution quality, they can switch providers.

In addition, as we said in response to CESR in 2005, competent authorities should not “expect” firms to consider any centrally laid down evaluation of their execution performance or the execution quality of the venues and entities to which they have recourse. This is a matter for firms, and is not prescribed in MiFID.

It is also important for CESR to note that there are existing processes in place in the market. Clients of investment firms, particularly fund managers, consistently measure “execution quality” delivered by the firms they use. However, it should be noted that clients use many factors in judging which investment firms they use, and only one of these – albeit a very important one – is execution quality.

Call for evidence on demonstrating compliance with best execution

#96: Developments in respect of data consolidation, pre- and post-trade transparency and execution quality data will also be relevant for demonstrating compliance. CESR is interested in receiving suggestions and feedback from industry on possible implementation approaches in this area with a view to promoting supervisory convergence on these important points after implementation of MiFID.

We are concerned that CESR’s call for evidence is premature and not specific enough to be useful. It is premature because MiFID has not yet been implemented. Even after it has been implemented, it will take time to gauge its impact on the behaviour of markets. The call for evidence is also not specific enough to be useful because the parameters for data consolidation, pre and post-trade transparency have not yet been set.